

Three and half years ago, I enthusiastically joined **Yahoo**! The magnitude of the opportunity was only matched by the magnitude of the assets. And an amazing team has been responsible for rebuilding Yahoo!

It has been a profound experience. I am fortunate to have been a part of dramatic change for the Company. And our successes speak for themselves. More users than ever, more engaging than ever and more profitable than ever!

I proudly bleed purple and yellow everyday! And like so many people here, I love this company

But all is not well. Last Thursday's NY Times article was a blessing in the guise of a painful public flogging. While it lacked accurate details, its conclusions rang true, and thus was a much needed wake up call. But also a call to action. A clear statement with which I, and far too many Yahoo's, agreed. And thankfully a reminder. A reminder that the measure of any person is not in how many times he or she falls down - but rather the spirit and resolve used to get back up. The same is now true of our Company.

It's time for us to get back up.

I believe we must embrace our problems and challenges and that we must take decisive action. We have the opportunity - in fact the invitation - to send a strong, clear and powerful message to our shareholders and Wall Street, to our advertisers and our partners, to our employees (both current and future), and to our users. They are all begging for a signal that we recognize and understand our problems, and that we are charting a course for fundamental change. Our current course and speed simply will not get us there. Short-term band-aids will not get us there.

It's time for us to get back up and seize this invitation.

I imagine there's much discussion amongst the Company's senior most leadership around the challenges we face. At the risk of being redundant, I wanted to share my take on our current situation and offer a recommended path forward, an attempt to be part of the solution rather than part of the problem.

Recognizing Our Problems

We lack a focused, cohesive vision for our company. We want to do everything and be everything -- to everyone. We've known this for years, talk about it incessantly, but do nothing to fundamentally address it. We are scared to be left out. We are reactive instead of charting an unwavering course. We are separated into silos that far too frequently don't talk to each other. And when we do talk, it

isn't to collaborate on a clearly focused strategy, but rather to argue and fight about ownership, strategies and tactics.

Our inclination and proclivity to repeatedly hire leaders from outside the company results in disparate visions of what winning looks like -- rather than a leadership team rallying around a single cohesive strategy.

I've heard our strategy described as spreading peanut butter across the myriad opportunities that continue to evolve in the online world. The result: a thin layer of investment spread across everything we do and thus we focus on nothing in particular.

I hate peanut butter. We all should.

We lack clarity of ownership and accountability. The most painful manifestation of this is the massive redundancy that exists throughout the organization. We now operate in an organizational structure -- admittedly created with the best of intentions -- that has become overly bureaucratic. For far too many employees, there is another person with dramatically similar and overlapping responsibilities. This slows us down and burdens the company with unnecessary costs.

Equally problematic, at what point in the organization does someone really OWN the success of their product or service or feature? Product, marketing, engineering, corporate strategy, financial operations... there are so many people in charge (or believe that they are in charge) that it's not clear if anyone is in charge. This forces decisions to be pushed up - rather than down. It forces decisions by committee or consensus and discourages the innovators from breaking the mold... thinking outside the box.

There's a reason why a centerfielder and a left fielder have clear areas of ownership. Pursuing the same ball repeatedly results in either collisions or dropped balls. Knowing that someone else is pursuing the ball and hoping to avoid that collision - we have become timid in our pursuit. Again, the ball drops.

We lack decisiveness. Combine a lack of focus with unclear ownership, and the result is that decisions are either not made or are made when it is already too late. Without a clear and focused vision, and without complete clarity of ownership, we lack a macro perspective to guide our decisions and visibility into who should make those decisions. We are repeatedly stymied by challenging and hairy decisions. We are held hostage by our analysis paralysis.

We end up with competing (or redundant) initiatives and synergistic opportunities living in the different silos of our company.

- YME vs. Musicmatch
- Flickr vs. Photos
- YMG video vs. Search video
- Deli.cio.us vs. myweb
- Messenger and plug-ins vs. Sidebar and widgets
- Social media vs. 360 and Groups

- Front page vs. YMG
- Global strategy from BU's vs. Global strategy from Int'l

We have lost our passion to win. Far too many employees are "phoning" it in, lacking the passion and commitment to be a part of the solution. We sit idly by while -- at all levels -- employees are enabled to "hang around". Where is the accountability? Moreover, our compensation systems don't align to our overall success. Weak performers that have been around for years are rewarded. And many of our top performers aren't adequately recognized for their efforts.

As a result, the employees that we really need to stay (leaders, risk-takers, innovators, passionate) become discouraged and leave. Unfortunately many who opt to stay are not the ones who will lead us through the dramatic change that is needed.

Solving our Problems

We have awesome assets. Nearly every media and communications company is painfully jealous of our position. We have the largest audience, they are highly engaged and our brand is synonymous with the Internet.

If we get back up, embrace dramatic change, we will win.

I don't pretend there is only one path forward available to us. However, at a minimum, I want to be part of the solution and thus have outlined a plan here that I believe can work. It is my strong belief that we need to act very quickly or risk going further down a slippery slope. The plan here is not perfect; it is, however, FAR better than no action at all.

There are three pillars to my plan:

1. Focus the vision.
2. Restore accountability and clarity of ownership.
3. Execute a radical reorganization.

1. Focus the vision

- a) We need to boldly and definitively declare what we are and what we are not.
- b) We need to exit (sell?) non core businesses and eliminate duplicative projects and businesses.

My belief is that the smoothly spread peanut butter needs to turn into a deliberately sculpted strategy -- that is narrowly focused.

We can't simply ask each BU to figure out what they should stop doing. The result will continue to be a non-cohesive strategy. The direction needs to come decisively from the top. We need to place our bets and not second guess. If we believe Media will maximize our ROI -- then let's not be bashful about reducing our investment in other areas. We need to make the tough decisions, articulate them and stick with them -- acknowledging that some people (users / partners / employees) will not like it. Change is hard.

2. Restore accountability and clarity of ownership

- a) Existing business owners must be held accountable for where we find ourselves today -- heads must roll,
- b) We must thoughtfully create senior roles that have holistic accountability for a particular line of business (a variant of a GM structure that will work with Yahoo!'s new focus)
- c) We must redesign our performance and incentive systems.

I believe there are too many BU leaders who have gotten away with unacceptable results and worse -- unacceptable leadership. Too often they (we!) are the worst offenders of the problems outlined here. We must signal to both the employees and to our shareholders that we will hold these leaders (ourselves) accountable and implement change.

By building around a strong and unequivocal GM structure, we will not only empower those leaders, we will eliminate significant overhead throughout our multi-headed matrix. It must be very clear to everyone in the organization who is empowered to make a decision and ownership must be transparent. With that empowerment comes increased accountability -- leaders make decisions, the rest of the company supports those decisions, and the leaders ultimately live/die by the results of those decisions.

My view is that far too often our compensation and rewards are just spreading more peanut butter. We need to be much more aggressive about performance based compensation. This will only help accelerate our ability to weed out our lowest performers and better reward our hungry, motivated and productive employees.

3. Execute a radical reorganization

- a) The current business unit structure must go away.
 - b) We must dramatically decentralize and eliminate as much of the matrix as possible.
 - c) We must reduce our headcount by 15-20%.
- I emphatically believe we simply must eliminate the redundancies we have created and the first step in doing this is by restructuring our organization. We can be more efficient with fewer people and we can get more done, more quickly. We need to return more decision making to a new set of business units and their leadership. But we can't achieve this with baby step changes, We need to fundamentally rethink how we organize to win.

Independent of specific proposals of what this reorganization should look like, two key principles must be represented:

Blow up the matrix. Empower a new generation and model of General Managers to be true general managers. Product, marketing, user experience & design, engineering, business development & operations all report into a small number of focused General Managers. Leave no doubt as to where accountability lies.

Kill the redundancies. Align a set of new BU's so that they are not competing against each other. Search focuses on search. Social media aligns with community and communications. No competing owners for Video, Photos, etc. And Front Page becomes Switzerland. This will be a delicate exercise -- decentralization can create inefficiencies, but I believe we can find the right balance.

I love Yahoo! I'm proud to admit that I bleed purple and yellow. I'm proud to admit that I shaved a Y in the back of my head.

My motivation for this memo is the adamant belief that, as before, we have a tremendous opportunity ahead. I don't pretend that I have the only available answers, but we need to get the discussion going; change is needed and it is needed soon. We can be a stronger and faster company - a company with a clearer vision and clearer ownership and clearer accountability.

We may have fallen down, but the race is a marathon and not a sprint. I don't pretend that this will be easy. It will take courage, conviction, insight and tremendous commitment. I very much look forward to the challenge.

So let's get back up.

Catch the balls.

And stop eating peanut butter.

SAM HINKIE
3601 SOUTH BROAD STREET
PHILADELPHIA, PENNSYLVANIA 19148

[REDACTED]
[REDACTED]

April 6, 2016

To the equity partners of Philadelphia 76ers, L.P.:

I hope this letter finds you well. I have been serving the Sixers at your pleasure for the past 34 months. Atul Gawande, a Surgeon at Brigham and Women's Hospital in Boston, remains (from afar) one of my favorite reads. He laughs that reading scientific studies has long been a guilty pleasure. Reading investor letters has long been one of mine.

What I hope to accomplish here is to give you insight into what has transpired behind the scenes in ways you might not have otherwise heard about. Many of you attended our most recent board meeting in New York, where many of these topics were addressed. But for all twelve of you, I hope that this provides a deeper look into what you have at your organization. Accordingly, you should anticipate some mild cheerleading (of others) sprinkled with a healthy dose of self-flagellation about things I've done wrong.

There has been much criticism of our approach. There will be more. A competitive league like the NBA necessitates a zig while our competitors comfortably zag. We often chose not to defend ourselves against much of the criticism, largely in an effort to stay true to the ideal of having the longest view in the room. To attempt to convince others that our actions are just will serve to paint us in a different light among *some* of our competitors as progressives worth emulating, versus adversaries worthy of their disdain. Call me old-fashioned, but sometimes the optimal place for your light is hiding *directly* under a bushel.

Lastly, this letter will only speak to the part of the business that I'm today's steward of: the basketball team and its attendant operations. With Scott O'Neil running our business operations, you are in good hands. I can assure you that when your team is eventually able to compete deep into May, Scott will ably and efficiently separate the good people of the Delaware Valley from their wallets on your behalf. Worry not.

A league with 30 intense competitors requires a culture of finding new, better ways to solve repeating problems. In the short term, investing in that sort of innovation often doesn't look like much progress, if any. Abraham Lincoln said "give me six hours to chop down a tree and I will spend the first four sharpening the axe."

In May of 1969, a 38-year-old Warren Buffett sat down at a typewriter to inform his investors that he was closing his fund (then Buffett Partnership). His reason: market conditions were such that he no longer had the requisite confidence that he could make good decisions on behalf of the investors and deliver on his commitments to them. So he would stop investing on their behalf.

For me, that's today. Given all the changes to our organization, I no longer have the confidence that I can make good decisions on behalf of investors in the Sixers—you. So I should step down. And I have.

In one sense, it pains me that it has come to this and that I would go at the end of a particularly down year in the standings, one that has been painful for all of us. But the fact is—and a young Buffett said it much better than I ever could—“I am not attuned to this environment, and I don’t want to spoil a decent record by trying to play a game I don’t understand just so I can go out a hero.”

Yup.

Thinking about thinking

I admire Seth Klarman a great deal. I am consistently impressed by his conviction and humility, a rare combination. About their approach at Baupost, he says, “it isn’t the only way of thinking, but it’s how we approach it.” Below is some insight into a few things we value and how we’ve approached decision making at the Sixers.

First, this list is anything but exhaustive, and hardly mine alone. Whenever possible, I think cross-pollinating ideas from other contexts is far, far better than attempting to solve our problems in basketball as if no one has ever faced anything similar. Accordingly, this approach comes from a frequent search into behavioral economics, cognitive science, and a lot of observation and trial and error over my 11 years in the NBA. And mistakes. Lots and lots of mistakes.

To begin, let’s stand on the shoulders of Charlie Munger, a giant to me. He is a man that’s been thinking about thinking longer than I’ve been alive. Let’s start with him and his approach. His two-part technique is:

1. First, what are the factors that really govern the interests involved, rationally considered?
2. Second, what are the subconscious influences where the brain at a subconscious level is automatically doing these things—which by and large are useful, but which often malfunctions?

To do this requires you to divorce process from outcome. You can be right for the wrong reasons. In our business, you’re often lionized for it. You can be wrong for the right reasons. This may well prove to be Joel Embiid. There is signal everywhere that Joel is unique, from the practice gyms in Lawrence, Kansas to Bala Cynwyd, Pennsylvania to Doha, Qatar where he does something awe inspiring far too regularly. We remain hopeful (and optimistic) about his long-term playing career, but we don’t yet know exactly how it will turn out. The decision to draft Joel third, though, still looks to me to be the correct one in hindsight given the underlying reasoning. But to call something that could be wrong (“failed draft pick”) right (“good decision”) makes all of our heads hurt, mine included.

So we have to look deeper at process. Here’s a go at it:

(I would be dismayed if you don’t see pockets of this kind of thinking throughout the organization. In fact, I will feel like I’ve let you down.)

The importance of intellectual humility

Lifelong learning is where it’s at. To walk down that path requires a deep-seated humility about a) what’s knowable, and b) what each of us know. We hire for this aggressively. We celebrate this internally. And we’ve been known to punish when we find it woefully lacking.

We talk a great deal about being curious, not critical. About asking the question until you understand something truly. About not being afraid to ask the obvious question that everyone else seems to know the answer to. And about the willingness to say three simple words, “I don’t know.”

Tesla’s Elon Musk describes his everyday stance as, “You should take the approach that you’re wrong. Your goal is to be less wrong.” The physicist James Clerk Maxwell described it as a “thoroughly conscious ignorance—the prelude to every real advance in science.” Bill James of the Boston Red Sox (and, I might add, a Kansas basketball expert) added a little flair when asked whether the learnings available via examining evidence were exhausted: “we’ve only taken a bucket of knowledge from a sea of ignorance.”

A way to prop up this kind of humility is to keep score. Use a decision journal. Write in your own words what you think will happen and why before a decision. Refer back to it later. See if you were right, and for the right reasons (think Bill Belichick’s famous 4th down decision against Indianapolis in 2009 which summarizes to: good decision, didn’t work). Reading your own past reasoning in your own words in your own handwriting time after time causes the tides of humility to gather at your feet. I’m often in waist-deep water here.

The other reason to keep track yourself is you’re often the only one to see the most insidious type of errors, the ones the narrative generating parts of our lizard brains storytell their way around—errors of omission. You don’t have a wobbly understanding of just the things you got wrong, but the things you got right but not right *enough*. Listen to Charlie Munger talk about how he and Berkshire Hathaway should be measured not by their success, but by how much more successful they would have been if they bought more of something: “We should have bought more Coke.”

* * * * *

The necessity of innovation

Investing in disruptive innovation doesn’t ferment misunderstanding, it *necessitates* it. Jeff Bezos says it this way: “There are a few prerequisites to inventing...You have to be willing to fail. You have to be willing to think long-term. You have to be willing to be misunderstood for long periods of time.”

A yearning for innovation requires real exploration. It requires a persistent search to try (and fail) to move your understanding forward with a new tool, a new technique, a new insight. Sadly, the first innovation often isn’t even all that helpful, but may well provide a path to ones that are. This is an idea that Steven Johnson of *Where Good Ideas Come From* popularized called the “adjacent possible.” Where finding your way through a labyrinth of ignorance requires you to first open a door into a room of understanding, one that by its very existence has new doors to new rooms with deeper insights lurking behind them.

In most endeavors, it’s fine to be content to woodshed until you get something near perfect. You want that to be you. Grit matters. But it won’t be long until some innovation makes all that effort newly obsolete. You want that to be you, too.

* * * * *

The longest view in the room

It is critical to be cycle aware in a talent-driven league. In a situation like yours at the Sixers, where a variety of circumstances left you near a trough in the cycle (and falling), amplifying this cycle became crucial. Today’s outcomes for every team are heavily impacted by decisions past (who to draft, sign, trade, hire, etc.).

Jeff Bezos says that if Amazon has a good quarter it's because of work they did 3, 4, 5 years ago—not because they did a good job that quarter. Today's league-leading Golden State Warriors acquired Draymond Green, Andrew Bogut, and Klay Thompson almost 4 years ago, nearly 4 years ago exactly, and almost 5 years ago. In this league, the long view picks at the lock of mediocrity.

While some organizations (like ours) have this as part of their ethos, for others it *is* the ethos. Check out the 10,000 Year Clock. It is no mere thought experiment, but an actual clock being designed to be placed inside a mountain in West Texas, wound, and left to tick and chime for ten thousand years. Why? Because to design something that lasts that long makes us all consider what the world will look like between now and then. In return, we might be inspired to do something about it.

More practically, to take the long view has an unintuitive advantage built in—fewer competitors. Here's Warren Buffett in the late 80s on this topic: "In any sort of a contest—financial, mental, or physical—it's an enormous advantage to have opponents who have been taught that it's useless to even try." Ask who wants to trade for an in-his-prime Kevin Garnett and 30 hands will go up. Ask who planned for it three or four years in advance and Danny Ainge is nearly alone. Same for Daryl Morey in Houston trading for James Harden. San Antonio's Peter Holt said after signing LaMarcus Aldridge this summer, "R.C. [Buford] came to us with this plan three years ago, four years ago—seriously. And we've worked at it ever since."

* * * * *

A contrarian mindset

This one is tricky, and getting more so in a league as healthy and popular as the NBA that is covered by beat writers, columnists, bloggers, commentators, and fans minute-to-minute. If you want to have real success you have to *very often* be willing to do something different from the herd.

A few examples might help. Step away from basketball and imagine for a moment this is investment management, and your job is to take your client's money and make it grow. It's January 1, 2015 and the S&P 500 is \$171.60, exactly the same price it has been since January 1, 1985. No fluctuation up or down. Flat every single day. And your job for every day of the past 30 years is to make money for your clients by investing. What would you do?

In the NBA, that's wins. The same 82 games are up for grabs every year for every team. Just like in 1985 (or before). To get more wins, you're going to have to take them from someone else. Wins are a zero-growth industry (how many of you regularly choose to invest in those?), and the only way up is to steal share from your competitors. You will have to do something different. You will have to be contrarian.

Howard Marks describes this as a necessary condition of great performance: you have to be non-consensus and right. Both. That means you have to find some way to have a differentiated viewpoint from the masses. And it needs to be right. Anything less won't work.

But this is difficult, emotionally and intellectually. Seth Klarman talks about the comfort of consensus. It's much more comfortable to have people generally agreeing with you. By definition, those opportunities in a constrained environment winnow away with each person that agrees with you, though. It reminds me of when we first moved to Palo Alto. Within about a week of living there a voice kept telling me, "This is great. Great weather, 30 minutes to the ocean, 3 hours to ski, a vibrant city 30 miles away, and one of the world's best research universities within walking distance. People should really move here." Then

I looked at real estate prices. I was right, yes, but this view was decidedly *not* a non-consensus view. My viewpoint as a Silicon Valley real estate dilettante, which took a whole week to form, had been priced in. Shocking.

To develop truly contrarian views will require a never-ending thirst for better, more diverse inputs. What player do you think is most undervalued? Get him for your team. What basketball axiom is most likely to be untrue? Take it on and do the opposite. What is the biggest, least valuable time sink for the organization? Stop doing it. Otherwise, it's a big game of pitty pat, and you're stuck just hoping for good things to happen, rather than developing a strategy for how to make them happen.

There has to be a willingness to tolerate counterarguments, hopefully in such a way that you can truly understand and summarize the other side's arguments at least as well as they can. And then, after all that, still have the conviction to separate yourself from the herd.

* * * * *

A tolerance of uncertainty

This one can be really difficult, especially when the stakes are high. But it's critical to making rational decisions over the long term. We are all so tempted to simplify when something is hard to think about, simply to get it out of our mind by treating it as impossible.

This goes from academic sounding to life altering in basketball team building, though. Looking at a player with an estimated 10% or 20% chance of being a star over the next three or four years can't be written to zero—that's about as high as those odds ever get. That's surely a very, very high number for any player that is ever available to you to be added to your team. Once you accept that, it becomes clear that shrinking the confidence interval around that estimate (and the estimates of the downside risk at the other end of the spectrum) becomes pretty darn important.

But our well worn thinking patterns often let us down here. Phil Tetlock, from just down the street at Penn, addresses this well in his most recent remarkable book *Superforecasting* where he quotes the great Amos Tversky saying, "In dealing with probabilities...most people only have three settings: "gonna happen," "not gonna happen," and "maybe".". Jeff Van Gundy sums it up succinctly on our telecasts, "it's a make or miss league." He's right.

In some decisions, the uncertainties are savage. You have to find a way to get comfortable with that range of outcomes. If you can't, you're forced to live with many fewer options to choose amongst which leads over the long term to lesser and lesser outcomes.

The illusion of control is an opiate, though. Nonetheless, it is annoyingly necessary to get comfortable with many grades of maybe. Sixers fans come up to me to say hello and many of them say the same thing (almost instinctively) as we part, "Good luck." My standard reply: "Thanks. We'll need it."

* * * * *

Be long science

Science is about predictions. Understanding the world until you can make a prediction about what will happen next. If you're not sure, test it. Measure it. Do it again. See if it repeats.

“So if we want to think like a scientist more often in life, those are the three key objectives—to be humbler about what we know, more confident about what’s possible, and less afraid of things that don’t matter.” That’s from Tim Urban, who will soon be recognized as one of tomorrow’s polymaths (like many of you, he lives in New York—I’d recommend meeting him for coffee sometime).

For the Sixers, this has meant efforts like tracking every shot in every gym where we shoot, making predictions in writing about what we think will happen with a player or a team, and generally asking more questions about the game than some are comfortable to have said aloud.

* * * * *

A healthy respect for tradition

While contrarian views are absolutely necessary to truly deliver, conventional wisdom is still wise. It is generally accepted as the conventional view because it is considered the best we have. Get back on defense. Share the ball. Box out. Run the lanes. Contest a shot. These things are real and have been measured, precisely or not, by thousands of men over decades of trial and error. Hank Iba. Dean Smith. Red Auerbach. Gregg Popovich. The single best place to start is often wherever they left off.

There are plenty of caricatures of our approach on your behalf, the most common of which is that folks here don’t even watch the games. That instead there is some mystical way by which we make decisions that doesn’t have anything to do with building a basketball team. That’s simply untrue.

Maybe someday the information teams have at their disposal won’t require scouring the globe watching talented players and teams. That day has not arrived, and my Marriott Rewards points prove it from all the Courtyards I sleep in from November to March. There is so much about projecting players that we still capture best by seeing it in person and sharing (and debating) those observations with our colleagues. What kind of teammate is he? How does he play under pressure? How broken is his shot? Can he fight over a screen? Does he respond to coaching? How hard will he work to improve? And maybe the key one: will he sacrifice—his minutes, his touches, his shots, his energy, his body—for the ultimate team game that rewards sacrifice? That information, as imperfect and subjective as it may be, comes to light most readily in gyms and by watching an absolute torrent of video.

Some tradition awaits us everyday at the office. I inherited Marlene Barnes as my executive assistant, a widowed lifelong Philadelphian that joined the Sixers in the fall of 1977. I was born in the winter of 1977. Marlene has worked for 11 different GMs and 5 head coaches at the Sixers. The names evoke many memories for you lifelong Sixers fans and students of history like me: Pat Williams, John Nash, Gene Shue, Jim Lynam, John Lucas, Brad Greenberg, Larry Brown, Billy King, Ed Stefanski, Rod Thorn. With us, she was immediately thrown into a new, more entrepreneurial work environment with a boss full of quirks different than any she had ever encountered. She adapted wonderfully, and now is a regular Slack wizard along with much of our staff, has seamlessly plugged into one productivity hack after another, and has ordered more books from Amazon than she ever thought possible. Her presence served as an everyday reminder to me of the impermanence of my leadership. I told her within a few weeks of working together that when I see her in the mornings I’m reminded that I am a steward—*today’s* steward—of her Sixers.

* * * * *

A reverence for disruption

So often a new management regime looks at an organization and decides that the primary goal is to professionalize the operation. For you, I hope that doesn't happen next. As I described to you in our first ever board meeting, we were fundamentally aiming for something different—disruption. We should concentrate our efforts in a few key areas in ways others had proven unwilling. We should attempt to gain a competitive advantage that had a chance to be lasting, hopefully one unforeseen enough by our competition to leapfrog them from a seemingly disadvantaged position. A goal that lofty is anything but certain. And it sure doesn't come from those that are content to color within the lines.

This is true everywhere, as the balance in any market or any ecosystem ebbs and flows until something mostly unexpected lurches ahead. We see it in spades—past, present, and future.

- New Zealand's flightless bird the moa (measuring in at 10 ft, 400 lbs.) had *the life* tramping around the South Island for a great long run; then the first Māori explorers washed ashore in canoes, and that was that.
- I still miss Blackberry's keyboard, but the 2007 iPhone debut rendered it nearly obsolete to all but a few of us curmudgeons.
- Watch what's happening with the collaboration between IBM's Watson and M.D. Anderson or Google DeepMind's AlphaGo. It won't be just an ancient board game that's disrupted. It's also anything but a game to Lee Sedol.

Nobel Prize winning physicist Max Planck got right to it: "A new scientific truth does not triumph by convincing its opponents and making them see the light, but rather because its opponents eventually die." That sounds harsh, more harsh than anything I would ever say. But think about it in your context as an equity partner in the Sixers. Every April you will watch 16 of the 30 teams—the last time that exact configuration of players and coaches will ever be together—"die" as their season ends. Within a few weeks, another seven go fishing. By early June, 29 of the 30 opponents are forced to see the light of the competition's greatness as only one raises the Larry O'Brien trophy.

* * * * *

I can imagine that some of these sound contradictory: contrarian thinking, but respect for tradition, while looking to disrupt. That yin and yang is part of it—keep looking. Questioning.

Investment objectives

Starting position

In May of 2013 when I spoke with several of you—and even when we first met in the summer of 2012—the situation was clear. Your crops had been eaten. A team that clawed its way to a disappointing 34 wins in 2012-13 had a few handfuls of those wins walking out the door (Dorell Wright, Nick Young, Damien Wilkins, Royal Ivey) and a player that drove a bit more who had just undergone a surgery and was expected to be out for the season (Jason Richardson). That left the club with expected wins in the low 20s before replacing anyone. The young players on rookie-scale deals numbered two: Evan Turner & Arnett Moultrie. Two future first round picks were gone as was the recent youth pipeline of Nik Vučević & Moe Harkless. Gulp.

Outsiders agreed. ESPN regularly ranks the forward-looking three years for each team in their Future Power Rankings. They take into account the team's current roster and future potential of those players as about half the rating, then include future draft picks, cap position, coaching, management, etc. The Sixers near-term future ranked 24th in a 30-team league.

In the press conference announcing my arrival at the Sixers, I said:

- Our challenge was not for the faint of heart. *It wasn't.*
- Our challenge was big enough to humble me to think about the enormity of it. *It did.*

We would have to get so very much right.

Goals

The strategy we settled on was straightforward, even if arduous. Replenish the talent pipeline, improve the quality and quantity of players on the roster, shift the style of play towards tomorrow's champions, and become a culture focused on innovation.

You heard me speak of these goals at each of our quarterly board meetings; always the same since June of 2013. Variety is overrated.

This continuity of focus has served to frustrate many. I've found those most frustrated are those that either underestimate the enormity of the challenge or fundamentally want something else.

Specifically, we set out to maximize the odds of acquiring star players using all three available methods of acquiring players (draft, free agency, and trade).

1. Draft: invest in the deepest pool of star players—young players via the NBA Draft.
2. Free Agency: maintain financial flexibility to assume contract liabilities of other teams to acquire picks and prospects and move quickly toward special opportunities in signings/trade.
3. Trade: gather attractive, improving players to (best case) develop to win games for the Sixers, or (worst case) trade for better players or players likely to improve at a faster rate.

We determined to play a faster style that recognizes the importance of speed in tomorrow's NBA and one that quickly integrates young players. We set out to improve our shot selection toward high efficiency basketball. We also wanted to build a defensive identity that—in time—could thwart tomorrow's high-efficiency offenses. Lastly, we needed to build a world-class training center, develop an ever-evolving player development program, and change the organization's culture to one of innovation and a constant search for competitive edge.

These goals were not to fit some preferred style of play, but instead were aiming for where future champions would be crowned. That original document I gave to Josh and David in 2012 said:

History's lessons are clear, but tomorrow's championship caliber teams may break from historical trends:

- *Example: A 3PA-happy champion like Orlando under Stan Van Gundy*
- *Example: A fast-paced champion like Phoenix under Mike D'Antoni*

Fast forward three years and Golden State made the 3rd most 3s in NBA history to win the Finals against the Cleveland Cavaliers, who made the 8th most 3s in NBA history. Coach Van Gundy's most 3PA-happy team from Orlando proudly sits smack dab between them in 5th place all time (for now). The Warriors did this in part by playing at the fastest pace of any NBA team last season, considerably faster than Coach D'Antoni's fastest Suns team.

Results

The dozen of you know much about our team, our players, and how we're positioned. I won't waste your time by going through each person in detail, as you have had many opportunities to meet our coaches and players, hear about our talented staff, and see their performance dissected and analyzed in our meetings. Instead, I will try to make the best use of your time by sharing some insight into the inner workings behind the scenes and a few details that aren't appropriate for wider consumption.

Players

It is worth noting that over the long term, basketball teambuilding is about one primary thing—the players. Those players the team has on the roster at the time and those they hold the rights to. Plus those that are to follow. All of the operations, from management to coaches to support staff to systems only exist for one reason—the players.

We have had the good fortune of drafting relatively early, giving us access to some especially talented players, including Jahlil Okafor (#3), Joel Embiid (#3), and Nerlens Noel (#6). Many in our office tried to set a line of when Jahlil would see his first double team in this league. Those with the under looked smart by the end of opening night, where he went for 26 points and 7 rebounds.

We also put ourselves into position to draft in the second round, where we found two 22-year-old gems to date, including Jerami Grant (#39) and Richaun Holmes (#37). Outside of the top 60 selections delivered two more players with real NBA futures in 24-year-old T.J. McConnell and 25-year-old Robert Covington.

Robert is a mistake I rubbed my own nose in for over a year. The 2013 Draft was a flurry of activity for us—a handful of trades and selections in both the first and second rounds. We had more action following the draft as we tried to finalize our summer league team and get the myriad trade calls set up with the NBA. I could see this coming a few days before and we informed the media that this kind of approach might lead to an unusually late start for the post-draft press conference. Several of you were still there late that night. At about 1:00 a.m. I went downstairs to address an equally exhausted media on deadline from their editors. When I returned upstairs, the undrafted Robert Covington was gone, having agreed to play for another club's summer league team, eventually making their regular season roster. He torched the D-League that year, haunting me all the while. When he became available 17 months later, we pounced. But I shudder, even now, at that (nearly) missed opportunity.

Even our efforts to support our players serve as a reminder of the enormity of our challenge. Something important to us is to find ways to be supportive to our players' larger extended families and loved ones that take this journey with them. One group, too casually referred to as "the wives club" at many NBA teams, helps support players' families in getting acclimated to the city by handling tickets for loved ones, volunteering in community events, hosting baby showers, and the like. In 2013 my wife and I arrived at the arena one night to host a few from this group. While I was prepared to highlight for the group the team's

family room, child care at the arena, etc., it turned out that our attendance at this event totaled two. Two mothers. It was a pointed reminder of just how young our team was.

This story underscores what our players, particularly our best players, are in greatest need of—time. The gap between driving wins today and driving wins tomorrow will be heavily influenced by a bunch of factors, but the biggest one is time. For players like Jahlil, Nerlens, and Jerami, getting much nearer the middle of their new NBA cohort will go a long way toward letting their talents shine through, just as it has their whole basketball lives when they were nearer the middle of those cohorts. Get down the experience curve, the faster the better. They are 20, 21, and 22 years old.

* * * * *

A larger quiver

We need to identify high potential prospects and find ways to add them to our program. Then we need to work with them on their game in a targeted way to maximize their performance, their impact on the floor, and their value. One way is to draft them and put them on our 15-man roster. We do that.

Another is to draft them and hold their exclusive NBA rights while they play professionally in a league that doesn't start with N and end with A. Now we do that.

These players can develop under our guidance while not counting against our roster, giving us not just 15 opportunities at one time, but several more. When appropriate for our team—but subject to buyout clauses in their professional contracts abroad—we can sign them to our club as one of our 15. This can happen within a season, at season's end, or whenever their contract is available for buyout.

These sets of players are viable players for the Sixers and viable options to trade in the interim. The goal is simple—a larger quiver. This quiver will give us more options immediately and more options over time. Several players have been affiliated with us during the past several years while playing for teams in Australia, Asia, several clubs in Europe, and our minor-league affiliate the Delaware 87ers. As of now, we hold three players on this list, highlighted by the 21-year-old Dario Šarić. Dario is a 6-10 forward with a guard's skills and a big's toughness. Twice voted as FIBA European Young Player of the Year, we were in position to draft him in part because he required something you've had in ample supply: one part courage, two parts patience. He will look great in Sixers blue.

This approach, like many that create value, isn't popular, particularly locally. But it's also nothing new, just the same typeface bolded. It requires deep player evaluations around the globe, is helped by a network of international relationships, and most of all, patience. The venerable San Antonio Spurs don't have three rights-held players playing internationally like we now do, they have thirteen. Most of their names are hard for many fans to pronounce. Ginobili used to be, too.

The NBA began this season with 100 international players from 37 countries on opening night rosters, comprising over 20% of the league. This is no set of wallflowers either, with four of the last thirteen Finals MVPs in this group. I pine for the days of the Long Beach Summer League at the Pyramid—I now spend as much time in China as Los Angeles.

* * * * *

Draft picks

While the young players on our team and rights-held players internationally continue to show promise, our ability to add to that group by layering in additional high quality talent via the draft, free agency, and trade is at an all-time high.

In the first 26 months on the job we added more than one draft pick (or pick swap) per month to our coffers. That's more than 26 new picks or options to swap picks over and above the two per year the NBA allots each club. That's not any official record, because no one keeps track of such records. But it *is* the most ever. And it's not close. And we kick ourselves for not adding another handful.

Many of us remember exactly where we were when tragedy strikes and we think of what could have been. For me—and this is sad for my own mental well being—that list includes the January day in 2014 when Miami traded Joel Anthony and two second round picks to our formidable competitors the Celtics. I can still picture the child's play table I paced around at Lankenau Medical Center on my cell phone while negotiating with Miami's front office. This was in between feedings for our newborn twins, when my wife and I were still sleeping in the hospital. Danny Ainge finalized that deal (and several other better ones) and received one first-place vote for Executive of the Year that season: mine.

We have used several of those picks to move around in the draft, to facilitate other deals, in trade for players to add to our team, and to select players for our team. Players like Jerami Grant (part of the haul from the Spencer Hawes trade), Nerlens Noel & Dario Saric (via the Jrue Holiday trade and its derivative), Ish Smith (used one of the two picks we acquired in the Eric Maynor trade, plus another), Richaun Holmes (part of the proceeds via the K.J. McDaniels trade), and others. Yet we still retain the rights to more future 2nd round picks at our disposal going forward than 27 other NBA teams.

In the upcoming May draft lottery, we have what will likely be the best ever odds to get the #1 overall pick (nearly 30%), a roughly 50/50 chance at a top-2 pick (the highest ever), and a roughly 50/50 chance at two top-5 picks, which would be the best lottery night haul ever. That same bounce of a ping pong ball (almost a flip of a coin) will determine if we have three first round picks this year (unusual) or four (unprecedented). That's this year. Or this quarter, if you will.

If you were to estimate the value of those firsts and the ones to follow, from this point forward we have essentially two NBA teams' worth of first round pick value plus the third most second round picks in the league.

* * * * *

Salary cap position

Our salary cap position going forward is easily the NBA's best. The most room, the most flexibility, providing the widest available set of options in free agency or trade of any club. This stockpile can be used all at once or strategically over the ensuing years to acquire players that fit your team, improve in your development program, and help you move up the standings. During this phase of acquiring players and picks to really invest in our future and climb higher than we have in over 30 years, we spent a bit over \$135M on payroll across the three seasons, while the NBA median spend was over \$200M. That won't last, as over time a climb up the standings will see spend rise precipitously as well.

These advantages over our competitors are material, but well short of deterministic. From here a whole host of solid decisions are necessary to play our hand out of this stacked deck.

* * * * *

Other

Building a talent pipeline into our program, while important, is of course not the only goal we had. Even with young players and expected roster turnover, we needed to move the club toward a style that was conducive to winning in tomorrow's NBA. We improved our pace from below average to 1st immediately, then settled into about 6th for the next two seasons. We moved our shot selection from consistently bottom two in the league to consistently 2nd in the league. And our defensive principles are increasingly top-notch, showing that we can play above average defense (13th) when we had solid veteran defenders like Luc Mbah a Moute on the roster, but also struggle with some of the NBA's youngest talent defending every night (bottom 5).

Outlook

Your club is on solid footing now, with much hard work yet to be done. As we continued to invest in young players, acquire more draft selections, and maintain cap flexibility the forward-looking markets took notice. Our Future Franchise Rankings (ESPN's) that began at 24th in a 30-team league in May of 2013 climbed to 19th in 2014, 17th in 2015, and most recently via RealGM's rankings in December of 2015, 12th. I think that is imminently reasonable, as is a couple of spots higher.

Lottery night will be nerve-wracking for most and exciting for all. I said to Josh & David last year during the NBA's Draft Lottery that it is rare for the importance of luck in our lives to be laid bare for the whole world to see. Walking out with a top-5 pick in each hand would be exciting, but it's not necessary. The rights to those picks don't extinguish, but instead move forward to a future year, one filled with new possibilities and challenges both.

Regardless of the haul that comes out of a May night in New York, the team is likely to see additional lottery pick talent hit the court next season regardless. Two additional first round picks this year are available to you as well. Plus additional draft picks are set to flow in regularly for many years to come. Plus the league's best cap position. A bevy of young players. A deep and passionate coaching staff. An innovative management team. A beautiful new practice facility set to open before training camp. In a city with wonderful basketball heritage. You could do worse.

The NBA can be a league of desperation, those that are in it and those that can avoid it. So many find themselves caught in the zugzwang, the point in the game where all possible moves make you worse off. Your positioning is now the opposite of that.

A sincere thank you

Thank you for the opportunity you all gave me to lead this storied franchise. My gratification is beyond my power to express. What is unequivocal is that the principal beneficiary of your largesse has been me. Thank you.

Philadelphia has been wonderful to our family. Two of our children were born here. Lincoln said that to meet with the public “renewed in me my perceptions of responsibility and duty.” Those words rang hollow until we moved here and I talked with our fans. Everywhere I went, lifelong Sixers fans told me stories about how they wanted the team to be good again—really good.

It’s clear now that I won’t see the harvest of the seeds we planted. That’s OK. Life’s like that. Many of my NBA friends cautioned me against the kind of seed sowing that felt appropriate given the circumstances for exactly this reason. But this particular situation made it all the more necessary, though. Part of the reason to reject fear and plow on was *exactly because* fear had been the dominant motivator of the actions of too many for too long.

I will be repotted professionally. That is often uncomfortable; most growth is. But it’s also often healthier over the longer sweep of history, too.

In the interim, I’ll probably be with my wife and kids for a few weeks. If you need to reach me—now or later—I am available at [REDACTED] and I suspect someday soon on Twitter via @samhinkie.

I wish you the best of luck. Like other Sixers fans, I will cross my fingers for you on lottery night in New York.

We Don't Sell Saddles Here



Stewart Butterfield

[Follow](#)

12 min read · Feb 17, 2014

26K

85

The memo below was sent to the team at Tiny Speck, the makers of [Slack](#), on July 31st, 2013. It had been a little under seven months since development began and was two weeks before the launch of Slack's 'Preview Release'. It is presented verbatim, as written (including original pull-quotes), with two exceptions: the removal of an introductory section discussing launch logistics and replacement of a link which pointed to an internal company resource with the equivalent public link.

Build Something People Want

We know that we have built something which is genuinely useful: almost any team which adopts Slack as their central application for communication would be significantly better off than they were before. That means we have something people want.

However, almost all of them have no idea that they want Slack. How could they? They've never heard of it. And only a vanishingly small number will have imagined it on their own. They think they want something different (if

they think they want anything at all). They definitely are not looking for Slack. (But then no-one was looking for Post-it notes or GUIs either.)

Just as much as our job is to build something genuinely useful, something which really does make people's working lives simpler, more pleasant and more productive, our job is also to understand what people think they want and then translate the value of Slack into their terms.

A good part of that is "just marketing," but even the best slogans, ads, landing pages, PR campaigns, etc., will fall down if they are not supported by the experience people have when they hit our site, when they sign up for an account, when they first begin using the product and when they start using it day in, day out.

Therefore, "understanding what people think they want and then translating the value of Slack into their terms" *is something we all work on*. It is the sum of the exercise of all our crafts. We do it with copy accompanying signup forms, with fast-loading pages, with good welcome emails, with comprehensive and accurate search, with purposeful loading screens, and with thoughtfully implemented and well-functioning features of all kinds.

"Marketing from Both Ends"

Much has been written about "product-market fit" in the last few years, probably as a result of the popularity of the lean startup movement (though the idea has been around much longer). The term refers to the degree to which a product *could* be successful, given sufficient promotion, appropriate pricing, adequate customer support and so on (before you find that fit, all the pushing in the world won't get you up the hill).

In this [classic post](#) on Marc Andreessen's old blog, he calls getting to product-market fit the “only thing that matters” for startups and offers a way of thinking about the life of the startup that divides it into two distinct phases: before product-market fit and after. Once the product fits the market, a company is able to step on the gas, spending to promote a product that will actually sell. The things you need to do before are very different from the things you need to do after (generally test & iterate vs scale & optimize).

We are right in the middle of that first phase. It seems we are doing well and there are many encouraging signs, but we're definitely still in the first phase and it is very, very hard to tell how far we have to go to cross over into the promised land (the last 10% is 90% of the work, etc.) So, we should be working carefully from *both* the product end and the market end:

- Doing a better and better job of providing what people want (whether they know it or not)
- Communicating the above more and more effectively (so that they know they want it)

In the best case, there is a dialectic at play here: the product itself and the way people use it should suggest new ways of articulating the value — and refinements to how we communicate the value should lead to principles which clarify decision-making around product features and design.

Our position is different than the one many new companies find themselves in: we are not battling it out in a large, well-defined market with clear incumbents (which is why we can't get away with “[Other group chat products are poisonous. Slack is toasted.](#)”). Despite the fact that there are a handful of direct competitors and a muddled history of superficially similar tools, we

are setting out to define a new market. And that means we can't limit ourselves to tweaking the product; we need to tweak the market too.



Sell the innovation, not the product

The best — maybe the only? — real, direct measure of “innovation” is change in human behaviour. In fact, it is useful to take this way of thinking as definitional: innovation *is* the sum of change across the whole system, not a thing which *causes* a change in how people behave. No small innovation ever caused a large shift in how people spend their time and no large one has ever failed to do so.

By that measure, Slack is a real and large innovation. It is not as eye-catching as self-driving cars or implantable chips — it is not basic research-y kind of stuff. But, for organizations that adopt it, there will be a dramatic shift in how time is spent, how communication happens, and how the team's archives are utilized. There will be changes in how team members relate to one another and, hopefully, significant changes in productivity.

We are unlikely to be able to sell “a group chat system” very well: there are just not enough people shopping for group chat system (and, as pointed out elsewhere, our current fax machine works fine).

That's why what we're selling is organizational transformation.

What we are selling is *not* the software product — the set of all the features, in their specific implementation — because there are just not many buyers for this software product. (People buy “software” to address a need they already know they have or perform some specific task they need to perform, whether that is tracking sales contacts or editing video.)

However, if we are selling “a reduction in the cost of communication” or “zero effort knowledge management” or “making better decisions, faster” or “all your team communication, instantly searchable, available wherever you go” or “75% less email” or some other valuable *result* of adopting Slack, we will find many more buyers.

That's why what we're selling is organizational transformation. The software just happens to be the part we're able to build & ship (and the means for us to get our cut).

We're selling a reduction in information overload, relief from stress, and a new ability to extract the enormous value of hitherto useless corporate archives. We're selling better organizations, better teams. That's a good thing for people to buy and it is a much better thing for us to sell in the long run. We will be successful to the extent that we create better teams.

To see why, consider the hypothetical Acme Saddle Company. They could just sell saddles, and if so, they'd probably be selling on the basis of things like the quality of the leather they use or the fancy adornments their saddles include; they could be selling on the range of styles and sizes available, or on durability, or on price.

Or, they could sell *horseback riding*. Being successful at selling horseback riding means they grow the market for their product while giving the perfect context for talking about their saddles. It lets them position themselves as the leader and affords them different kinds of marketing and promotion opportunities (e.g., sponsoring school programs to promote riding to kids, working on land conservation or trail maps). It lets them think big and potentially be big.

Because the best possible way to find product-market fit
is to define your own market.

This isn't a new idea. There are many brands whose marketing activities or positioning has them selling something other than (and usually larger than) their product: Harley Davidson sells motorcycle riding, but it especially sells freedom and independence. Most luxury brands sell something that comes down to "being better than you are" (richer, better looking, more attractive to those you find desirable, etc.)

Get Stewart Butterfield's stories in your inbox

Join Medium for free to get updates from this writer.

Enter your email

Subscribe

My favorite recent example is Lululemon: when they started, there was not a large market for yoga-specific athletic wear and accessories. They sold yoga like crazy: helping people find yoga studios near their homes, hosting free classes, sponsorships and scholarships, local ambassadors and training, etc. And as a result, they sold just under \$1.4 billion worth of yoga-specific athletic wear and accessories in their most recent fiscal year.

But going back to the Acme Saddle Company, the better analogy to what we are doing now is to imagine them selling horseback riding ... about 4,000 years ago. It is almost inevitable that centralized internal communication systems will gradually replace email for most organizations over the next 10-20 years and we should do what we can to accelerate the trend and “own it”. We are at the beginning of a transition. We have an opportunity to both define the category and push hard for the whole market’s growth. We’d be crazy not to take it, because the best possible way to find product-market fit is to define your own market.

Who Do We Want Our Customers to Become?

A few months ago, I read a fairly mediocre ebook called “Who Do You Want Your Customers to Become?” (available [here](#)). It was mediocre because it was nearly 70 pages when it could have been 20, not because the ideas were bad: in fact, the core ideas of the piece are fascinating and, I think, very useful to us as we think about the next year or so of Slack.

A central thesis is that *all products are asking things of their customers*: to do things in a certain way, to think of themselves in a certain way — and usually that means changing what one does or how one does it; it often means changing how one thinks of oneself.

We are asking a lot from our customers. We are asking them to spend hours a day in a new and unfamiliar application, to give up on years or even decades of experience using email for work communication (and abandon all kinds of ad hoc workflows that have developed around their use of email). We are asking them to switch a model of communication which defaults to public; it is an almost impossibly large ask. Almost.

To get people to say yes to a request that large, we need to (1) offer them a reward big enough to justify their effort and (2) do an exceptional, near-perfect job of execution.

The best way to imagine the reward is thinking about who we want our customers to become:

- We want them to become relaxed, productive workers who have the confidence that comes from knowing that any bit of information which might be valuable to them is only a search away.
- We want them to become masters of their own information and not slaves*, overwhelmed by the neverending flow.
- We want them to feel less frustrated by a lack of visibility into what is going on with their team.
- We want them to become people who communicate purposefully, knowing that each question they ask is actually building value for the whole team.

This is what we have to be able to offer them, and it is the aim and purpose of all the work we are doing. We need to make them understand what's at the end of the rainbow if they go with Slack, and then we have to work our asses off in order to ensure they get there.

How Do We Do It?

We do it really, really fucking good.

The reason for saying we need to do ‘an exceptional, near-perfect job of execution’ is this: When you want something really bad, you will put up with a lot of flaws. But if you do not yet know you want something, your tolerance will be much lower. That’s why it is especially important for us to build a beautiful, elegant and considerate piece of software. Every bit of grace, refinement, and thoughtfulness on our part will pull people along. Every petty irritation will stop them and give the impression that it is not worth it.

That means we have to find all those petty irritations, and quash them. We need to look at our own work from the perspective of a new potential customer and *actually see what's there*. Does it make sense? Can you predict what's going to happen when you click that button or open that menu? Is there sufficient feedback to know if the click or tap worked? Is it fast enough? If I read the email on my phone and click the link, is it broken?

None of the work we are doing to develop the product is an end in itself.

It is always harder to do this with one’s own product: we skip over the bad parts knowing that we plan to fix it later. We already know the model we’re using and the terms we use to describe it. It is very difficult to approach Slack with beginner’s mind. But we have to, all of us, and we have to do it every day, over and over and polish every rough edge off until this product is as smooth as lacquered mahogany.

Each of you knows “really good”. Each of you is able to see when things are not done well. Certainly we all complain enough about other people’s software, and we all know how important first impressions are in our own judgements. That is exactly how others will evaluate us.

Putting yourself in the mind of someone who is coming to Slack for the first time — especially a real someone, who is being made to try this thing by their boss, who is already a bit hangry because they didn’t have time for breakfast, and who is anxious about finishing off a project before they take off for the long weekend — putting yourself in their mind means looking at Slack the way you look at some random piece of software in which you have no investment and no special interest. Look at it hard, and find the things that do not work. Be harsh, in the interest of being excellent.

Why?

There's no point doing this to be small. We should go big, if only because there are a lot of people in the world who deserve Slack. Going big also means that it will have to be really, really good. But that's convenient, since there's also no point doing it if it is not really, really good. Life is too short to do mediocre work and it is definitely too short to build shitty things.

To do this well, we need to take a holistic approach and not just think about a long list of individual tasks we are supposed to get through in a given week. We get 0 points for just getting a feature out the door if it is not actually contributing to making the experience better for users, or helping them to understand Slack, or helping us understand them. None of the work we are doing to develop the product is an end in itself; it all must be squarely aimed at the larger purpose.

Consider the teams you see in action at great restaurants, and the totality of their effort: the room, the vibe, the timing, the presentation, the attention, the anticipation of your needs (and, of course, the food itself); nothing can be off. There is a great nobility in being of service to others, and well-run restaurants (or hotels, or software companies) serve with a quality that is measured by its attention to detail. This is a perfect model for us to emulate.

Ensuring that the pieces all come together is not someone else's job. It is your job, no matter what your title is and no matter what role you play. The pursuit of that purpose should permeate everything we do.

But Slack is a bit more complicated than a restaurant (at least in some ways). Since it is new and less familiar, we are less able to fall back on well-established best practices. That means we need to listen, watch & analyze carefully. We'll need to build tools to capture users' behaviour and reactions. And then we'll need to take all that information and our best instincts and be continuously improving.

We are an exceptional software development team. But, we now also need be an excellent customer development team. That's why, in the first section of this doc, I said "build a customer base" rather than "gain market share": the nature of the task is different, and we will work together to understand, anticipate and better serve the people who trust us with their teams' communications, one customer at a time.

The answer to "Why?" is "because why the fuck else would you even want to be alive but to do things as well as you can?". Now: let's do this.

Slack's preview release began two weeks after this document was sent, on August 14th, 2013. A little under six months later, on February 12th, 2014, it was

From: Howard Schultz
Sent: Wednesday, February 14, 2007 10:39 AM Pacific Standard Time
To: Jim Donald
Cc: Anne Saunders; Dave Pace; Dorothy Kim; Gerry Lopez; Jim Alling; Ken Lombard; Martin Coles; Michael Casey; Michelle Gass; Paula Boggs; Sandra Taylor
Subject: The Commoditization of the Starbucks Experience

As you prepare for the FY 08 strategic planning process, I want to share some of my thoughts with you.

Over the past ten years, in order to achieve the growth, development, and scale necessary to go from less than 1,000 stores to 13,000 stores and beyond, we have had to make a series of decisions that, in retrospect, have lead to the watering down of the Starbucks experience, and, what some might call the commoditization of our brand.

Many of these decisions were probably right at the time, and on their own merit would not have created the dilution of the experience; but in this case, the sum is much greater and, unfortunately, much more damaging than the individual pieces. For example, when we went to automatic espresso machines, we solved a major problem in terms of speed of service and efficiency. At the same time, we overlooked the fact that we would remove much of the romance and theatre that was in play with the use of the La Marzocca machines. This specific decision became even more damaging when the height of the machines, which are now in thousands of stores, blocked the visual sight line the customer previously had to watch the drink being made, and for the intimate experience with the barista. This, coupled with the need for fresh roasted coffee in every North America city and every international market, moved us toward the decision and the need for flavor locked packaging. Again, the right decision at the right time, and once again I believe we overlooked the cause and the affect of flavor lock in our stores. We achieved fresh roasted bagged coffee, but at what cost? The loss of aroma—perhaps the most powerful non-verbal signal we had in our stores; the loss of our people scooping fresh coffee from the bins and grinding it fresh in front of the customer, and once again stripping the store of tradition and our heritage? Then we moved to store design. Clearly we have had to streamline store design to gain efficiencies of scale and to make sure we had the ROI on sales to investment ratios that would satisfy the financial side of our business. However, one of the results has been stores that no longer have the soul of the past and reflect a chain of stores vs. the warm feeling of a neighborhood store. Some people even call our stores sterile, cookie cutter, no longer reflecting the passion our partners feel about our coffee. In fact, I am not sure people today even know we are roasting coffee. You certainly can't get the message from being in our stores. The merchandise, more art than science, is far removed from being the merchant that I

believe we can be and certainly at a minimum should support the foundation of our coffee heritage. Some stores don't have coffee grinders, French presses from Bodum, or even coffee filters.

Now that I have provided you with a list of some of the underlying issues that I believe we need to solve, let me say at the outset that we have all been part of these decisions. I take full responsibility myself, but we desperately need to look into the mirror and realize it's time to get back to the core and make the changes necessary to evoke the heritage, the tradition, and the passion that we all have for the true Starbucks experience. While the current state of affairs for the most part is self induced, that has lead to competitors of all kinds, small and large coffee companies, fast food operators, and mom and pops, to position themselves in a way that creates awareness, trial and loyalty of people who previously have been Starbucks customers. This must be eradicated.

I have said for 20 years that our success is not an entitlement and now it's proving to be a reality. Let's be smarter about how we are spending our time, money and resources. Let's get back to the core. Push for innovation and do the things necessary to once again differentiate Starbucks from all others. We source and buy the highest quality coffee. We have built the most trusted brand in coffee in the world, and we have an enormous responsibility to both the people who have come before us and the 150,000 partners and their families who are relying on our stewardship.

Finally, I would like to acknowledge all that you do for Starbucks. Without your passion and commitment, we would not be where we are today.

**To: Investors
Re: YouTube****From: RFB****September 2, 2005****Introduction**

YouTube represents an interesting seed-stage investment opportunity. The company's goal is to become the primary outlet of *user-generated video content* on the Internet, and to allow anyone to upload, share, and browse this content.

The three entrepreneurs are scrappy and smart. They have built a very easy-to-use, fast growing service that taps several strong veins: user-generated content, online advertising, wide proliferation of inexpensive digital video capture devices, and continued broadband adoption.

The company has also developed code snippets that allow users to embed YouTube videos directly into other sites. In this way, the company is building a wide content distribution network, in addition to its direct-to-site traffic.

Deal

Our proposal is to invest \$1m in the seed stage, followed by a \$4m Series A once specific milestones are met. Sequoia would own ~30% post Series A, with a pool of ~17%.

Competition

There are several direct and potential competitors to YouTube. These include:

- direct competitors (dailymotion, vimeo)
- community photo sites (flickr, webshots)
- online photo sharing sites (ofoto, shutterly, snapfish)
- large internet players (Google & Yahoo video search)
- entertainment sites (big-boys, ebaumsworld)
- file sharing services (ourmedia.org, putfile)
- IPTV companies (Open Media Network, Brightcove)

YouTube appears to have a clear lead over its two direct start-up competitors. The other categories of potential competitors are not necessarily focused on video content, or are not focused on user-generated content within the context of a community-based site. Nevertheless, the company will need to stay very focused over the next 3-6 months to ensure that it builds a rich set of features and content depth to increase its defensibility.

Hiring plan

We need to help the company quickly hire a CEO and VP BD/Sales. The founding team is enthusiastic about bringing on an experienced CEO to help lead the company. However, I'm not sure whether we can land a CEO before the Series A. I would appreciate any ideas on potential candidates for either role. My preference would be to launch a search immediately and to have a CEO in place within 90 days.

Two additional former PayPal engineers are set to join in the next week. Both are exceptional.

The plan is to house the company in our incubation area for the near term. That will help us frequently interact with the team until we can surround the company with an experienced management team.

Key risks

- Competition/defensibility

As outlined above, YouTube faces significant potential competition. The company needs to remain laser focused on improving the user experience to ensure that it continues its early growth trajectory.

- Revenue model

I believe that YouTube has a clear advertising revenue opportunity. However, we don't yet know what form of advertising would work best. Specifically, can the company develop attractive ad products that are not intrusive to the consumer experience? We can model revenue as follows: # unique videos streamed per day x % of videos monetized x CPM x 365 = estimated annual revenue. Several of the parameters are unknown:

- i. We don't know what CPM rates YouTube could command. Video ad CPMs could range from a low of \$5 to over \$30.
- ii. We don't know what percentage of inventory (videos served) could be monetized
- iii. We are not sure how much YouTube could grow from its current level of 100,000 videos served per day.

Below are different scenarios and their associated revenue potential:

	Videos served/day	CPM	% of videos monetized	Implied annual revenue
Scenario 1	10 million	\$10	15%	\$6m
Scenario 2	20 million	\$15	20%	\$22m
Scenario 3	30 million	\$20	25%	\$55m

We will need to test these assumptions carefully over the next few months to get an accurate handle on the company's revenue potential. We also need to test the success of the company's content distribution network, and whether we can generate advertising revenue from this network. (Google earns ~55% of its revenue from Google-owned sites, and 45% from Network websites.)

Serving 10-30 million videos may appear daunting, as it represents >100x increase over the company's current activity levels. But the company has achieved its current scale in only two months, and only has 15,000 videos today. (For point of comparison, Flickr and Webshots, two comparable photo community sites, serve 200-500x as many pageviews per day as YouTube.)

- Scalability

As the table above indicates, YouTube will need to scale significantly from its current level for the company to achieve meaningful revenue. We need ensure that YouTube can inexpensively scale orders of magnitude from current levels.

- Balancing growth

YouTube has already drawn the attention of larger media companies (e.g., Turner, Transcosmos) that see the potential of distributing YouTube content. As with any marketplace, we need to ensure that we balance demand and supply. It would be inadvisable to grow the viewer base significantly without a substantial increase in the number of videos available on the site. The company cannot afford to disappoint large numbers of customers due to inadequate depth of content.

- o Exit

We cannot point to many high comparable exit valuations.

A few comparable companies include Webshots, flickr, Ofoto, Shutterfly, and Snapfish. While these companies deal only with still images, there are some similarities with YouTube. None of these companies have had exceptional exits. CNET bought Webshots for ~\$70m, Yahoo! bought flickr for <\$50m. Apparently Shutterfly is preparing to file its IPO. Ofoto and Snapfish were acquired by Kodak and HP, respectively, although financial terms were not disclosed.

Another comparable is Blogger, acquired by Google in 2002 for an undisclosed amount.

There are some other examples of businesses that built successful models leveraging user-generated content, including TripAdvisor, acquired by IAC in 2004 years ago for over \$100m (to the best of my knowledge).

Recommendation

I first met with the company three weeks ago, and we are in pole position for the financing. Several VCs have been cold calling the company, and a few media companies have also approached YouTube. I'd like to give the company our decision on Monday.

I recommend that we proceed with the financing as proposed.

YouTube has a great founding team that has hit on several promising themes. The company follows a trend of user-generated content that started with text (blogs), images (flickr, webshots, ofoto), and audio (podcasting). Video is a natural next step, and YouTube is well positioned to capture the lead. The company has not yet enabled advertising revenue streams. But our checks with Yahoo! and Adbrite indicated very strong advertiser demand for online video advertising. We will rapidly need to surround the company with management talent, specifically a CEO.

Contents

1. Investment summary	1
2. Competitive analysis	2
3. Technology overview	5
4. Team bios	6
5. Company presentation	12
6. Company metrics	17

Investment summary

Founded by three early PayPal employees. Two engineers, one designer. Seed-stage investment opportunity. Top 10,000 internet site within two months of launch.

- **Business**
 - YouTube's goal is to become the primary outlet for *user-generated video content* on the internet. The company provides a very easy-to-use interface for users to upload, share, and browse their content.
 - Every digital camera now ships with digital video recording capability. But consumers have no easy way to share their personal video content – files are too large, hosting and bandwidth is expensive, and there are no standardized video file formats.
 - Users upload videos to YouTube. The encoding backend converts uploaded videos to Flash Video, which works on ~98% of web browsers. The streaming format means that no file downloading is required.
- **Market**
 - YouTube provides a platform and community for video self-publishing. We've seen similar self-publishing emerge for text (blogs), photos (flickr, webshots, hotornot), and audio (podcasting). This presents interesting advertising revenue opportunities.
 - There are also interesting vertical market opportunities: eBay auction videos (e.g., autos), real estate videos, etc.
- **Financials – TBD**
 - The company currently serves 100,000 videos per day, at an all-in hosting cost of \$4,000 per month.
 - The team has developed a software abstraction layer that enables it to use very inexpensive hardware and bandwidth to deliver videos.
- **Competition**
 - Big players: Google Video Search, Ourmedia.org, Open Media Network
 - Small players: DailyMotion, Vimeo, Putfile
- **Team**
 - Steve Chen. UIUC, CS. Recruited as one of PayPal's earliest engineers
 - Chad Hurley. PayPal's first designer, responsible for site design and logo
 - Jawed Karim. UIUC, CS. Graduate CS student at Stanford. Also one of PayPal's earliest engineers
- **Proposed terms**
 - Two-stage, milestone-based financing: \$1m seed stage, \$4m Series A.
 - SC to own ~30% after Series A.
 - Proposed Series A milestones:
 - Develop comprehensive business plan, including financial plan
 - Develop self-serve advertising product
 - Sign up at least five (5) advertisers who place \$5,000 or greater advertising orders
 - Ensure platform scalability to handle at least one million video views per day
 - Recruit a VP of Business Development

Competition

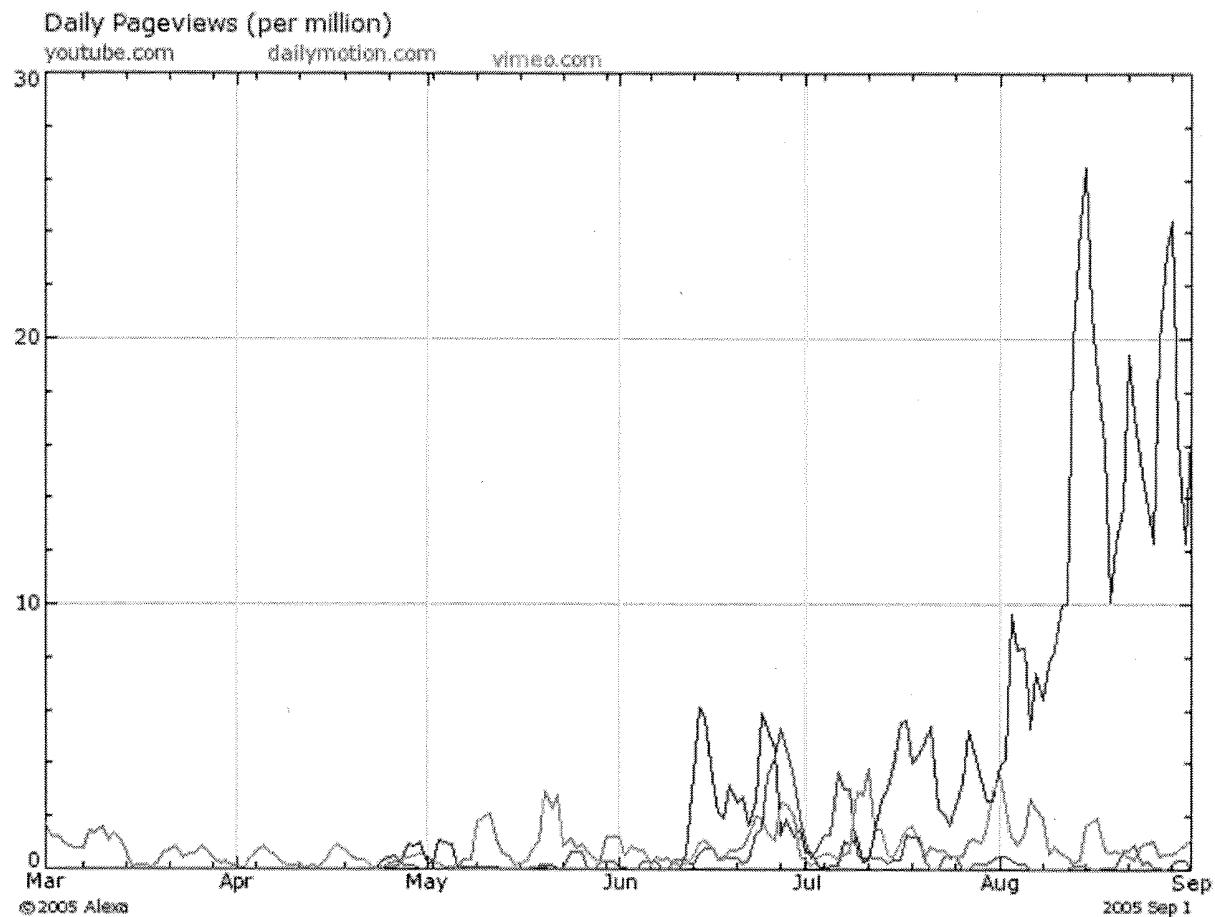
There are several potential and direct competitors to YouTube.

1. Direct competition

The two direct start-up competitors are Dailymotion and Vimeo.

- Dailymotion is based in France. It positions itself as a site to 'watch, publish, share.' The site has pretty good UI, but its navigation and layout is not as intuitive as for YouTube. All videos are encoded and rendered in Quicktime. Quicktime has lower penetration than Flash, so users may be faced with needing to download the player to experience the site.
- "Vimeo is for sharing your video clips." Vimeo was started by Connected Ventures in New York. Their mission is to "develop and manage good websites." They also run a popular site called CollegeHumor. They also claim to draw inspiration from flickr, and launched in February 2005. Vimeo also uses Quicktime. Their site layout is not very intuitive, and makes it hard to find content (e.g., there is no search capability).

The graph below shows the comparative daily pageviews for YouTube, Dailymotion and Vimeo. YouTube's traffic has rapidly overtaken that of these two competitors.



2. Community photo sites

Community photo sites share many features with YouTube: tagging, social networking, discussion groups, ease-of-use. However, they seem focused on still images rather than video.

YouTube admits that it drew inspiration from the popular site Flickr. Flickr has ~200-300x the number of daily pageviews of YouTube. Yahoo! acquired Flickr earlier this year for an undisclosed sum, believed to be ~\$30m. Reid Hoffman was an investor in Flickr, and assures the YouTube team that they have no plans to launch a video product in the next 1-2 years.

Webshots is another potential competitor. CNET acquired the company in 2004 for ~\$70m at a time that they forecast \$15-17m annual revenue. The founding team all just left the company, and it's unclear how much new product innovation there is. Webshots seems very focused on photos for now.

3. Online photo sharing sites

The main online photo sharing services, Ofoto, Shutterfly, and Snapfish, are also potential competitors. They do not have community-like features. They also earn revenue primarily from printing. As a result, I think they will remain focused on photos.

4. Entertainment sites

There are several popular online entertainment sites that have significant traffic: Big-boys, ebaumsworld, ifilm.

According to YouTube: "Big-boys and ebaumsworld get a lot of traffic but that's to be expected for the type of content they host. You are guaranteed to have something interesting, something shocking to watch when you visit these sites. However, the disadvantage is that they can never transition their sites into an actual product. Due to the content on the site, they're forever stuck in that segment of the market. If I were to categorize the content on YouTube today, I would break it down into two large categories: personal videos and viral videos. The viral videos, due to copyrights and obscene content, I admit, big-boys and ebaumsworld may beat us there. Although, we have seen our share of viral videos on YouTube. The bigger draw for YouTube is all the personal videos, the ones of your pet, your kid, your family, your vacation, so on. Big-boys and ebaumsworld, due to their origins, can never transition their product into something that hosts these other types of files."

Big-boys and ebaumsworld also position themselves as much broader entertainment sites, offering "Jokes, Pictures, Office Humor, Flash Animation, Soundboards, Prank Calls, Audio, Video, Games, Illusions, Magic."

"IFILM is one of the leading video-entertainment destinations on the Web, offering channels of movies, short films, TV clips, video-game trailers, music videos, action sports and its celebrated Viral Videos collection. IFILM.com delivers more than 30 million streams per month, making it one of the top ten streaming media sites in the world." IFILM is a clear potential competitor, although they don't have the same focus on user-generated content, nor YouTube's community features.

5. Larger competitors

Google and Yahoo are building video search products. Google requires the user to download a new "Google Video Viewer" while Yahoo plays videos in the native file format. In neither case are they providing the simple consumer upload and share experience, nor the community features.

6. File storage services

Putfile and Ourmedia.org are examples of file storage providers that essentially provide a free, web interface to FTP. None of them seem to have a compelling product, and do not focus solely on user-generated video content.

7. IPTV

Finally, there are companies such as the Open Media Network and Brighthcove that are focused on the delivery of mainstream video over the Internet. I do not believe that this competes directly with YouTube's proposition.

The table below attempts to summarize the competitive matrix:

	YouTube	Direct competition	Community photo sites	Photo sharing services	Entertainment sites	Large Internet players	File storage	IPTV
Ease of submitting video/degree of automation	Easy	Easy	N/A	N/A	Not easy or automated	N/A	Easy	N/A
Focus	Video	Video	Photos	Photos	Varied	Varied	Varied	Video
Community features	Yes	Yes	Yes	No	No	Yahoo working on it	No	No
Rendering format	Flash	Quick-time	N/A	N/A	Quick-time	Varied	Varied	Varied

The Technology Infrastructure (company supplied)

As mentioned previously, in order to keep costs down, our video distribution technology is built on clusters with multiple machines in each cluster for redundancy and higher throughput. When a video is uploaded to the site, it is sent to a single machine within a single cluster. This is chosen based on space and, in the future, cpu/bandwidth utilization on the machine and cluster. Newly uploaded videos are picked up by two services running on each of the machines, 1) convert and 2) replicate.

The converter will analyze the video and look at things like framerates, aspect ratios (16:9 vs 4:3), audio encoding (sampling rates, audio codec), and the video codec used on the original video. It uses these heuristics to best convert the video to play on YouTube with adjustments to things inserting the black bands on top/bottom of a 16:9 video, altering the sampling rate to best conform to the incoming sound, guess at frames per second of the incoming video, etc. As part of this process, video stills of each video are also generated.

At the end of this process, the video server communicates back to the central database changing the status from "Uploaded" to "Awaiting Replication".

While all this is going on, the replication service is standing by looking for videos that need to be replicated. When a video enters this queue, it's picked up by the replication service and the video is replicated to every machine within the video cluster. After the replication is finished, it talks to the database and marks the video as "Processed".

A newly uploaded video will go from a "Uploaded" -> "Awaiting Replication" -> "Processed" state in about 1-2 minutes.

The best part about this technology is that it really is infinitely scalable. We can add more capacity directly at the video conversion/transport layer at will.

The math for this comes out to:

By bandwidth --

\$239 / 1 machine / 1 month

1 machine has 2000 GB transfer / month

$2000 \text{ GB} * 1000 \text{ MB / GB} = 2,000,000 \text{ MB transfer / machine / month}$

7 MB average size of video

$2,000,000 / 7 = 285,714 \text{ videos served from each machine / month}$

\$239.0 / 285,714 = \$0.00083 cost per video served.

By storage --

\$239 / 1 machine / 1 month

1 machine has 2x160 GB HD for 320 GB

$320 \text{ GB} * 1000 \text{ MB / GB} = 320,000 \text{ MB / machine}$

7 MB average size of video

$320,000 / 7 = 45,714 \text{ videos / video cluster}$

\$239/45,714 = \$0.005228 cost per video stored.

\$0.005228 * 2 machines / cluster = \$0.010456 / video replicated.

The video serving technology provides a substantial barrier to entry. The video clustering solution sounds obvious and straight-forward post implementation but it certainly wasn't when we were faced with the question of -- "how do we keep costs down while having access to massive storage/bandwidth?" There's also the encoding technology. We're constantly improving this side of the product by incorporating the latest codecs.

Team bios

Chad Hurley is a co-founder of YouTube. Chad has an experienced background in web development and graphic design. He was the first member of the PayPal design team, where he lead efforts to develop the interface for the original Palm-based program that enabled secure wireless money transfers between handhelds. As the product evolved, he effectively designed auction features which solidified PayPal's long term success and is a credited member of two critical auction patents. Chad looks forward to building an empowering video service for the world.

Jawed Karim is a co-founder of YouTube. He was previously a computer science student at the University of Illinois, where he was recruited by Max Levchin to become one of the earliest engineers at PayPal. There hepled the implementation of PayPal's first real-time anti-fraud models for credit card and bank payments, working closely with Roelof Botha. As part of PayPal's Architecture Team (a group of five out of a total of over 100 engineers), he later worked on challenging scalability problems to ensure PayPal's ability to scale to 80 million users and beyond. He is currently a graduate student in computer science at Stanford.

Steve Chen is a co-founder of YouTube. As the Chief Technology Officer for YouTube, he is responsible for leading the engineering efforts in distributed video clusters and meeting the high-availability demands of video. Before YouTube, Steve spent 6 years at PayPal on the technology team. At PayPal, he led the engineering teams behind products such as PayPal China, PayPal Developer XML APIs, and PayPal Shopping Cart.

On 5/5/14, 8:22 AM, "Sheryl Sandberg" <sheryl@fb.com> wrote:

>Adding Fischer and Dan
>
>I love the basic vision - performance-based ads. Lots of work to do to
>make this happen so we need to prioritize, as Mark points out.
>
>I think figuring out the prioritization, especially on the
>business-facing side is important. We need to give businesses quick
>and easy - but important ways - to think of their Page or FB presences
>(whatever it might be) as their hub for mobile as there will be a huge
>push to be first in doing this and once businesses start investing,
>easier to get them to do more. The good news is that with 25M SMB
>Pages, we are ahead.
>
>One other point is that both our ads system and Google's have the
>property that we have built-in incentives for ads to be relevant and
>perform well. We need those for our ad delivery mechanisms too. I
>believe that is part of what mark is saying below - but worth calling
>out as this is so important.
>
>-----Original Message-----
>From: Mark Zuckerberg
>Sent: Monday, May 05, 2014 1:09 AM
>To: Javier Olivan; Mike Vernal; Sheryl Sandberg; Dan Rose; Mike
>Schroepfer; Tom Stocky; Deborah Liu; Sam Lessin; Andrew Bosworth
>Subject: Thoughts on Messenger business ecosystem
>
>In this note, I'm going to sketch out how I think the Messenger
>business ecosystem will work.
>
>At the highest level, I believe Messenger will be a performance-based
>ads business. That is, I expect businesses to pay us to get people to
>perform concrete actions within Messenger or within their stores.
>
>When I say performance-based ads, I am specifically contrasting to two
>other potential businesses: brand ads and payments.
>
>I do not believe Messenger is a good medium for brands ads because
>people need to choose to open messages, which makes it inferior for
>mass reach of rich content, especially compared with our other products
>like News Feed and Instagram.
>
>I also do not believe our business will be payments directly, because
>charging for payments themselves will not allow us to price
>discriminate and receive a higher percentage of the value delivered like ads do.
>
>That said, I do expect payments and transactions to be critical in this
>ecosystem. A great payment system dramatically reduces friction in all
>transactions and therefore significantly increases the value of ads.

>For example, consider the value of search ads on desktop vs mobile ads today.

>The mobile ads are worth far less because of all the friction to

>transacting: the landing pages are worse and payments are worse.

>

>So even though businesses will bid to pay us for performance actions

>like getting someone to buy something or getting someone into their

>store rather than paying us for the payments directly, building out

>payments and transactions is strategically important despite not being

>our direct business. In fact, I think our ideal strategy is to give

>away payments for free -- or at no profit margin for ourselves -- in

>order to build up the transactional capacity of our network so we can

>ultimately have the best performing ads business.

>

>-----

>

>Like any ads business, the two levers to understand its potential scale

>are how many ads you can show and how well the ads perform.

>

>I'm going to start by outlining some of the touch points for people to

>interact with businesses in Messenger. Further below, I'll outline a

>framework for how many ads we can show at different stages in the

>evolution of this business.

>

>At the most basic level, there are three ways that I expect people will

>interact with business content:

>

>- A business can send you a message just like a person can today.

>Alternatively, you can send the business a message and it can reply.

>

>- We will have a discovery tab within Messenger where, in addition to

>highlighting organic suggestions like people nearby, we can also

>highlight relevant businesses, paid content or suggest apps to install.

>

>- While you're in a thread messaging with a person, we can show content

>inline if it's very relevant to your conversation.

>

>I'll discuss how much inventory will be available in each of these in

>more detail below, but for now I just want to call out that while the

>first and third touch points will eventually make up the vast majority

>of our inventory, they each need to have an extremely high quality bar

>before we start inserting any paid content there. The discovery tab

>will have much less traffic, but it will be very important for building

>this ecosystem by enabling people to engage with businesses organically

>as we build enough scale and quality to fill the first two touch points

>with good content.

>

>You can think about the discovery tab roughly like how we or Google

>thought about our right hand column ads before putting ads in News Feed

>or on top of search respectively. It's lower volume but enough to start

>building quality and building the business.

>

>Next, I'll go through each of those three basic touch points in a bit

>more detail.
>
>-----
>
>The first touch point is message threads with businesses.
>
>This branches into two very different experiences: a business messaging
>you out of the blue, and you messaging a business and it replying to you.
>
>The first experience -- a business messaging you out of the blue -- is
>where I expect most of our business to be over time. However, it's also
>one of the most sensitive experiences that we need to be careful with.
>The whole value proposition of Messenger is that it is a high signal
>channel where every message you receive has an expectation of intimacy
>and urgency. If we start buzzing your pocket with ads daily, then we
>could easily destroy this experience.
>
>There are a couple ways around this over the long term. The first is to
>not send you a push notification for these messages, so you just see
>them in your inbox when you open the app but they don't interrupt you
>otherwise. A "silent message" like this is a new behavior we'd have to
>build since it doesn't exist today. WeChat and Line both support this
>notion today. The second is to make sure the quality is high enough so
>people actually want these pushes. My guess is that we'll eventually do
>both: we'll have silent messages for most paid messages, but for ones
>that are very relevant we will consider doing pushes.
>
>As we phase these in, we'll need to make the product perform such that
>most businesses pay on a per-action rather than per-impression basis.
>The basic math of this is that even in the limit there will be so many
>fewer impressions here than in News Feed < both because total time
>spent is lower in Messenger and because the intimacy of the product
>affords fewer intrusions < that if we only support the same kinds of
>advertiser value propositions we do in News Feed, this will never be as
>big of a business for us as we hope.
>
>Instead, I think we will need to do the hard work to make payments and
>offers work frictionlessly inline. This can create much higher value
>impressions < more similar to search < that take advantage of the
>intimate and interruptive nature of the environment. For example, a
>business will be able to message people with specific offers when
>people are nearby and people will be able to redeem them inline,
>include paying right there.
>
>Even though this is fundamentally structured as an ads auction, a large
>percent of the work will be doing everything necessary to make the
>payment experience seamless so these offers actually convert and
>deliver value for both people and businesses. It will be easy for us to
>underestimate the amount of payments work required here compared to ads
>work since we have historically focused on ads rather than payments,
>but I expect there will be a very deep thread of work to do to make
>this payments experience integrated enough < both into people's

>accounts and businesses' workflows < that this experience really works end to end.
>
>If we can pull this off, then we can enable experiences like you're
>walking down the street and get a notification for a personalized offer
>to a nearby shop based on your identity and history there. You can open
>the notification and tell the cafe or store what you want, pay inline,
>and have it ready for you as soon as you walk in, all while receiving a
>discount and building a profile to have better personalized experiences
>in the future.
>
>Interruptive examples like this may be the long term, but before we get
>there we will likely want to explore silent messages first since
>they're less disruptive. These can still be a good testing ground for
>inserting relevant nearby content when you're in the app.
>
><
>
>Regardless, even silent messages are disruptive to the high signal and
>intimate feeling of the product today, so I wouldn't even start there.
>Instead, I'd start by building person-initiated threads with businesses
>and over time work up to enabling businesses to message people out of
>the blue.
>
>That brings us to the second experience -- you messaging a business and
>having it reply to you. In the Messenger business ecosystem, a thread
>with a business is the equivalent of a page on Facebook. It will be
>relatively low frequency that a person visits this thread -- just like
>it's relatively low frequency that a person visits a business page
>directly -- but it's a fundamental part of how businesses exist in the
>ecosystem and an organic way that people can interact with them.
>
>The next question is how will the business actually reply to messages?
>
>The naive answer is that the business owner can reply when they get
>around to it. I think we can support this behavior, but this is very
>slow and not a great experience for the person messaging the business.
>
>Instead, I think we should build an automated system that understands
>basic natural language so that business entities can respond
>automatically and instantaneously to people.
>
>This would enable businesses to respond to both informational questions
>like "Are you open now?" as well as actionable questions like "Can you
>make me a tall mocha frappuccino?". In the first case, the business,
>could just answer with the information. In the second, ideally this
>would then ask the person to pay inline in the thread and then tell a
>barista to start making the frappuccino so it would be ready as soon as
>you walked into the Starbucks.
>
>There are a few reasons this is a very powerful new way to interact
>with businesses, especially local businesses. First, everyone knows
>language but people hate calling businesses, so texting is a natural

>way to interact that doesn't require learning anything new. Second, the
>payment experience can be stored and optimized, which takes a huge
>amount of friction out of these interactions, especially compared with
>web-based interfaces or other apps you'd have to install. Third, most
>businesses you want to interact with will be on Messenger eventually,
>which is vastly preferable to using a large number of different apps.

>
>I expect that when you want to interact with a business, you'll search
>for them on Messenger and then begin a message thread with them. Before
>you send a message, I imagine each business will have some default
>message that starts every thread with them. This default message can
>outline what things the business knows how to do on Messenger, like
>order a frapuccino, buy tickets or so on. This message can also contain
>structured links to different functionality directly, so you can do
>some things without having to type any text at all. We should look at
>what others have done here, like WeChat, for example, has links to
>inline ³stores² that graphically list the business's inventory and let
>you browse and purchase inline.

>
>You'll also be able to type whatever you want, and we'll have to build
>a system that is smart enough at understanding your input and easy
>enough for businesses to configure for themselves that we can take your
>input and map it to what the business knows how to do, or at least come
>up with some other intelligent response.

>
>It will be difficult to build a good natural language system like this
>and it will require real investment, but it should be possible. The
>technological advantage we'll develop doing this will also be a
>competitive barrier for other messaging products like WeChat that try
>to compete with us for either consumer attention or business dollars.

>
>Over time, it will be possible for our systems to deliver more nuanced
>responses. It will also be possible to deliver types of replies that
>don't make sense in traditional search- or web-based interfaces, like
>time-delayed replies or follow-on replies later when more information
>becomes available. You should be able to ask a business a question like
>"tell me when a table becomes available" and in addition to being able
>to reply immediately to confirm it will do this, it should also be able
>to message you at a future point when it has the answer to your question.

>
>It's worth noting that time-delayed responses to person-initiated
>messages could be a great way to ease people into getting push
>notifications when businesses message them. We should probably ease
>people into this use case by building organic use cases like this
>before enabling purely paid messages that send push notifications.

>
>In addition to being able to message businesses back and forth with
>text, we will want the ability to send money and other kinds of
>structured data
>-- like loyalty card data -- as well. These kinds of interactions will
>be necessary to make sure that businesses actually get value from
>interacting with people on Messenger, especially since the branding

>value will be relatively minimal.

>

>Payments as a primitive is simple to explain but will be very
>complicated to fully implement. Within a messages thread, anyone should
>be able to either send money to or request money from anyone else.
>Within the UI, this would take the form of another kind of content you
>could attach to a message, just like a photo, sticker or voice clip.

>

>To make this really work as a social behavior, we'll need to create a
>social norm around people being comfortable sending money through
>messaging. To make this work as a product, we'll need to make it
>frictionless and cheap, which means we'll need credentials on file for
>large percentages of people. Over time, we'll need not only credit
>cards but also bank account information so we can make transfers cheap.

>

>A whole thread of our strategy is going to need to be focused on
>increasing payments usage and helping people add credentials. We'll
>need to support use cases like person-to-person money transfer to help
>establish this norm, even though it won't be a direct revenue driver
>for our business. As part of this, I imagine we're going to need to run
>constant promotions like WeChat has to encourage people to pay and
>transfer money in different ways -- as gifts on new years, paying for
>taxis, investing in mutual funds, etc. This is a very deep thread of
>work that will require a lot of work, but will ultimately be necessary
>for making the ads and interactions that businesses pay for valuable.

>

>In addition to investment of people on our teams and financial
>resources, we'll also need to dedicate real estate within our app to
>this promoting interactions with payments. At a minimum, I expect
>payments will be a permanent item within the message composer in
>message threads, a major part of the real estate on the Settings tab,
>and initially a large number of the promotions and recommended content
>on the discovery tab. We'll also need to do significant work on the
>business side, probably integrating into our own business-facing UIs
>like Page Manager as well as making sure we support businesses' own payment systems.

>

>Another example of structured exchange between people and businesses is
>loyalty programs. We should be able to build the best loyalty programs
>in the world based on our understand of people's identity and locations
>coupled with the business interfaces we've built. If you can message a
>business to initiate a loyalty card / relationship and then ever time
>you go to that business from then on you get a message updating you on
>your status and available offers, that could be very compelling.

>

>Of course, a lot of the nuance of designing business threads is going
>to come down to important details around how interruptive they can be,
>what they need to do to get permission to be interruptive, how easily
>you can mute them or turn them off, and so on. These rules can evolve
>over time, but making sure we get them right at each stage will be very important.

>

>Finally, it's worth noting that even though everything I've discussed
>here has been in the context of businesses, these kinds of business

>threads should be available to anyone who would currently have a page
>on Facebook today, including celebrities, politicians, bands and other
>types of entities that we don't typically think of as businesses but
>who produce important content for our ecosystem.
>
>-----
>
>After message threads, the second business touch point is the discovery
>tab.
>
>Imagine this tab as a new second tab in the app's main navigation,
>between Recent and Groups.
>
>The primary purpose of the discovery tab is to introduce people to new
>people, businesses and content that can improve their messaging
>experience.
>
>This is important because people will not just wake up one morning and
>start messaging businesses. First, we need to introduce the idea of
>businesses within Messenger to people and show people how they can be
>useful. The brute force way of doing this would be by starting to
>inject business content into the main inbox that the person had not
>directly asked for yet. That seems dangerous and unnatural, so the
>alternative is giving people a space where they can discover this
>business content on their own and start messaging businesses themselves
>rather than just having businesses start messaging them out of the blue.
>
>Of course, this presents its own problem: why would people ever go to
>the discovery tab? The answer is that we have to include content here
>that is relevant not just to the business ecosystem, but also for the
>social experience people are looking to have with Messenger.
>
>For example, you could imagine an early incarnation of the discovery
>tab being called Nearby and focusing on people and business that are nearby.
>We could use Aura to show friends nearby, highlight friends visiting
>from out of town and potentially even show other people nearby if they
>want to meet new people -- which is a very popular feature on WeChat.
>We could expand it beyond Nearby over time to include friends with
>birthdays or major life events, etc. I think this tab would quickly
>become more useful and more used than the static Groups and People
>tabs, which is why I suggested we'd place it second in the nav above.
>
>Once we build an experience here that is organically useful, the second
>stage is to insert business-related content to educate people about the
>value of the business ecosystem we're building. We could highlight
>businesses that can do useful things over Messenger and get you to
>engage with those first. Perhaps we'd start by making partnerships with
>a few chains or larger companies to increase the coverage of people who
>would have relevant business content here.
>
>For example, we might make a nationwide deal with Starbucks that
>enables you to order drinks through Messenger. You could tap on

>Starbucks in nearby and it would create a thread that would sit in your
>inbox from then on. When you first open the thread, you'd see
>Starbucks's default message and maybe some structured menu items, and
>you could tap or type to order something, pay inline, and then when you
>show up the barista will have your drink ready and hand it to you,
>knowing who you are because your identity shows up on an iPad at the cashier.
>
>Beyond Starbucks, another good example could be ordering a cab. This is
>worth mentioning because it's how WeChat started building up their
>payment base, and we are currently in discussions with Uber about doing
>something similar with them. That said, I don't think WeChat made this
>a great experience beyond just sending you to the taxi app, so there's
>a lot more we'd want to do here as well. I'll get into that more below.
>
>Initially, I expect we'd highlight these businesses on Messenger for
>free or very cheaply. But once we have a good number in there, then the
>third stage of evolution for the discovery tab is to turn this into a
>market and start charging for paid placement in addition to showing
>good organic people and business content.
>
>As I said above, the discovery tab is like the right hand column of
>Facebook or Google. It will be enough volume to get some interesting
>behaviors going within the ecosystem and to start building the
>business, but given the much smaller volume of visits compared the main
>inbox, this will never turn into a huge business by itself. This
>roadmap by itself is a stepping stone to the main business of
>interacting with businesses in the main inbox by getting people used to
>engaging with businesses in Messenger.
>
>One open question is whether we want to use the discovery tab to only
>promote business interactions on Messenger, or whether we want to run
>more general ads here, including app install ads.
>
>The argument for app install ads is that it's easier and more
>understandable for businesses, especially early on. For example, the
>taxi integration that WeChat did was primarily just about driving app
>installs to the taxi app rather than doing much actual integration.
>It's easy to imagine how we could make some money adding app install
>ads, especially early on, before we had a full business ecosystem.
>
>The argument against app install ads is that any space we allocate to
>them has a large opportunity cost against building the business we
>eventually want in the main inbox. Any app install ad that sends a
>person to another app is a wasted opportunity to educate people on
>interacting with businesses in Messenger. Arguably, WeChat is stuck at
>the stage of running ads in a secondary discovery tab because they took
>the easy money and never built out a full enough ecosystem to be able
>to monetize the main inbox where most of the traffic is. They're still
>doing at a bit more than ~\$3 per person annually, but our goal is to
>reach the monetization levels we see in News Feed of greater than \$10
>per person, if not more.
>

>There are other types of content to consider, like stickers or
>in-message games. These could help us make money, but they will also
>have the property that they make Messenger better for people and get
>people more invested in the product. So these are a different kind of
>tradeoff and opportunity cost that we'll have to weigh when we get
>there. It's easy to say these things are silly, but I think this is how
>WeChat and Line make 30-50% of their revenue today.

>
>My guess is that we'll want to experiment with all of these things but
>will need to be careful. We'll need to be disciplined about starting
>off by building a valuable people-centric consumer experience, then we
>can add some business content with the goal of educating people that
>you can have good business experiences within Messenger. Only after
>these two should we really think about adding other content and making
>any real money from the discovery tab itself.

>
>-----
>

>After message threads and the discovery tab, the third business touch
>point is inline during message threads with people you're talking to.

>
>This is different from the ecosystem of interacting with business
>entities described in the first two touch points above because in this
>case you're not actually communicating with a business.

>
>Instead, this plays on the technical work we're going to have to do to
>understand the context of messages in order to support automatic,
>instantaneous replies from business for the above use cases. Once we
>have the technical ability to do this, we can use it to show relevant
>context in other places as well.

>
>The basic idea here is that if you ask a friend a question as part of
>your message thread with them and we know the answer, it could be
>useful for to show you the answer inline in your conversation. For
>example, if you ask a friend if a movie is playing or when an event is,
>we can quickly add that information to the thread. If you ask your
>friend if they want to get dinner but you don't know where to meet, we
>can also show suggestions inline.

>
>Intuitively, this seems like it would be useful, but there's a very
>high quality and relevance bar before this becomes annoying. It would
>be very easy to create terrible experiences by inserting the wrong
>information at the wrong times. Because of this risk, we should be very
>conservative about when and how we insert information while we're ramping up.

>
>It's worth noting that what businesses pay us for here will be
>different from in the ecosystem above where people interact with
>business entities directly. In the ecosystem of interacting with
>businesses, person-initiated interactions are free for businesses, and
>businesses will need to pay for distribution to get in front of people
>in non-person-initiated cases. In a way, this has similarities to a
>traditional display ads business. However, this next ecosystem of

>inserting relevant context inline is closer to a traditional search
>business. We can show only show relevant context inline in response to
>the right prompt, and when that prompt appears, we can show whichever
>bit of relevant context we think is most valuable, taking into account
>both engagement and revenue.
>
>Because this is a different kind of business, we could postpone
>developing this touch point until later and just focus on the touch
>points above for the first few years.
>
>However, the technology required to understand natural language context
>to power this touch point will be significantly overlapping with the
>technology required to build the first ecosystem above, so once we've
>developed it I see little reason to wait to get started here.
>
>Further, getting good at showing relevant content in response to
>contextual cues is something we're already working on in Utility with
>After Party, where we show relevant contextual information after you
>check in or post with other structured minutia from the composer in our
>main app. That means we should be able to take that team's effort,
>apply it to Messenger and start seeing an early experience here without
>many months of work.
>
>Focusing After Party on Messenger is also about where there's the most
>leverage. There are currently only ~50 million After Party-eligible
>actions in the main composer today, so the ~7 billion mobile messages
>in Messenger and >20 billion in WhatsApp should be a more leveraged
>surface to redirect this work once it's a good experience. Even if only
>1% of messages have any relevant context for an After Party experience,
>that would still be more After Party actions in Messenger alone than in
>the main app.
>
>---

>
>There are other threads of work related to contextual understanding and
>inline replies as well.
>
>One question I've thought a lot about is how people will find the right
>businesses to message in the first place. One possible answer to this
>is that you'll search for them. For example, if you want to see if a
>restaurant is open or get reservations, you could search for that
>restaurant and then ask it your question. But this seems clunky to me.
>
>So much of the value in the messages UI paradigm is that it's not search.
>If people wanted to use search to find out something about a business,
>it's probably easier to just use Google. The reason people would use
>this is because it's a more natural and less search-based UI than where
>Google is today.
>
>There's a good reason to believe the future of search is moving in this
>direction -- and it's that even Google (as well as Microsoft and Apple)
>seem to think it is. They're all focused on building the next version

>of their search products as digital assistants that you communicate
>with by asking conversational questions, and they try to provide you
>with answers rather than a list of links.
>
>If search companies think that conversation is the future of search
>rather than initiating queries by searching, then why would we want our
>conversational UI to be initiated by searching? It doesn't make much
>sense.
>
>Instead, what makes more sense to me is that we'd develop our own kind
>of assistant that lives inside Messenger. Think of it as the entity
>"Facebook" and you could message it just like you'd message any other
>business in this system. The only difference is that this entity
>performs one special task that the others don't -- it mediates between
>all of the other entities. If the other business entities act as
>digital assistants for interacting with those businesses, then the
>Facebook entity is a sort of meta-assistant that helps you interact
>with all of those other assistants. This means that instead of ever
>having to search for a business, you could just message the Facebook
>business entity and it will connect you with the right business entity directly.
>
>For example, you could ask this special entity when some business is
>open until, and this entity would be able to do two things: first, it
>could communicate with the other entity in the background and answer
>your question for you; and second, it could connect you directly to the
>right entity to talk to in the future so you don't have to search for
>it yourself.
>
>This may sound very abstract and complex, but I actually think it would
>be relatively simple to build once we had the technology we needed for
>business entities to make automatic, instantaneous replies themselves,
>which is required to build this ecosystem anyway.
>
>Once we have that technology, then we'll already be able to understand
>the meaning of many questions. We'll also already have a registry of
>what businesses know how to answer which questions and do which things,
>since this is required for us to have them reply automatically. With
>these pieces, building this meta-assistant is just a matter of enabling
>our special Facebook entity to answer any question that has a
>registered response from any other entity in our system.
>
>The biggest technical problems we'd have to solve would be figuring out
>which of the entities that say they can answer a question are actually
>the best to do it.
>
>For example, if I message Facebook and say I want a taxi, then we will
>likely know of multiple services that have registered with us to be
>able to answer queries about wanting a taxi, so we'll need to decide
>which one is best and connect you with that service. The solution here
>will be a mix of machine learning reputations and quality scores for
>the different entities, plus figuring out how we accept financial bids
>in our system. I assume that if we are in a position where we're

>deciding which taxi service you're going to use, then we will make
>money from whichever service we send you to.
>
>This meta-assistant vision may seem far-fetched right now. It's
>possible we don't need to start working on it today. But I would. From
>two different perspectives, this seems like the right approach. First,
>digital assistants from Google, Apple and Microsoft are becoming more
>useful and important over time, so I don't see why this metaphor
>wouldn't hold for us too. Second, this really is the simplest way to
>interact with all of the different businesses in our system. It's much
>better than searching and starting a thread yourself.
>
>If we follow this approach, I think there's a good chance our
>meta-assistant could become the most useful of all. Google and everyone
>else are building their assistants by trying to have a single
>search-like system understand everything. We're taking the opposite
>approach by having everyone create individual entities, and then we're
>just linking all those different entities together.
>
>In the real world, there doesn't tend to be one person or assistant
>that you want to ask all your questions to. There are lots of different
>people you ask different questions to. We're constructing our system
>the way people interact in the real world. There would be one
>meta-assistant that could help you navigate who you talk to, but in
>general you'd be asking questions and interacting with different domain
>experts rather than always with a single assistant.
>
>If we can succeed in building the most useful assistant -- for which
>the most important step would be getting as many businesses as possible
>into Messenger -- then this could actually be the future of search in
>addition to a big part of the future of advertising and commerce.
>
>-----
>
>Those are all of the main touch points for people to interact with
>businesses in this ecosystem.
>
>Now here's a list of all the different threads of work that I discussed
>above.
>
>1. Business entities
>
> - Entity accounts and scaffolding
>
> - Natural language response system
>
> - Menus and structured stores
>
> - Loyalty programs
>
> - Policies around when businesses can message and interrupt you
>

>2. Payments
>
> - Basic primitives of sending and requesting money
>
> - Optimizing friction, credentials and rates for people
>
> - Integrating with businesses' workflows
>
> - Promotions and deals to drive adoption and credentials
>
 >3. Discovery tab
>
> - Nearby people recommendations
>
> - Business entity recommendations
>
> - App install ads
>
> - Other content, like stickers and games
>
 >4. Inline content suggestions
>
> - After Party for messages
>
> - Inline games
>
 >5. Meta-assistant
>
> - Registry of all entity knowledge and actions
>
> - Mediate requests with multiple handlers
>
> - Special UI for meta-assistant
>
 >6. Ad system integration
>
> - Auction for inbox messages and discovery space
>
> - Performance-based bid options
>
 >7. Language technology investments
>
> - Natural language research
>
> - Voice recognition improvements
>

>
>Thanks for reading all the way through this. I know it was very long,
>as I tried to be as detailed as possible. I'm looking forward to
>discussing further soon.
>

Mark Zuckerberg

I'm glad we got a chance to talk yesterday. I appreciate the open style you have for working through these issues. It makes me want to work with you even more.

I was thinking about our conversation some more and wanted to share a few more thoughts.

On the thread about Instagram joining Facebook, I'm really excited about what we can do to grow Instagram as an independent brand and product while also having you take on a major leadership role within Facebook that spans all of our photos products, including mobile photos, desktop photos, private photo sharing and photo searching and browsing. This would be a role where we'd be working closely together and you'd have a lot of space to shape the way that the vast majority of the world's photos are shared and accessed.

We have ~300m photos added daily with tens of billions already in the system. We have almost 100m mobile photos a day as well and it's growing really quickly -- and that's without us releasing and promoting our mobile photos product yet. We also have a lot of our infrastructure built around storing and serving photos, querying them, etc which we can do some amazing things with. Overall I'm really excited about what you'd be able to do with this and what we could do together.

One thought I had on this is that it might be worth you spending some time with [REDACTED] to get a sense for the impact you could have here and the value of using all of the infrastructure that we've built up rather than having to build everything from scratch at a startup. This would probably be a useful perspective for you to have.

On the thread of integrating OG deeply (whether or not Instagram joins Facebook), you expressed some doubt about whether it would be good for Instagram to send so many photos over to Facebook. I think it would be quite good for everyone -- users, Instagram and Facebook -- and I wanted to share one mental model I use for thinking about this.

I often think about Wikipedia as the best example of a crowd-sourced corpus of content. One interesting thing about it is that they allow anyone to download their whole encyclopedia and copy it to use as their own. This might seem like a bad business strategy for the same reasons you're concerned, but in fact it's really helpful for them and doesn't hurt them at all. The reasons why it helps them are obvious -- they get more distribution, authors want to contribute more since they know their work will be in many places, etc. The reasons why it doesn't hurt them are more interesting. I think the best way to look at this is that the value of Wikipedia isn't really that it's an Encyclopedia; it's that it is a community and engine that continually produces the best Encyclopedias. Because of this, they know that even if people use their data that they have all the leverage since they're the engine that produces the core data set.

I actually think you guys are in a similar position with us. By pushing a lot of data into OG, you get distribution but you remain the engine that produces Instagram photos, which will become more powerful over time. From this perspective you may wonder why Facebook is happy with the arrangement, and the answer is that we're playing a meta-game. Rather than being the engine that produces photos or any specific kind of content, our goal is to be the engine (or platform) that helps produce other engines (or apps) that produce content. That's the only way we'll ever scale to helping people share every kind of thing they want.

So in short: I'm really excited about the acquisition and I think it would set up Instagram and you personally to have the biggest impact possible. If we do that -- or even if we don't -- I still think having a deep OG integration is very good for both companies and all of our users.

Let me know when you want to talk some more. If you have any feedback on my offer I'd love to hear it. I'm looking forward to continuing the conversation.

March 19 Kevin Systrom

Hey - I wanted to go away and think about our conversation a bit and have a reply that was well formed. I know where our head's at now and I'll drop you a longer note today. Thanks man

March 20 Kevin Systrom

Hey Mark -

I've been thinking a lot since we talked last, and I wanted to share how my thinking has evolved. Getting to chat about our paths and how they cross has been eye-opening I think for us in many ways.

First, it's humbling to know that you guys look at what we're doing in the mobile space and think it's as innovative and strong as we'd like it to be. I've always been a fan of what you're doing -- and in many ways I've shared similar passions for the problems that you've wanted to solve along the way as well. There's a mutual respect that I think will help us get a bunch of things done together around OG going forward.

Second, I've never had to stand back and look at our company at a 50k foot level and ask what it might look like as part of something larger. For this reason alone I wanted to meet with you to understand what Instagram would mean to you and to Facebook.

In many ways we're aligned. We both believe in the power of mobile to change the way people share information. We see the transformation happening very quickly as people adopt new products like Instagram, etc. We are both, at our core, engineering-driven in culture and vision. We both have a passion for social products, and realize that by building what we're building we can (and have the responsibility to) positively influence culture and the world at large.

I also realize that Instagram is a foreign citizen in the world of Facebook. We produce more photos week over week that have found a

CONFIDENTIAL

HIGHLY CONFIDENTIAL TREATMENT REQUESTED

NOT FOR CIRCULATION/COMMITTEE MEMBERS AND STAFF ONLY

FTC-IG0004474

FB-HJC-ACAL-00091648

home inside Facebook. At the same time, we have a very independent and disparate browsing and 'friend' experience within our own network. Most of the photos on Instagram are not social photos, but instead tend towards photos of the world around us. Our graphs are significantly different as well. For one, we have an asymmetric visual interest graph – one which I'm sure differs from most peoples' fb graphs. Also, we're primarily mobile in experience, we have no web in our DNA as of yet, and for this reason we've focused on mobile photos rather than photos in general.

Regardless, I think there's a world where Instagram with Facebook just makes a lot of sense. Though the particular balance at this time makes Mike and I feel that we'd like to stay independent for the time being. Really it just comes down to wanting complete independence to pave our own path. This in particular means not limiting the scope of Instagram to just photos - but to explore other mediums as well which support the original vision of Burbn being to improve the way we communicate and share in the real world. There's volatility and optionality that make both Mike and I really excited to build a long-term viable business from where we are today long into the future.

To be clear, you've been nothing but helpful. When asked if it made sense for you to think about acquiring our company, there wasn't any fuss around it – it was a straightforward yes/no decision that you made with confidence and for that I'm thankful. I'm not coming back at you asking to change the offer because I don't think that's what drives us. Of course there's a limit to that logic, but honestly I'm not sure at the point we discuss those limits that we're doing this for the right reason.

Either way I think we should start a more open discussion because even if it's not now it could make sense in the future. Of course this may mean the economics are less favorable given a large raise, but it's worth it to me to explore what we're actually building here. Is it a next-generation photos app or is it a next-generation communication app? I don't mean to get overly philosophical, but the limits of our ambitions have really yet to be tested, and I want to see that through at least for now. The desire to have an effect at the scale of FB is real and tangible, and one that is actually quite hard to balance in our minds. That being said, I think you should meet Mike my co-founder and we should spend more time with your leadership going forward. I hope this clarifies my current position and if anything helps you understand the depth of our ambition to create something really meaningful in the world.

On the OG stuff, you're right. I do think there's a valid question in thinking through whether or not sending all our photos to FB makes sense. I actually don't think we'd ever go out of our way to discourage or make it difficult for anyone to share from Instagram to Facebook, we just want to make sure it's up to the user. Right now, users are voting that 15% of all photos on Instagram end up on Facebook. Whether or not that's because it's a different audience, or a different type of content I'm really not sure. All I can go on is data - and I think we're giving a pretty good experience so far in the form of full photos in the timeline with absolutely no restrictions. We win when users are happy - and users seem to be really happy with that option of selectively sending over content. We rarely if ever hear complaints that the share to a service toggle not being sticky is a problem, so it makes me feel that we shouldn't go out of our way to make that the default without a really clear thesis on why it's better for everyone.

I think your comparison to Wikipedia has its merits, but in some ways isn't as applicable. Wikipedia doesn't care that their content is distributed and copied elsewhere because they realize that the freshest and most up to date content will always be on Wikipedia. Since they have the economies of scale, there's no incentive for people to go anywhere other than WP to make edits, etc.

With FB, we have a different situation. You guys actually have all the economies of scale around photos. That is, you guys have all the systems to make a photos experience really awesome. In many ways, once we send our original content over to FB, it starts getting likes, comments, etc and takes a life of its own. It's as if a Wikipedia article gets copied somewhere else, and starts evolving on another site with larger scale. Trust me, I realize the comparison is a bit tenuous but I hope it shows where I'm coming from and why I think the Wikipedia comparison is hard for me to grok exactly.

At the same time, I think your point around being the meta-engine makes total sense. I agree that FB should be really happy when engines like us come along and plug in. I guess I wouldn't feel nearly as strongly if independently you weren't building a mobile photos app that makes people choose which engine to use. Listen, this is all based on me not actually knowing what the overlap in what you're doing and what we're doing is – rather it's based on the speculation that there's a future where all our content flows away from Instagram and over time Instagram becomes less of the place for people to share and interact with content from the real world because the scale and tools exist elsewhere (FB).

I actually think that if done well, complete integration around likes + maybe even comments could be really cool. I think have my preferences expressed to my fb friends could be really valuable to me as a user but also to Instagram for distribution.

I don't want to seem as though I'm against the idea of open graph at all - I think it could totally set us up for incredible distribution. It's just very hard to balance sending over all our original content that lives inside a very separate photos experience which creates a fractured experience of two comment streams, two like streams and two feeds for Instagram and Fb separately.

I hope you take this as open and honest feedback for how a developer in the ecosystem is trying to balance the decisions of sharing/not sharing with the hope that it sets of a discourse where we are both very happy about the integration going forward.

Either way I think I've had some of the most interesting conversations I've had in a long time with you over the last few weeks. It's made me think about our company in a different way, and also helped push me to form a stronger opinion about what we are and what we aren't. Regardless, it's been super valuable and I hope we can continue that going forward.

I'm happy to chat about this more in person – just let me know. And thanks again for all your support for everything we're trying to do.

CONFIDENTIAL

HIGHLY CONFIDENTIAL TREATMENT REQUESTED
NOT FOR CIRCULATION/COMMITTEE MEMBERS AND STAFF ONLY

FTC-IG0004475
FB-HJC-ACAL-00091649

Best,
Kevin

March 20Mark Zuckerberg
A few thoughts on both pieces:

On acquisition, everything you're saying seems reasonable, but it's a pretty unfulfilling conclusion for me since it doesn't feel like you've explored it fully. The process began with you asking if we'd do this at \$500m, but then you didn't want to end up doing it at that valuation. I am curious to know at what valuation you would do this, and then I can just let you know whether we'd do that. I get that you're not primarily doing this for money, but there usually is some continuum here and given the time we've put into this so far I do think it would be worth it to be honest about where that is.

Related, you reference flexibility and things you'd like to do independently that you couldn't do at Facebook. I'm curious what you think you couldn't do at Facebook, given that what I offered was for you to keep building out Instagram as a separate product and brand. I actually think you'll be able to do all the same things with Instagram at Facebook plus you'll have more distribution firepower behind you, so there will be a bigger chance anything you do takes off. So I'm curious to hear what your concerns are here.

A final sub-point on this is that if you choose to stay independent, it's really important to me that this doesn't become a public story about how you guys turned us down to go do something independently. That just isn't a positive story. I know it won't leak from my team so I'd ask that you make sure it doesn't leak from yours either.

On Open Graph, there's a lot of nuance here that you haven't captured in your note.

I'm not suggesting that you make your current setting sticky. What I've specifically suggested is making it so there's a toggle where all of your social activity -- photos, likes, comments and follows -- get synced to your timeline in the background. In this mode, these items wouldn't show up on in News Feed as you post them, but you'd still have them as a collection on your timeline. This addresses a major pain point for people which is that they don't want to spam their friends. I would implement this so that when a user connects to Facebook this is turned on and they can turn it off at any time. In addition to this, I'd also keep the current option you have to broadcast any individual photo to your friends on Facebook.

If you did this, I think you'd create a lot of value for your users, Instagram and Facebook. People may not be asking for a sticky toggle, but that's not what this is. If you listen to your user feedback on why people share more or less on different networks a lot of it is because they don't want to spam their friends/followers on different networks, but they want to share these photos and are comfortable doing it in a photo-specific setting like Instagram. Using Open Graph the way I'm suggesting allows that. It's not simply a matter of people voting that they want to share 15% of their photos. The actual dynamics around how this works are very important.

Most photos on Instagram are public and many people follow all of their friends, so this clearly isn't a privacy issue -- it's an issue of how the photos are shared. Simply saying that people want to share only 15% of photos is overly simplistic. I think you know that, so making this argument just makes me think you don't want to do this for some other reason.

The whole point of Open Graph is to create a social dynamic where it is socially acceptable to sync all of your social activity in another app with your timeline without spamming your friends, so this is the core problem we're trying to solve. This creates better timelines for our users and lots of distribution and brand awareness for you. You can use Open Graph to sync individually photos like you're experimenting with now, but fundamentally there's nothing special about using Open Graph over our traditional APIs for this, so over time we wouldn't really consider this a deep Open Graph implementation.

At some point soon, you'll need to figure out how you actually want to work with us. This can be an acquisition, through a close relationship with Open Graph, through an arms length relationship using our traditional APIs, or perhaps not at all. I'm willing to put effort into whichever approach you'd like to take, but you should be clear and honest with me about what you'd like to do so I don't waste time working on things you're not interested in. Of course, at the same time we're developing our own photos strategy, so how we engage now will also determine how much we're partners vs competitors down the line -- and I'd like to make sure we decide that thoughtfully as well.

Overall though, I'm still very optimistic about what you're doing and would love to find a way to work together. My preference is to work together extremely deeply since I think there are lots of things we can do together than can't currently be exposed through our current Open Graph implementation that we'd need to work on closely together -- either as one company or two.

March 20Kevin Systrom

Hey Mark - thanks for the thoughts. I would never leak this, and I think it would be really bad for a bunch of reasons for us so I'm on the same page. I've messaged that to [REDACTED] and Mike so we're on the same page.

I realize it's unfulfilling - and I agree we haven't explored it fully. We have a board meeting today. I'm going to spend a significant amount of time discussing our relationship with Facebook. I want to be respectful of your time as I know you have many things to deal with, so let us come to you with a clear thesis. I tried my best to explain where my head's at, but I take your points and I'm going to work on it.

I have a feeling we should probably discuss this in person as the sincerity for how I'd like to work with you probably gets lost in a message. Would you be ok with that?

March 20Mark Zuckerberg

CONFIDENTIAL

HIGHLY CONFIDENTIAL TREATMENT REQUESTED
NOT FOR CIRCULATION/COMMITTEE MEMBERS AND STAFF ONLY

FTC-IG0004476
FB-HJC-ACAL-00091650

FYI, apparently it leaked to the Wall Street Journal that we and Twitter were talking to you about acquisition. I didn't tell anyone on my side that you were talking to Twitter, so this must have come from your end.

March 20Kevin Systrom

Hey - honestly it didn't come from me or anyone inside my circle (you know [REDACTED] an [REDACTED]). It's absolutely not in my interest for this to be out

March 20Kevin Systrom

If you're down, I'd like to chat live - can be phone or in person. Have some thoughts after our board mtg that I can share. Let me know

March 21Mark Zuckerberg

Sure -- I'm around later this afternoon and evening if you want to talk.

March 21Kevin Systrom

Ok. 7:30 phone? Wsj/spencer just reached out to me via email btw. My plan would be to chat with him and stonewall on anything around financing/our discussions. If you guys have talked to him and I should have context let me know (not responding may be more of a signal than not)

March 21Mark Zuckerberg

Let's talk at 7:30. We can cover this other stuff then too.

March 21Kevin Systrom

Ok. Call me? [REDACTED]

March 22Mark Zuckerberg

Following up from last night:

- On acquisition, I'll wait to hear more from you here. Given the leaks and that I put the last offer on the table, it doesn't make sense for me to put another offer on the table before you provide more guidance on what you'd accept. If you're not comfortable doing this then we can just discuss this down the line, but it seems like the right next step now and one you should be able to do is for you to give me clear guidance on what you'd accept.

- On partnership and Open Graph, the ball is also in your court here. Although you've said that you want Instagram users to be able to share and sync whatever they want on Facebook and elsewhere, it seems like you have real strategic discomfort around the idea of moving the percent of photos synced to Facebook from 15% up to 40-50%. Obviously if you don't actually want your users to be able to do this then we won't produce something good together, so I'm just going to wait for you to answer this question before engaging further.

I'm obviously happy to help out and support you guys in any way I can. On these two things issues, let me know when you want to talk more.

April 2Mark Zuckerberg

I just got back from my trip to China. I'm not sure if you're ready to follow up on either of these things, but if so I'm back in town now.

April 3Kevin Systrom

I am - sorry about the lack of response. Was on a trip overseas and today was (am) dealing with android stuff. What's your week looking like? We can do in person or over phone
Haven't slept in 36 hrs so bear with me

April 3Mark Zuckerberg

Congrats on the Android launch. It looks great. I just got back a trip out of the country as well, so no worries on that. I'm around tomorrow evening and around lunch time Thursday if either of those work for you.

April 3Kevin Systrom

Let me check on tomorrow night and get back to ya. Thanks again for your patience

April 4Kevin Systrom

Tonight 7:30ish at your place or somewhere in palo alto work?

April 4Mark Zuckerberg

Sure -- want to come by my place?

April 4Kevin Systrom

Sounds good. Looking fwd to hanging

April 4Mark Zuckerberg

BTW, I've already eaten, but I'm happy to go out and grab some food if you're hungry.

April 4Kevin Systrom

No prob at all. I'm down for meeting elsewhere but don't want to call attention to the conversation given the topics. Up to you - I was

CONFIDENTIAL

HIGHLY CONFIDENTIAL TREATMENT REQUESTED

NOT FOR CIRCULATION/COMMITTEE MEMBERS AND STAFF ONLY

FTC-IG0004477

FB-HJC-ACAL-00091651

going to grab something before I left.

April 4Mark Zuckerberg

If you're eating too, then let's just meet at my place. See you in a bit.

April 4Kevin Systrom

Traffic is stopped here at millbrae. Will be there 745 if that's ok

April 4Mark Zuckerberg

No worries

April 5Kevin Systrom

Hey can we schedule a call for whenever your free post lunch?

April 5Mark Zuckerberg

Hey, I had a chance to talk to Sheryl and David last night and then again this morning for a while. I was planning to call you during lunch after a couple of meetings I have, but I was wondering instead if you'd be up for getting together in person this afternoon or evening.

April 5Kevin Systrom

I am yes. What're you thinking?

April 5Mark Zuckerberg

I'm done with meetings today around 3:30. Want to meet up then?

April 5Kevin Systrom

Yes where's good?

April 5Mark Zuckerberg

If you're down here then we can meet at my place again.

April 5Kevin Systrom

Ok 3:30?

April 5Mark Zuckerberg

Also, just to be clear so I don't waste your time here, I can't get to \$2 billion. But if you're open to doing something in the range and structure we discussed last night, with an earn-out, valuing Facebook aggressively, etc, then I'm optimistic we can do something -- especially since we both seem to want to work together. If that's not worth discussing for you, then I totally understand though.

April 5Mark Zuckerberg

How about 4 so I have time to get home.

April 5Kevin Systrom

We should have the discussion - 2 was my yes absolutely number. Less is just something to think through together is that ok?

4 is good

April 5Mark Zuckerberg

Okay, see you then.

April 5Kevin Systrom

Ok

April 5Kevin Systrom

Any chance we could meet ASAP? It's really the pressure of this round. I don't mean to make you cancel meetings but a few hours makes a big difference. We could also just chat on the phone

April 5Mark Zuckerberg

I can move some meetings around and end early. Want to come down now? I can meet at 2.

April 5Kevin Systrom

Yes I will leave in 10

April 5Mark Zuckerberg

Great, see you in a bit.

April 5Mark Zuckerberg

Are you still coming?

April 5Kevin Systrom

Can I come over and chat?

CONFIDENTIAL

HIGHLY CONFIDENTIAL TREATMENT REQUESTED
NOT FOR CIRCULATION/COMMITTEE MEMBERS AND STAFF ONLY

FTC-IG0004478

FB-HJC-ACAL-00091652

April 5Mark Zuckerberg
Sure

April 5Kevin Systrom
Be there in 5

April 5Mark Zuckerberg
Just wrapped up my interview. Ready to talk more?

April 5Kevin Systrom
Ya finishing up a call in 10ish
Coming now

April 5Kevin Systrom
On a call with the guys.

April 5Mark Zuckerberg
Okay, let me know when you're done.

This doesn't have to be so long. Just tell them you want to do this and they'll let you!

April 5Kevin Systrom
Sorry give me 5

April 5Mark Zuckerberg
Take your time.

April 6Kevin Systrom
Can mike and I meet with you when you're free? 10 would work

April 6Mark Zuckerberg
Sure, I'll see you guy at 10.

April 6Mark Zuckerberg
Hey -- when I was explaining the terms to [REDACTED] I realized I misspoke on one important term. Most of the upfront deal consideration portion for you guys also needs to vest in addition to the retention package. It will have the same provisions of double-trigger etc to guarantee you eventually get it, but we can't just transfer all of the money immediately. You probably understood what I was saying here from other deals you've done, but I just wanted to clear this up since I think I misspoke on it.

April 6Kevin Systrom
Ok I understand now. Let's push forward. We need a term sheet to start the lawyers say. Can you guys put something together?

April 6Mark Zuckerberg
Yeah, [REDACTED] is getting started on this.

April 6Kevin Systrom
Ok

April 7Mark Zuckerberg
Want to talk this morning to try to finalize the open high level terms, like cash amount, cash/stock exchange rate, etc?

April 7Kevin Systrom
Yes but can I finish my calls with the lawyers over here?
Prob 11:30ish

April 7Mark Zuckerberg
Yeah, of course. I just woke up so I wanted to send you a note so you know I can talk whenever.

April 7Kevin Systrom
Great. Sounds good

April 7Mark Zuckerberg
How is everything going from your perspective?

April 7Kevin Systrom
Good, you? Want to meet in person and discuss this stuff? I think it's probably best

April 7Mark Zuckerberg

Sure. Want to come by at 11:45?

April 7Kevin Systrom

Sure I'm up in the city and need to pack up. Will try to hit 11:45 maybe closer to 12?

April 7Mark Zuckerberg

Sure, come by whenever.

12 is fine. I was just suggesting 11:45 earliest so I'd have time to finish waking up, getting dressed, etc.

April 7Kevin Systrom

Haha no worries. I'll get down there

April 7Kevin Systrom

More like 12:15 now just. As a heads up

April 7Kevin Systrom

Hey just to let you know things are going well and I'm here with [REDACTED] ironing things out

April 7Mark Zuckerberg

Awesome. I'm at home but let me know if there's anything I can help out with.

April 7Kevin Systrom

Ok cool

April 8Kevin Systrom

Congrats, man - really excited for everything. Looking forward to working together

April 8Mark Zuckerberg

Congrats to you too! This is going to be great. I'm looking forward to working more closely together as well.

April 9Mark Zuckerberg

Excited to announce this?

How is it going with your team?

April 9Kevin Systrom

Yes! Lots of talking and questions

April 9Mark Zuckerberg

But everyone is generally excited and happy?

T-minus 15 minutes on the announcement

April 9Kevin Systrom

Yes! Totally excited and surprised

I think you should spend a little time with everyone explaining how excited you are. I think maybe we're coming down?

April 9Mark Zuckerberg

Yeah, I'm definitely happy to do that whenever.

April 9Kevin Systrom

Ok will work out with schrep

April 9Mark Zuckerberg

Posted. Congrats!

CONFIDENTIAL

HIGHLY CONFIDENTIAL TREATMENT REQUESTED

NOT FOR CIRCULATION/COMMITTEE MEMBERS AND STAFF ONLY

FTC-IG0004480

FB-HJC-ACAL-00091654

A memo drafted by David Ogilvy for the management to circulate as they saw fit:

September 7, 1982

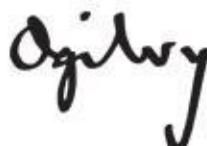
How To Write

The better you write, the higher you will go in Ogilvy & Mather.
People who *think* well, *write* well.

Good writing is not a natural gift. You have to *learn* to write well.
Here are 10 hints:

- (1) Read the Roman-Raphaelson book on writing.* Read it three times.
- (2) Write the way you talk. Naturally.
- (3) Use short words, short sentences and short paragraphs
- (4) Never use jargon words like *reconceptualize, demassification, attitudinally, judgmentally*. They are hallmarks of a pretentious ass.
- (5) Never write more than two pages on any subject.
- (6) Check your quotations.
- (7) Never send a letter or a memo on the day you write it. Read it aloud the next morning—and then edit it.
- (8) If it is something important, get a colleague to improve it.
- (9) Before you send your letter or memo, make sure it is crystal clear what you want the recipient to do.
- (10) If you want ACTION, *don't write*. Go and tell the guy what you want.

David

A handwritten signature in cursive script that reads "Ogilvy". The signature is fluid and expressive, with the "O" being particularly large and prominent.

ATTACHMENT B

[Redactions [Filed Under Seal.]

From: Steve Jobs <sjobs@apple.com>
To: Eddy Cue <cue@apple.com>
Subject: Fwd: HarperCollins
Received(Date): Sun, 24 Jan 2010 22:31:31 -0800

My last email to James Murdoch.

Sent from my iPhone

Begin forwarded message:

From: Steve Jobs <sjobs@apple.com>
Date: January 24, 2010 11:31:24 AM PST
To: James Murdoch [REDACTED]
Cc: Steve Jobs <sjobs@apple.com>
Subject: Re: HarperCollins

James,

Our proposal does set the upper limit for ebook retail pricing based on the hardcover price of each book. The reason we are doing this is that, with our experience selling a lot of content online, we simply don't think the ebook market can be successful with pricing higher than \$12.99 or \$14.99. Heck, Amazon is selling these books at \$9.99, and who knows, maybe they are right and we will fail even at \$12.99. But we're willing to try at the prices we've proposed. We are not willing to try at higher prices because we are pretty sure we'll all fail.

As I see it, HC has the following choices:

1. Throw in with Apple and see if we can all make a go of this to create a real mainstream ebooks market at \$12.99 and \$14.99.
2. Keep going with Amazon at \$9.99. You will make a bit more money in the short term, but in the medium term Amazon will tell you they will be paying you 70% of \$9.99. They have shareholders too.
3. Hold back your books from Amazon. Without a way for customers to buy your ebooks, they will steal them. This will be the start of piracy and once started there will be no stopping it. Trust me, I've seen this happen with my own eyes.

Maybe I'm missing something, but I don't see any other alternatives. Do you?

Regards,
Steve

On Jan 23, 2010, at 1:56 PM, James Murdoch wrote:

Steve,

I think the crux of this is our flexibility to offer product elsewhere at price-points you don't like.

If we could offer to you that a certain percentage of releases (>50%) would be available within your pricing structure (< or = 14.99), does that give you enough comfort?

I think we are worried more about the absolute holdback of product elsewhere, and our ceding of pricing to Apple, than we are about the actual haggle over what the price will be.

I haven't shared this with HC directly -- so this is only hypothetical. But if you were willing to accept that a supplier can exploit other avenues (at prices not disadvantageous to you), with a guarantee of substantial volume through Apple -- maybe I could work with HC to get to some common ground.

Please let me know.

A different question: we have four areas of discussion (related to our product) between our teams right now: Books, US Video, Int'l Video, and newspapers. All at different stages of maturity, these discussions are all centered, for us, around the desire to make our product widely available, and to make yours and our products more attractive for our customers. It seems though that we in each one we largely encounter a "take it or leave it" set of terms, and predictably we've so far failed to really strike the kind of partnerships that could move things forward.

Is it worth considering in the round, over the next few months or weeks, whether or not some of these loose ends can be tidied up? It's clear that Apple is already becoming an attractive platform for so many of our customers -- all over the world. As a creative company at our core, NWS should be more engaged with Apple, and I think Apple could be more engaged with NWS, globally, than either of us are today.

Best,

JRM

James,

A few thoughts to consider (I'd appreciate it if we can keep this between you and me):

1. The current business model of companies like Amazon distributing ebooks below cost or without making a reasonable profit isn't sustainable for long. As ebooks become a larger business, distributors will need to make at least a small profit, and you will want this too so that they invest in the future of the business with infrastructure, marketing, etc.
2. All the major publishers tell us that Amazon's \$9.99 price for new releases is eroding the value perception of their products in customer's minds, and they do not want this practice to continue for new releases.
3. Apple is proposing to give the cost benefits of a book without raw materials, distribution, remaindering, cost of capital, bad debt, etc., to the customer, not Apple. This is why a new release would be priced at \$12.99, say, instead of \$16.99 or even higher. Apple doesn't want to make more than the slim profit margin it makes

distributing music, movies, etc.

4. \$9 per new release should represent a gross margin neutral business model for the publishers. We are not asking them to make any less money. As for the artists, giving them the same amount of royalty as they make today, leaving the publisher with the same profits, is as easy as sending them all a letter telling them that you are paying them a higher percentage for ebooks. They won't be sad.

5. Analysts estimate that Amazon has sold slightly more than one million Kindles in 18+ months (Amazon has never said). We will sell more of our new devices than all of the Kindles ever sold during the first few weeks they are on sale. If you stick with just Amazon, B&N, Sony, etc., you will likely be sitting on the sidelines of the mainstream ebook revolution.

6. Customers will demand an end-to-end solution, meaning an online bookstore that carries the books, handles the transactions with their credit cards, and delivers the books seamlessly to their device. So far, there are only two companies who have demonstrated online stores with significant transaction volume - Apple and Amazon. Apple's iTunes Store and App Store have over 120 million customers with

credit

cards on file and have downloaded over 12 billion products. This is

the type of online assets that will be required to scale the ebook business into something that matters to the publishers.

So, yes, getting around \$9 per new release is less than the \$12.50 or

so that Amazon is currently paying. But the current situation is not sustainable and not a strong foundation upon which to build an ebook

business. [REDACTED]
[REDACTED]

Apple is the only other company currently capable of making a serious

impact, and we have 4 of the 6 big publishers signed up already.
Once

we open things up for the second tier of publishers, we will have plenty of books to offer. We'd love to have HC among them.

Thanks for listening.

Steve

On Jan 22, 2010, at 3:54 PM, James Murdoch wrote:

Steve,

Thanks for your call earlier today, and for the time last week.

I spoke to Brian Murray and Jon Miller tonight -- and Brian is sending a

note to Eddy today. I thin I have a handle on this now. In short -- we

would

like to be able to get something done with Apple -- but there are legitimate concerns.

The economics are simple enough. Kindle pays us a wholesale price of

\$13 and

sells it for 9.99.

An author gets \$4.20 on the sale of a hardcover and \$3.30 on the sale

of the

e-book on the Kindle.
[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Basically -- the entire hypothetical benefit of a book without raw materials

and distribution cost accrues to Apple, not to the publisher or to the creator of the work.

The other big issue is one of holdbacks. If we can't agree on the fair price for a book, your team's proposal restricts us from making that book

available elsewhere, even at a higher price. This is just a bridge too far for us.

Also, we are worried about setting prices to high -- lots of ebooks are

\$9.99. A new release window with a lower commission (say 10) for the first

six months would enable us to proce much more kenly for Apple customers.

We'd like to da that.

More on this below in Brian's note to Eddy. We outline a deal we can do.

Feel free to call or write anytime over the weekend to discuss if you like.

I am in the UK (so eight hours ahead of CA). My home number is [REDACTED]

[REDACTED]

I check the email regularly.

Steve, make no mistake that across the board (TV, Studios, Books, and

Newspapers) we would much rather be working with apple than

not. But

we, and

our partners who produce, write, edit, and otherwise make all this
with us,

have views on fair pricing, and care a lot about our future
flexibility. I

hope we can figure out a way, if not now and in time for this
launch of

yours, then maybe in the future.

Best,

JRM

From: Murray, Brian (HarperCollins US)

Sent: Friday, January 22, 2010 6:16 PM

To: Eddy Cue

Subject: Apple / HarperCollins

Eddy,

Thanks for coming in again this morning. We've talked over the
proposal and

I want to make sure that you have a summary of the deal that
HarperCollins
would be willing to do in your timeframe.

1. Pricing: We need flexibility to price on a title by title basis outside the prescribed tiers in the contract. We will use our best efforts

to meet the tiers we discussed.

2. MFN: In the event that HarperCollins and Apple disagree on a

consumer price for a title, HarperCollins needs to ability to make that

title available through other agents who support the higher price.

3. Commissions: We need a lower commission (10%) on new releases

for

the economics to work for us and our authors. We believe a 30% commission

will lead to more authors asking for ebooks to be delayed a result that

will not work for Apple or HarperCollins.

4. The new release window: We need to have flexibility on the

agency

window. We believe this window should be 6 months rather than 12

months in

the event that one or more large retailers do not move to an agency model.

Leslie will be sending Kevin a contract that reflects these points in
the
event you wish to move forward on these terms.

Thanks

Brian

"Please consider the environment before printing this e-mail"

The Newspaper Marketing Agency: Opening Up Newspapers:

<http://www.nmauk.co.uk/>

This e-mail and any attachments are confidential, may be legally
privileged and are the property of News International Limited
(which

is the holding company for the News International group, is
registered

in England under number 81701 and whose registered office is 1
Virginia St, London E98 1XY), on whose systems they were
generated. If

you have received this e-mail in error, please notify the sender
immediately and do not use, distribute, store or copy it in any way.

Statements or opinions in this e-mail or any attachment are those of
the author and are not necessarily agreed or authorised by News

International Limited or any member of its group. News International

Limited may monitor outgoing or incoming emails as permitted by law.

It accepts no liability for viruses introduced by this e-mail or attachments.

"Please consider the environment before printing this e-mail"

The Newspaper Marketing Agency: Opening Up Newspapers:

<http://www.nmauk.co.uk/>

This e-mail and any attachments are confidential, may be legally privileged and are the property of News International Limited (which is the holding company for the News International group, is registered in England under number 81701 and whose registered office is 1 Virginia St, London E98 1XY), on whose systems they were generated. If you have received this e-mail in error, please notify the sender immediately and do not use, distribute, store or copy it in any way.

Statements or opinions in this e-mail or any attachment are those of the author and are not necessarily agreed or authorised by News International Limited or any member of its group. News International Limited may monitor outgoing or incoming emails as permitted by law. It accepts no liability for viruses introduced by this e-mail or attachments.

Subject: Communication Within Tesla

There are two schools of thought about how information should flow within companies. By far the most common way is chain of command, which means that you always flow communication through your manager. The problem with this approach is that, while it serves to enhance the power of the manager, it fails to serve the company.

Instead of a problem getting solved quickly, where a person in one dept talks to a person in another dept and makes the right thing happen, people are forced to talk to their manager who talks to their manager who talks to the manager in the other dept who talks to someone on his team. Then the info has to flow back the other way again. This is incredibly dumb. Any manager who allows this to happen, let alone encourages it, will soon find themselves working at another company. No kidding.

Anyone at Tesla can and should email/talk to anyone else according to what they think is the fastest way to solve a problem for the benefit of the whole company. You can talk to your manager's manager without his permission, you can talk directly to a VP in another dept, you can talk to me, you can talk to anyone without anyone else's permission. Moreover, you should consider yourself obligated to do so until the right thing happens. The point here is not random chitchat, but rather ensuring that we execute ultra-fast and well. We obviously cannot compete with the big car companies in size, so we must do so with intelligence and agility.

One final point is that managers should work hard to ensure that they are not creating silos within the company that create an us vs. them mentality or impede communication in any way. This is unfortunately a natural tendency and needs to be actively fought. How can it possibly help Tesla for depts to erect barriers between themselves or see their success as relative within the company instead of collective? We are all in the same boat. Always view yourself as working for the good of the company and never your dept.

Thanks,
Elon

From: Mike Beckerman
Sent: Friday, January 17, 2003 5:09 PM
To: Ian Mercer; John Martin, Michael Halcoussis, Linda Averett
Cc: Chadd Knowlton; Ming-Chieh Lee; Allan Poore
Subject: RE: Windows Usability Systematic degradation flame

So, I take from this that we have lots of opinions and input. However, no one appears to be saying that we, WMPG, are chartered and/or should own this. So my feedback on the thread would then be that Dave should take ownership for driving groups around today's inconsistencies, and that we should send this mail to Bharat (owns WU) as well and ask who in his team can take requirements from DMD.

Any disagreement on this?

---- Original Message ----

From: Ian Mercer
Sent: Friday, January 17, 2003 5:02 PM
To: John Martin; Mike Beckerman; Michael Halcoussis; Linda Averett
Cc: Chadd Knowlton; Ming-Chieh Lee; Allan Poore
Subject: RE: Windows Usability Systematic degradation flame

I don't think you can abdicate this entirely to marketing. If WU is the preferred way to deliver bits to end users we all need to drive WU to deliver what we need, both individually and as a collective request from DMD.

One of the biggest issues today is that WU provides no way to promote a download to an end-user. We want to promote MM2 and WMP9S to end-users as something new and cool that they can get for Windows. Three lines of text describing it buried under "Windows XP" in a page that the user has to purposefully go find just isn't good enough. Why can't the WU client-side piece proactively display a bubble "Look! Cool, new features for Windows XP" and the option to display a much richer "advertisement" for the feature if the user wants to read more?

Other issues:-

MUI - I guess this is getting fixed now but it's always been an issue for us

Link to download through WU - why can't we send a user right in to WU to get MM2 without them having to wade through the whole site?

Critical updates that aren't really critical - if your machine is behind a firewall many just aren't critical

Too many fixes bombarding users all the time - I routinely ignore them now and perhaps update once a month as otherwise I'd be rebooting all the time

WU's inflexible release schedule. If there is a major tradeshow at which we want to announce we need flexibility in timing the release

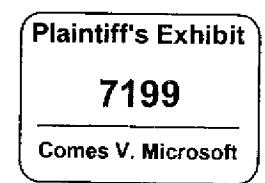
-ian

-----Original Message-----

From: John Martin
Sent: Friday, January 17, 2003 11:52 AM
To: Mike Beckerman; Ian Mercer; Michael Halcoussis; Linda Averett
Cc: Chadd Knowlton; Ming-Chieh Lee
Subject: RE: Windows Usability Systematic degradation flame

I have always been concerned about this and feel that this has a lot of engineering implications. I also feel that the reason it is such a mess is because marketing teams own release to web in this company. Frankly, we should be up in arms about this and want to program manager and develop whatever code we need to to ensure that every customer that even thinks they want to download our bits can do so in as easy and painless a way as possible. Downloading is the first step to setup and we should think of them equally or as one experience. But, if

12/23/2004



MS-CC-RN 000000308831
CONFIDENTIAL

you want nothing revolutionary and want to band-aid (which is fine and understandable) then I agree with your plan to give it to Dave.

John

---- Original Message ----

From: Mike Beckerman

Sent: Friday, January 17, 2003 7:36 AM

To: Mike Beckerman; John Martin; Ian Mercer; Michael Halcoussis; Linda Averett

Cc: Chadd Knowlton; Ming-Chieh Lee

Subject: RE: Windows Usability Systematic degradation flame

Importance: High

haven't heard anything from any of you on this.

My take is that this web-experience mess spans many groups and deliverables (like Plus), that we need one person/team to own the overall picture, driving it, tracking the experience, etc., and that WMPG isn't really the right place. I'm thinking Dave's team. What do you think?

From: Mike Beckerman

Sent: Wed 1/15/2003 4:39 PM

To: John Martin; Ian Mercer; Michael Halcoussis; Linda Averett

Cc: Chadd Knowlton; Ming-Chieh Lee

Subject: FW: Windows Usability Systematic degradation flame

More.

---- Original Message ----

From: Dave Fester

Sent: Wednesday, January 15, 2003 4:31 PM

To: Mike Beckerman; Amir Majidimehr; Tim Lebel

Subject: RE: Windows Usability Systematic degradation flame

I am working with MS.com to directly address the download/discoverability of our bits (both MP9S and MM2)

---- Original Message ----

From: Mike Beckerman

Sent: Wednesday, January 15, 2003 4:28 PM

To: Dave Fester; Amir Majidimehr; Tim Lebel

Subject: RE: Windows Usability Systematic degradation flame

I'm thinking about this and am discussing with my team.

I don't know what it means to "own website issues", nor am I yet sure the best way to handle the complex mess of coordinating between product teams, WU, and MS.COM. Dave, would you please forward the other reply you mentioned?

I expect to send more on this thread in a day or two.

---- Original Message ----

From: Dave Fester

Sent: Wednesday, January 15, 2003 3:58 PM

To: Amir Majidimehr; Mike Beckerman; Tim Lebel

Subject: RE: Windows Usability Systematic degradation flame

I replied as well. I am owning the website issues, but Mike should own the others.

12/23/2004

---- Original Message ----

From: Amir Majidimehr
Sent: Wednesday, January 15, 2003 3:55 PM
To: Mike Beckerman; Tim Lebel; Dave Fester
Subject: FW: Windows Usability Systematic degradation flame

Can you guys coordinate between you on how to deal with this situation on our bits? Bill's situation is worse than my personal experience but still, this aspect of the system needs to be looked at carefully and become a sign off item for each release.

Please let me know which one of you going to be BOL for this moving forward.

Amir

---- Original Message ----

From: Will Poole
Sent: Wednesday, January 15, 2003 1:27 PM
To: Amir Majidimehr; Chris Jones (WINDOWS)
Cc: Dave Fester; Rick Thompson
Subject: FW: Windows Usability Systematic degradation flame

Guess we should start working on a list of things that need to be fixed w/ the web sites, WU, and with windows, and identify owners. Bill's frustration is not unreasonable.

---- Original Message ----

From: Bill Gates
Sent: Wednesday, January 15, 2003 10:05 AM
To: Jim Allchin
Cc: Chris Jones (WINDOWS); Bharat Shah (NT); Joe Peterson; Will Poole; Brian Valentine; Anoop Gupta (RESEARCH)
Subject: Windows Usability Systematic degradation flame

I am quite disappointed at how Windows Usability has been going backwards and the program management groups don't drive usability issues.

Let me give you my experience from yesterday.

I decided to download Moviemake and buy the Digital Plus pack r so I went to Microsoft.com. They have a download place so I went there.

The first 5 times I used the site it timed out while trying to bring up the download page. Then after an 8 second delay I got it to come up

This site is so slow it is unusable.

It wasn't in the top 5 so I expanded the other 45.

These 45 names are totally confusing. These names make stuff like: C:\Documents and Settings\billg\My Documents\My Pictures seem clear.

They are not filtered by the system I can in on and so many of the things are strange.

I tried scoping to Media stuff. Still no moviemaker. I typed in moviemaker. Nothing. I typed in movie maker. Nothing.

12/23/2004

MS-CC-RN 000000308833
CONFIDENTIAL

So I gave up and sent mail to Amir saying - where is this Moviemaker download? Does it exist?

So they told me that using the download page to download something was not something they anticipated

They told me to go to the main page search button and type movie maker (not moviemaker!).

I tried that. The site was pathetically slow but after 6 seconds of waiting up it came.

I thought for sure now I would see a button to just go do the download.

In fact it is more like a puzzle that you get to solve. It told me to go to Windows Update and do a bunch of incantations.

This struck me as completely odd. Why should I have to go somewhere else and do a scan to download moviemaker?

So I went to Windows update. Windows Update decides I need to download a bunch of controls. Now just once but multiple times where I get to see weird dialog boxes.

Doesn't Windows update know some key to talk to Windows?

Then I did the scan. This took quite some time and I was told it was critical for me to download 17megs of stuff.

This is after I was told we were doing delta patches to things but instead just to get 6 things that are labeled in the SCARIEST possible way I had to download 17meg.

So I did the download. That part was fast. Then it wanted to do an install. This took 6 minutes and the machine was so slow I couldn't use it for anything else during this time.

What the heck is going on during those 6 minutes? That is crazy. This is after the download was finished.

Then it told me to reboot my machine. Why should I do that? I reboot every night - why should I reboot at that time?

So I did the reboot because it INSISTED on it. Of course that meant completely getting rid of all my Outlook state.

So I got back up and running and went to Windows Update again. I forgot why I was in Windows Update at all since all I wanted was to get Moviemaker.

So I went back to Microsoft.com and looked at the instructions. I have to click on a folder called WindowsXP. Why should I do that? Windows Update knows I am on Windows XP.

What does it mean to have to click on that folder? So I get a bunch of confusing stuff but sure enough one of them is Moviemaker.

So I do the download. The download is fast but the Install takes many minutes. Amazing how slow this thing is.

At some point I get told I need to go get Windows Media Series 9 to download.

So I decide I will go do that. This time I get dialogs saying things like "Open" or "Save". No guidance in the instructions which to do. I have no clue which to do.

The download is fast and the install takes 7 minutes for this thing.

So now I think I am going to have Moviemaker. I go to my add/remove programs place to make sure it is there.

12/23/2004

MS-CC-RN 000000308834
CONFIDENTIAL

It is not there.

What is there? The following garbage is there. Microsoft Autoupdate Exclusive test package, Microsoft Autoupdate Reboot test package, Microsoft Autoupdate testpackage1, Microsoft AUtoupdate testpackage2, Microsoft Autoupdate Test package3.

Someone decided to trash the one part of Windows that was usable? The file system is no longer usable. The registry is not usable. This program listing was one sane place but now it is all crapped up.

But that is just the start of the crap. Later I have listed things like Windows XP Hotfix see Q329048 for more information. What is Q329048? Why are these series of patches listed here? Some of the patches just things like Q810655 instead of saying see Q329048 for more information.

What an absolute mess.

Moviemaker is just not there at all.

So I give up on Moviemaker and decide to download the Digital Plus Package.

I get told I need to go enter a bunch of information about myself.

I enter it all in and because it decides I have mistyped something I have to try again. Of course it has cleared out most of what I typed

I try trying the right stuff in 5 times and it just keeps clearing things out for me to type them in again.

So after more than an hour of craziness and making my programs list garbage and being scared and seeing that Microsoft com is a terrible website I haven't run Moviemaker and I haven't got the plus package

The lack of attention to usability represented by these experiences blows my mind. I thought we had reached a low with Windows Network places or the messages I get when I try to use 802.11. (don't you just love that root certificate message?)

When I really get to use the stuff I am sure I will have more feedback.

12/23/2004

MS-CC-RN 000000308835
CONFIDENTIAL

To Executive Staff and direct reports
From Bill Gates
Date May 26, 1995

The Internet Tidal Wave

Our vision for the last 20 years can be summarized in a succinct way. We saw that exponential improvements in computer capabilities would make great software quite valuable. Our response was to build an organization to deliver the best software products. In the next 20 years the improvement in computer power will be outpaced by the exponential improvements in communications networks. The combination of these elements will have a fundamental impact on work, learning and play. Great software products will be crucial to delivering the benefits of these advances. Both the variety and volume of software will increase.

Most users of communications have not yet seen the price of communications come down significantly. Cable and phone networks are still depreciating networks built with old technology. Universal service monopolies, and other governmental involvement around the world have kept communications costs high. Private networks and the Internet which are built using state of the art equipment have been the primary beneficiaries of improved communication technology. The PC is just now starting to create additional demand that will drive a new wave of investment. A combination of expanded access to the Internet, ISDN, new broadband networks justified by video based applications and interconnections between each of these will bring low cost communication to most businesses and homes within the next decade.

The Internet is at the forefront of all of this and developments on the Internet over the next several years will set the course of our industry for a long time to come. Perhaps you have already seen memos from me or others here about the importance of the Internet. I have gone through several stages of increasing my views of its importance. Now I assign the Internet the highest level of importance. In this memo I want to make clear that our focus on the Internet is critical to every part of our business. The Internet is the most important single development to come along since the IBM PC was introduced in 1981. It is even more important than the arrival of graphical user interface (GUI). The PC analogy is apt for many reasons. The PC wasn't perfect. Aspects of the PC were arbitrary or even poor. However a phenomena grew up around the IBM PC that made it a key element of everything that would happen for the next 15 years. Companies that tried to fight the PC standard often had good reasons for doing so but they failed because the phenomena overcame any weaknesses that resisters identified.

The Internet Today

The Internet's unique position arises from a number of elements. The TCP/IP protocols that define its transport level support distributed computing and scale incredibly well. The Internet Engineering Task Force (IETF) has defined an evolutionary path that will avoid running into future problems even as virtually everyone on the planet connects up. The HTTP protocols that define HTML Web browsing are extremely simple and have allowed servers to handle incredible traffic reasonably well. All of the predictions about hypertext - made decades ago by pioneers like Ted Nelson - are coming true on the Web. Although other protocols on the Internet will continue to be used (FTP, Gopher, IRC, Telnet, SMTP, NNTP), HTML with extensions will be the standard that defines how information will be presented. Various extensions to HTML including content enhancements like tables, and functionality enhancements like secure transactions, will be widely adopted in the near future. There will also be enhanced 3D presentations providing for virtual reality type shopping and socialization.

M 1028049
CONFIDENTIAL

Microsoft Confidential

MS98 0112876
CONFIDENTIAL



Another unique aspect of the Internet is that because it buys communications lines on a commodity bid basis and because it is growing so fast, it is the only "public" network whose economics reflect the latest advances in communications technology. The price paid for corporations to connect to the Internet is determined by the size of your "on-ramp" to the Internet and not by how much you actually use your connection. Usage isn't even metered. It doesn't matter if you connect nearby or half way around the globe. This makes the marginal cost of extra usage essentially zero encouraging heavy usage.

Most important is that the Internet has booted itself as a place to publish content. It has enough users that it is benefiting from the positive feedback loop of the more users it gets, the more content it gets, and the more content it gets, the more users it gets. I encourage everyone on the executive staff and their direct reports to use the Internet. I've attached an appendix which Brian Fleming helped me pull together that shows some hot sites to try out. You can do this by either using the HTM enclosure with any Internet browser or, if you have Word set up properly, you can navigate right from within this document. Of particular interest are the sites such as "YAHOO" which provide subject catalogs and searching. Also of interest are the ways our competitors are using their Websites to present their products. I think SUN, Netscape and Lows do some things very well.

Amazingly it is easier to find information on the Web than it is to find information on the Microsoft Corporate Network. This inversion where a public network solves a problem better than a private network is quite stunning. This inversion points out an opportunity for us in the corporate market. An important goal for the Office and Systems products is to focus on how our customers can create and publish information on their LANs. All work we do here can be leveraged into the HTTP/Web world. The strength of the Office and Windows businesses today gives us a chance to superset the Web. One critical issue is runtime/browser size and performance. Only when our Office - Windows solution has comparable performance to the Web will our extensions be worthwhile. I view this as the most important element of Office 96 and the next major release of Windows.

One technical challenge facing the Internet is how to handle "real-time" content—specifically audio and video. The underlying technology of the Internet is a packet network which does not guarantee that data will move from one point to another at a guaranteed rate. The congestion on the network determines how quickly packets are sent. Audio can be delivered on the Internet today using several approaches. The classic approach is to simply transmit the audio file in its entirety before it is played. A second approach is to send enough of it to be fairly sure that you can keep playing without having to pause. This is the approach Progressive Networks Real Audio (Roo Glaser's new company) uses. Three companies (Internet Voice Chat, Vocaltec, and Netphone) allow phone conversations across the Internet but the quality is worse than a normal phone call. For video, a protocol called CU-SeeMe from Cornell allows for video conferencing. It simply delivers as many frames per second as it sees the current network congestion can handle, so even at low resolution it is quite jerky. All of these "hacks" to provide video and audio will improve because the Internet will get faster and also because the software will improve. At some point in the next three years, protocol enhancements taking advantage of the ATM backbone being used for most of the Internet will provide "quality of service guarantees". This is a guarantee by every switch between you and your destination that enough bandwidth has been reserved to make sure you get your data as fast as you need it. Extensions to IP have already been proposed. This might be an opportunity for us to take the lead working with UUNET and others. Only with this improvement and an incredible amount of additional bandwidth and local connections will the Internet infrastructure deliver all of the promises of the full blown Information Highway. However, it is in the process of happening and all we can do is get involved and take advantage.

I think that virtually every PC will be used to connect to the Internet and that the Internet will help keep PC purchasing very healthy for many years to come. PCs will connect to the Internet a variety of ways. A normal phone call using a 14.4k or 28.8k baud modem will be the most popular in the near future. An ISDN connection at 128kb will be very attractive as the connection costs from the RBOCs and the modem costs come down. I expect an explosion in ISDN usage for both Internet connection and point-to-point connections. Point-to-point allows for low latency which is very helpful for interactive games. iSDN

MS98 0112876.1
CONFIDENTIAL

M 1028050.
CONFIDENTIAL

point-to-point allows for simultaneous voice data which is a very attractive feature for sharing information. Example scenarios include planning a trip, discussing a contract, discussing a financial transaction like a bill or a purchase or taxes or getting support questions about your PC answered. Eventually you will be able to find the name of someone or a service you want to connect to on the Internet and rerouting your call to temporarily be a point-to-point connection will happen automatically. For example when you are browsing travel possibilities if you want to talk to someone with expertise on the area you are considering, you simply click on a button and the request will be sent to a server that keeps a list of available agents who can be working anywhere they like as long as they have a PC with ISDN. You will be reconnected and the agent will get all of the context of what you are looking at and your previous history of travel if the agency has a database. The reconnect approach will not be necessary once the network has quality of service guarantees.

Another way to connect a PC will be to use a cable-modem that uses the coaxial cable normally used for analog TV transmission. Early cable systems will essentially turn the coax into an Ethernet so everyone in the same neighborhood will share a LAN. The most difficult problem for cable systems is sending data from the PC back up the cable system (the "back channel"). Some cable companies will promote an approach where the cable is used to send data to the PC (the "forward channel") and a phone connection is used for the back channel. The data rate of the forward channel on a cable system should be better than ISDN. Eventually the cable operators will have to do a full upgrade to an ATM-based system using either all fiber or a combination of fiber and Coax—however, when the cable or phone companies will make this huge investment is completely unclear at this point. If these buildouts happen soon, when there will be a loose relationship between the Internet and these broadband systems. If they don't happen for some time, then these broadband systems could be an extension of the Internet with very few new standards to be set. I think the second scenario is very likely.

Three of the biggest developments in the last five years have been the growth in CD sales, the growth in On-line usage, and the growth in the Internet. Each of these had to establish crucial mass on their own. Now we see that these three are strongly related to each other and as they come together they will accelerate in popularity. The On-line services business and the Internet have merged. What I mean by this is that every On-line service has to simply be a place on the Internet with extra value added. MSN is not competing with the Internet although we will have to explain to content publishers and users why they should use MSN instead of just setting up their own Web server. We don't have a clear enough answer to this question today. For users who connect to the Internet some way other than paying us for the connection we will have to make MSN very, very inexpensive - perhaps free. The amount of free information available today on the Internet is quite amazing. Although there is room to use brand names and quality to differentiate from free content, this will not be easy and it puts a lot of pressure to figure out how to get ad-user funding. Even the CD-ROM business will be dramatically affected by the Internet. Encyclopedia Britannica is offering their content on a subscription basis. Cinemania type information for all the latest movies is available for free on the Web including theater information and Quicktime movie trailers.

Competition

Our traditional competitors are just getting involved with the Internet. Novell is surprisingly absent given the importance of networking to their position however Frankenberg recognizes its importance and is driving them in that direction. Novell has recognized that a key missing element of the Internet is a good directory service. They are working with AT&T and other phone companies to use the Netware Directory Service to fill this role. This represents a major threat to us. Lotus is already shipping the InternetNotes Web Publisher which replicates Notes databases into HTML. Notes V4 includes secure Internet browsing in its server and client. IBM includes Internet connection through its network in OS/2 and promotes that as a key feature.

Some competitors have a much deeper involvement in the Internet than Microsoft. All UNIX vendors are benefiting from the Internet since the default server is still a UNIX box and not Windows NT, particularly

MS98 0112876.2
CONFIDENTIAL

M1028051
CONFIDENTIAL

for high end demands. SUN has exploited this quite effectively. Many Web sites, including Paul Allen's ESPNET, put a SUN logo and link at the bottom of their home page in return for low cost hardware. Several universities have "Sunsites" named because they use donated SUN hardware. SUN's Java project involves turning an Internet client into a programmable framework. SUN is very involved in evolving the Internet to stay away from Microsoft. On the SUN Homepage you can find an interview of Scott McNealy by Joann Gage where Scott explains that if customers decide to give one product a big market share (Windows) that is not capitalism. SUN is promoting Sun Screen and HotJava with aggressive business ads promising that they will help companies make money.

SGI has also been advertising their leadership on the Internet including servers and authoring tools. Their ads are very business focused. They are backing the 3D image standard, VRML, which will allow the Internet to support virtual reality type shopping, gaming, and socializing.

Browsing the Web, you find almost no Microsoft file formats. After 10 hours of browsing, I had not seen a single Word DOC, AVI file, Windows EXE (other than content viewers), or other Microsoft file format. I did see a great number of Quicktime files. All of the movie studios use them to offer film trailers. Apple benefited by having TCP support before we did and is working hard to build a browser that built from OpenDoc components. Apple will push for OpenDoc protocols to be used on the Internet, and is already offering good server configurations. Apple's strength in education gives them a much stronger presence on the Internet than their general market share would suggest.

Another popular file format on the Internet is PDF, the short name for Adobe Acrobat files. Even the IRS offers tax forms in PDF format. The limitations of HTML make it impossible to create forms or other documents with rich layout and PDF has become the standard alternative. For now, Acrobat files are really only useful if you print them out, but Adobe is investing heavily in this technology and we may see this change soon.

Acrobat and Quicktime are popular on the network because they are cross platform and the readers are free. Once a format gets established it is extremely difficult for another format to come along and even become equally popular.

A new competitor, "born" on the Internet is Netscape. Their browser is dominant with 70% usage share, allowing them to determine which network extensions will catch on. They are pursuing a multi-platform strategy where they move the key API into the client to commoditize the underlying operating system. They have attracted a number of public network operators to use their platform to offer information and directory services. We have to match and beat their offerings including working with MCI, newspapers, and others who are considering their products.

One scary possibility being discussed by Internet fans is whether they should get together and create something far less expensive than a PC which is powerful enough for Web browsing. This new platform would optimize for the datatypes on the Web. Gordon Bell and others approached Intel on this and decided Intel didn't care about a low cost device so they started suggesting that General Magic or another operating system with a non-intel chip is the best solution.

Next Steps

In highlighting the importance of the Internet to our future I don't want to suggest that I am alone in seeing this. There is excellent work going on in many of the product groups. Over the last year, a number of people have championed embracing TCP/IP, hyperlinking, HTML, and building clients, tools and servers that compete on the Internet. However, we still have a lot to do. I want every product plan to try and go overboard on Internet features. One element that will be crucial is coordinating our various activities. The challenge/opportunity of the Internet is a key reason behind the recent organization. Paul Maritz will lead the Platform group to define an integrated strategy that makes it clear that Windows machines are the best choice for the Internet. This will protect and grow our Windows asset. Nathan and Pete will lead the Applications and Content group to figure out how to make money providing applications and content for the Internet. This will protect our Office asset and grow our Office.

MSG# 0112876.3
CONFIDENTIAL

M 1028052
CONFIDENTIAL

Consumer, and MSN businesses. The work that was done in the Advanced Technology group will be extremely important as it is integrated in with our products.

We must also invest in the Microsoft home page, so it will be clear how to find out about our various products. Today it's quite random what is on the home page and the quality of information is very low. If you look up speeches by me all you find are a few speeches over a year old. I believe the Internet will become our most important promotional vehicle and paying people to include links to our home pages will be a worthwhile way to spend advertising dollars. First we need to make sure that great information is available. One example is the demonstration files (Screenshot format) that Lotus includes on all of their products organized by feature. I think a measurable part of our ad budget should focus on the Internet. Any information we create - white papers, data sheets, etc., should all be done on our Internet server.

ITG needs to take a hard look at whether we should drop our leasing arrangements for data lines to some countries and simply rely on the Internet.

The actions required for the Windows platform are quite broad. Paul Maritz is having an Internet retreat in June which will focus on coordinating these activities. Some critical steps are the following:

1. Server. BSD is working on offering the best Internet server as an integrated package. We need to understand how to make NT boxes the highest performance HTTP servers. Perhaps we should have a project with Compaq or someone else to focus on this. Our initial server will have good performance because it uses kernel level code to blast out a file. We need a clear story on whether a high volume Web site can use NT or not because SUN is viewed as the primary choice. Our plans for security need to be strengthened. Other Backoffice pieces like SMS and SQL server also need to stay cut in front of working with the Internet. We need to figure out how OFS can help perhaps by allowing pages to be stored as objects and having properties added. Perhaps OFS can help with the challenge of maintaining Web structures. We need to establish distributed OLE as the protocol for Internet programming. Our server offerings need to beat what Netscape is doing including billing and security support. There will be substantial demand for high performance transaction servers. We need to make the media server work across the Internet as soon as we can as new protocols are established. A major opportunity/challenge is directory. If the features required for Internet directory are not in Cairo or easily addable without a major release we will miss the window to become the world standard in directory with serious consequences. Lotus, Novell, and AT&T will be working together to try and establish the Internet directory. Actually getting the content for our directory and popularizing it could be done in the MSN group.
2. Client. First we need to offer a decent client (O'Hare) that exploits Windows 95 shortcuts. However this alone won't get people to switch away from Netscape. We need to figure out how to integrate Blackbird, and help browsing into our Internet client. We have made the decision to provide Blackbird capabilities openly rather than tie them to MSN. However, the process of getting the size, speed, and integration good enough for the market needs work and coordination. We need to figure out additional features that will allow us to get ahead with Windows customers. We need to move all of our Internet value added from the Plus pack into Windows 95 itself as soon as we possibly can with a major goal to get OEMs shipping our browser preinstalled. This follows directly from the plan to integrate the MSN and Internet clients. Another place for integration is to eliminate today's Help and replace it with the format our browser accepts including exploiting our unique extensions so there is another reason to use our browser. We need to determine how many browsers we promote. Today we have O'Hare, Blackbird, SPAM, MediaView, Word, PowerPoint, Symmetry, Help and many others. Without unification we will lose to Netscape/HotJava.

Over time the shell and the browser will converge and support hierarchical/list/query viewing as well as document with links viewing. The former is the structured approach and the latter allows for richer presentation. We need to establish OLE protocols as the way rich documents are shared on the Internet. I am sure the OpenDoc consortium will try and block this.

M 1028053
CONFIDENTIAL

MS98 0112876.4
CONFIDENTIAL

- 3 File sharing/Window sharing/Multi-user. We need to give away client code that encourages Windows specific protocols to be used across the Internet. It should be very easy to set up a server for file sharing across the Internet. Our PictureTel screen sharing client allowing Window sharing should work easily across the Internet. We should also consider whether to do something with the Cixus code that allows you to become a Windows NT user across the Network. It is different from the PictureTel approach because it isn't peer to peer. Instead it allows you to be a remote user on a shared NT system. By giving away the client code to support all of these scenarios, we can start to show that a Windows machine on the Internet is more valuable than an arbitrary machine on the net. We have immense leverage because our Client and Server API story is very strong. Using VB or VC to write internet applications which have their UI remoted is a very powerful advantage for NT servers.
- 4 Forms/ Languages. We need to make it very easy to design a form that presents itself as an HTML page. Today the Common Gateway Interface (CGI) is used on Web servers to give forms "behavior" but its quite difficult to work with. BSD is defining a somewhat better approach they call BGI. However we need to integrate all of this with our Forms3 strategy and our languages. If we make it easy to associate controls with fields then we get leverage out of all of the work we are doing on data binding controls. Efforts like Frontier software's work and SUN's Java are a major challenge to us. We need to figure out when it makes sense to download control code to the client including a security approach to avoid this being a virus hole.
- 5 Search engines. This is related to the client/server strategies. Verity has done good work with Notes, Netscape, AT&T and many others to get them to adopt their scalable technology that can deal with large text databases with very large numbers of queries against them. We need to come up with a strategy to bring together Office, Mediaview, Help, Cairo, and MSN. Access and Fox do not support text indexing as part of their queries today which is a major hole. Only when we have an integrated strategy will we be able to determine if our in-house efforts are adequate or to what degree we need to work with outside companies like Verity.
- 6 Formats. We need to make sure we output information from all of our products in both vanilla HTML form and in the extended forms that we promote. For example, any database reports should be navigable as hypertext documents. We need to decide how we are going to compete with Acrobat and Quicken since right now we aren't challenging them. It may be worth investing in optimizing our file formats for these scenarios. What is our competitor to Acrobat? It was supposed to be a combination of extended metafiles and Word but these plans are inadequate. The format issue spans the Platform and Applications groups.
- 7 Tools Our disparate tools efforts need to be brought together. Everything needs to focus on a single integrated development environment that is extensible in an object oriented fashion. Tools should be architected as extensions to this framework. This means one common approach to repository/projects/source control. It means one approach to forms design. The environment has to support sophisticated viewing options like timelines and the advanced features Softimage requires. Our work has been separated by independent focus on on-line versus CD-ROM and structured display versus animated displays. There are difficult technical issues to resolve. If we start by looking at the runtime piece (browser) I think this will guide us towards the right solution with the tools.

The actions required for the Applications and Content group are also quite broad. Some critical steps are the following:

- I Office. Allowing for collaboration across the Internet and allowing people to publish in our file formats for both Mac and Windows with free readers is very important. This won't happen without specific evangelization. DAD has written some good documents about Internet features. Word could lose out to focused Internet tools if it doesn't become faster and more WYSIWYG for HTML. There

MS98 0112876.5
CONFIDENTIAL

M 1028054
CONFIDENTIAL

is a crucial strategy issue of whether Word as a container is a strict superset of our DataDoc containers allowing our Forms strategy to embrace Word fully.

- 2 MSN The merger of the On-line business and Internet business creates a major challenge for MSN. It can't just be the place to find Microsoft information on the Internet. It has to have scale and reputation that it is the best way to take advantage of the Internet because of the value added. A lot of the content we have been attracting to MSN will be available in equal or better form on the Internet; so we need to consider focusing on areas where we can provide something that will go beyond what the Internet will offer over the next few years. Our plan to promote Blackbird broadly takes away one element that would have been unique to MSN. We need to strengthen the relationship between MSN and Exchange/Caro for mail security and directory. We need to determine a set of services that MSN leads in - money transfer, directory, and search engines. Our high-end server offerings may require a specific relationship with MSN.
- 3 Consumer. Consumer has done a lot of thinking about the use of on-line for its various titles. On-line is great for annuity revenue and eliminating the problems of limited shelf-space. However, it also lowers the barriers to entry and allows for an immense amount of free information. Unfortunately today an MSN user has to download a huge browser for every CD title making it more of a demo capability than something a lot of people will adopt. The Internet will assure a large audience for a broad range of titles. However the challenge of becoming a leader in any subject area in terms of quality, depth, and price will be far more brutal than todays CD market. For each category we are in we will have to decide if we can be #1 or #2 in that category or get out. A number of competitors will have natural advantages because of their non-electronic activities.
- 4 Broadband media applications. With the significant time before widespread iTV deployment we need to look hard at which applications can be delivered in an ISDN/Internet environment or in a Satellite PC environment. We need a strategy for big areas like directory, news, and shopping. We need to decide how to pursue local information. The Cityscape project has a lot of promise but only with the right partners.
- 5 Electronic commerce. Key elements of electronic commerce including security and billing need to be integrated into our platform strategy. On-line allows us to take a new approach that should allow us to compete with Intuit and others. We need to think creatively about how to use the internet/on-line world to enhance Money. Perhaps our Automatic teller machine project should be revived. Perhaps it makes sense to do a tax business that only operates on on-line. Perhaps we can establish the lowest cost way for people to do electronic bill paying. Perhaps we can team up with Quickbook competitors to provide integrated on-line offerings. Intuit has made a lot of progress in overseas markets during the last six months. All the financial institutions will find it very easy to buy the best Internet technology tools for us and others and get into this world without much technical expertise.

from

The Future

We enter this new era with some considerable strengths. Among them are our people and the broad acceptance of Windows and Office. I believe the work that has been done in Consumer, Euro, Advanced Technology, MSN, and Research position us very well to lead. Our opportunity to take advantage of these investments is coming faster than I would have predicted. The electronic world requires all of the directory, security, linguistic and other technologies we have worked on. It requires us to do even more in these areas than we were planning to. There will be a lot of uncertainty as we first embrace the Internet and then extend it. Since the Internet is changing so rapidly we will have to revise our strategies from time to time and have better inter-group communication than ever before.

Our products will not be the only things changing. The way we distribute information and software as well as the way we communicate with and support customers will be changing. We have an opportunity to

MS98 0112876.6
CONFIDENTIAL

M 1028055
CONFIDENTIAL

Bill Gates
May 26 1995
The Internet Tidal Wave

do a lot more with our resources. Information will be disseminated efficiently between us and our customers with less chance that the press miscommunicates our plans. Customers will come to our "home page" in unbelievable numbers and find out everything we want them to know.

The next few years are going to be very exciting as we tackle these challenges and opportunities. The Internet is a tidal wave. It changes the rules. It is an incredible opportunity as well as incredible challenge. I am looking forward to your input on how we can improve our strategy to continue our track record of incredible success.

HyperLink Appendix

Related reading, double click to open them On-line! (*Microsoft LAN only, Internet Assistant is not required for this part!!*):

- [Gordon Bell on the Internet](#) email by Gordon Bell
- [Affordable Computing: advertising subsidized hardware.](#) by Nicholas Negroponte
- [Brief Lecture Notes on VRML & Hot Java](#) email by William Barr
- [Notes from a Lecture by Mark Andreessen \(Netscape\)](#) email by William Barr
- [Advertisement Strategies for the World Wide Web](#) by Peter Pathe (Contains many more links!)

Below is a list of Internet Web sites you might find interesting. I've included it as an embedded .HTM file which should be readable by most Web Browsers. Double click it if you're using a Web Browser like O'Hare or Netscape.



A second copy of these links is below as Word HTML links. To use these links, you must be running the Word Internet Assistant, and be connected to the Web

Cool Cool, Cool..

[The Lycos Home Page](#)
[Yahoo](#)
[RealAudio Homepage](#)
[HotWired - New Thinking for a New Medium](#)

Competitors

[Microsoft Corporation World-Wide-Web Server](#)
[Welcome To Oracle](#)
[Lotus on the Web](#)
[Novell Inc. World Wide Web Home Page](#)
[Symantec Corporation Home Page](#)
[Burland Online](#)
[Disney/Buena Vista](#)
[Paramount Pictures](#)
[Adobe Systems Incorporated Home Page](#)
[MCI](#)
[Sony Online](#)

MS98 0112876.7
CONFIDENTIAL

M 1028056
CONFIDENTIAL

Bill Gates
May 26, 1995
The Internet Tidal Wave

Sports

ESPNET SportsZone
The Gale Cybersports Page
The Sonris Server
Las Vegas Sports Page

News

CRAYON
Mercury Center Home Page

Travel/Entertainment

ADDICTED TO NOISE
CDnow! The Internet Music Store
Travel & Entertainment Network home page
Virtual Tours! World Map
Citi Net

Auto

DealersNet
Popular Mechanics

MS98 0112876.8
CONFIDENTIAL

M 1028057
CONFIDENTIAL

I was at Amazon for about six and a half years, and now I've been at Google for that long. One thing that struck me immediately about the two companies -- an impression that has been reinforced almost daily -- is that Amazon does everything wrong, and Google does everything right. Sure, it's a sweeping generalization, but a surprisingly accurate one. It's pretty crazy. There are probably a hundred or even two hundred different ways you can compare the two companies, and Google is superior in all but three of them, if I recall correctly. I actually did a spreadsheet at one point but Legal wouldn't let me show it to anyone, even though recruiting loved it.

I mean, just to give you a very brief taste: Amazon's recruiting process is fundamentally flawed by having teams hire for themselves, so their hiring bar is incredibly inconsistent across teams, despite various efforts they've made to level it out. And their operations are a mess; they don't really have SREs and they make engineers pretty much do everything, which leaves almost no time for coding -- though again this varies by group, so it's luck of the draw. They don't give a single shit about charity or helping the needy or community contributions or anything like that. Never comes up there, except maybe to laugh about it. Their facilities are dirt-smeared cube farms without a dime spent on decor or common meeting areas. Their pay and benefits suck, although much less so lately due to local competition from Google and Facebook. But they don't have any of our perks or extras -- they just try to match the offer-letter numbers, and that's the end of it. Their code base is a disaster, with no engineering standards whatsoever except what individual teams choose to put in place.

To be fair, they do have a nice versioned-library system that we really ought to emulate, and a nice publish-subscribe system that we also have no equivalent for. But for the most part they just have a bunch of crappy tools that read and write state machine information into relational databases. We wouldn't take most of it even if it were free.

I think the pubsub system and their library-shelf system were two out of the grand total of three things Amazon does better than google.

I guess you could make an argument that their bias for launching early and iterating like mad is also something they do well, but you can argue it either way. They prioritize launching early over everything else, including retention and engineering discipline and a bunch of other stuff that turns out to matter in the long run. So even though it's given them some competitive advantages in the marketplace, it's created enough other problems to make it something less than a slam-dunk.

But there's one thing they do really really well that pretty much makes up for ALL of their political, philosophical and technical screw-ups.

Jeff Bezos is an infamous micro-manager. He micro-manages every single pixel of

Amazon's retail site. He hired Larry Tesler, Apple's Chief Scientist and probably the very most famous and respected human-computer interaction expert in the entire world, and then ignored every goddamn thing Larry said for three years until Larry finally -- wisely -- left the company. Larry would do these big usability studies and demonstrate beyond any shred of doubt that nobody can understand that frigging website, but Bezos just couldn't let go of those pixels, all those millions of semantics-packed pixels on the landing page. They were like millions of his own precious children. So they're all still there, and Larry is not.

Micro-managing isn't that third thing that Amazon does better than us, by the way. I mean, yeah, they micro-manage really well, but I wouldn't list it as a strength or anything. I'm just trying to set the context here, to help you understand what happened. We're talking about a guy who in all seriousness has said on many public occasions that people should be paying him to work at Amazon. He hands out little yellow stickies with his name on them, reminding people "who runs the company" when they disagree with him. The guy is a regular... well, Steve Jobs, I guess. Except without the fashion or design sense. Bezos is super smart; don't get me wrong. He just makes ordinary control freaks look like stoned hippies.

So one day Jeff Bezos issued a mandate. He's doing that all the time, of course, and people scramble like ants being pounded with a rubber mallet whenever it happens. But on one occasion -- back around 2002 I think, plus or minus a year -- he issued a mandate that was so out there, so huge and eye-bulgingly ponderous, that it made all of his other mandates look like unsolicited peer bonuses.

His Big Mandate went something along these lines:

1. All teams will henceforth expose their data and functionality through service interfaces.
2. Teams must communicate with each other through these interfaces.
3. There will be no other form of interprocess communication allowed: no direct linking, no direct reads of another team's data store, no shared-memory model, no back-doors whatsoever. The only communication allowed is via service interface calls over the network.
4. It doesn't matter what technology they use. HTTP, Corba, Pubsub, custom protocols -- doesn't matter. Bezos doesn't care.
5. All service interfaces, without exception, must be designed from the ground up to be externalizable. That is to say, the team must plan and design to be able to expose the interface to developers in the outside world. No exceptions.
6. Anyone who doesn't do this will be fired.
7. Thank you; have a nice day!

Ha, ha! You 150-odd ex-Amazon folks here will of course realize immediately that #7 was a little joke I threw in, because Bezos most definitely does not give a shit about your day.

#6, however, was quite real, so people went to work. Bezos assigned a couple of Chief Bulldogs to oversee the effort and ensure forward progress, headed up by Uber-Chief Bear Bulldog Rick Dalzell. Rick is an ex-Army Ranger, West Point

Academy graduate, ex-boxer, ex-Chief Torturer slash CIO at Wal*Mart, and is a big genial scary man who used the word "hardened interface" a lot. Rick was a walking, talking hardened interface himself, so needless to say, everyone made LOTS of forward progress and made sure Rick knew about it.

Over the next couple of years, Amazon transformed internally into a service-oriented architecture. They learned a tremendous amount while effecting this transformation. There was lots of existing documentation and lore about SOAs, but at Amazon's vast scale it was about as useful as telling Indiana Jones to look both ways before crossing the street. Amazon's dev staff made a lot of discoveries along the way. A teeny tiny sampling of these discoveries included:

- pager escalation gets way harder, because a ticket might bounce through 20 service calls before the real owner is identified. If each bounce goes through a team with a 15-minute response time, it can be hours before the right team finally finds out, unless you build a lot of scaffolding and metrics and reporting.
- every single one of your peer teams suddenly becomes a potential DOS attacker. Nobody can make any real forward progress until very serious quotas and throttling are put in place in every single service.
- monitoring and QA are the same thing. You'd never think so until you try doing a big SOA. But when your service says "oh yes, I'm fine", it may well be the case that the only thing still functioning in the server is the little component that knows how to say "I'm fine, roger roger, over and out" in a cheery droid voice. In order to tell whether the service is actually responding, you have to make individual calls. The problem continues recursively until your monitoring is doing comprehensive semantics checking of your entire range of services and data, at which point it's indistinguishable from automated QA. So they're a continuum.
- if you have hundreds of services, and your code MUST communicate with other groups' code via these services, then you won't be able to find any of them without a service-discovery mechanism. And you can't have that without a service registration mechanism, which itself is another service. So Amazon has a universal service registry where you can find out reflectively (programmatically) about every service, what its APIs are, and also whether it is currently up, and where.
- debugging problems with someone else's code gets a LOT harder, and is basically impossible unless there is a universal standard way to run every service in a debuggable sandbox.

That's just a very small sample. There are dozens, maybe hundreds of individual learnings like these that Amazon had to discover organically. There were a lot of wacky ones around externalizing services, but not as many as you might think. Organizing into services taught teams not to trust each other in most of the same ways they're not supposed to trust external developers.

This effort was still underway when I left to join Google in mid-2005, but it was

pretty far advanced. From the time Bezos issued his edict through the time I left, Amazon had transformed culturally into a company that thinks about everything in a services-first fashion. It is now fundamental to how they approach all designs, including internal designs for stuff that might never see the light of day externally. At this point they don't even do it out of fear of being fired. I mean, they're still afraid of that; it's pretty much part of daily life there, working for the Dread Pirate Bezos and all. But they do services because they've come to understand that it's the Right Thing. There are without question pros and cons to the SOA approach, and some of the cons are pretty long. But overall it's the right thing because SOA-driven design enables Platforms.

That's what Bezos was up to with his edict, of course. He didn't (and doesn't) care even a tiny bit about the well-being of the teams, nor about what technologies they use, nor in fact any detail whatsoever about how they go about their business unless they happen to be screwing up. But Bezos realized long before the vast majority of Amazonians that Amazon needs to be a platform.

You wouldn't really think that an online bookstore needs to be an extensible, programmable platform. Would you?

Well, the first big thing Bezos realized is that the infrastructure they'd built for selling and shipping books and sundry could be transformed an excellent repurposable computing platform. So now they have the Amazon Elastic Compute Cloud, and the Amazon Elastic MapReduce, and the Amazon Relational Database Service, and a whole passel' o' other services browsable at aws.amazon.com.

These services host the backends for some pretty successful companies, reddit being my personal favorite of the bunch.

The other big realization he had was that he can't always build the right thing. I think Larry Tesler might have struck some kind of chord in Bezos when he said his mom couldn't use the goddamn website. It's not even super clear whose mom he was talking about, and doesn't really matter, because nobody's mom can use the goddamn website. In fact I myself find the website disturbingly daunting, and I worked there for over half a decade. I've just learned to kinda defocus my eyes and concentrate on the million or so pixels near the center of the page above the fold.

I'm not really sure how Bezos came to this realization -- the insight that he can't build one product and have it be right for everyone. But it doesn't matter, because he gets it. There's actually a formal name for this phenomenon. It's called Accessibility, and it's the most important thing in the computing world.

The. Most. Important. Thing.

If you're sorta thinking, "huh? You mean like, blind and deaf people Accessibility?" then you're not alone, because I've come to understand that there are lots and LOTS of people just like you: people for whom this idea does not have the right Accessibility, so it hasn't been able to get through to you yet. It's not your fault for not understanding, any more than it would be your fault for being blind or deaf or motion-restricted or living with any other disability. When software -- or idea-ware

for that matter -- fails to be accessible to anyone for any reason, it is the fault of the software or of the messaging of the idea. It is an Accessibility failure.

Like anything else big and important in life, Accessibility has an evil twin who, jilted by the unbalanced affection displayed by their parents in their youth, has grown into an equally powerful Arch-Nemesis (yes, there's more than one nemesis to accessibility) named Security. And boy howdy are the two ever at odds.

But I'll argue that Accessibility is actually more important than Security because dialing Accessibility to zero means you have no product at all, whereas dialing Security to zero can still get you a reasonably successful product such as the Playstation Network.

So yeah. In case you hadn't noticed, I could actually write a book on this topic. A fat one, filled with amusing anecdotes about ants and rubber mallets at companies I've worked at. But I will never get this little rant published, and you'll never get it read, unless I start to wrap up.

That one last thing that Google doesn't do well is Platforms. We don't understand platforms. We don't "get" platforms. Some of you do, but you are the minority. This has become painfully clear to me over the past six years. I was kind of hoping that competitive pressure from Microsoft and Amazon and more recently Facebook would make us wake up collectively and start doing universal services. Not in some sort of ad-hoc, half-assed way, but in more or less the same way Amazon did it: all at once, for real, no cheating, and treating it as our top priority from now on.

But no. No, it's like our tenth or eleventh priority. Or fifteenth, I don't know. It's pretty low. There are a few teams who treat the idea very seriously, but most teams either don't think about it all, ever, or only a small percentage of them think about it in a very small way.

It's a big stretch even to get most teams to offer a stubby service to get programmatic access to their data and computations. Most of them think they're building products. And a stubby service is a pretty pathetic service. Go back and look at that partial list of learnings from Amazon, and tell me which ones Stubby gives you out of the box. As far as I'm concerned, it's none of them. Stubby's great, but it's like parts when you need a car.

A product is useless without a platform, or more precisely and accurately, a platform-less product will always be replaced by an equivalent platform-ized product.

Google+ is a prime example of our complete failure to understand platforms from the very highest levels of executive leadership (hi Larry, Sergey, Eric, Vic, howdy howdy) down to the very lowest leaf workers (hey yo). We all don't get it. The Golden Rule of platforms is that you Eat Your Own Dogfood. The Google+ platform is a pathetic afterthought. We had no API at all at launch, and last I checked, we had one measly API call. One of the team members marched in and told me about it when they launched, and I asked: "So is it the Stalker API?" She got all glum and said "Yeah." I mean, I was joking, but no... the only API call we offer is to get

someone's stream. So I guess the joke was on me.

Microsoft has known about the Dogfood rule for at least twenty years. It's been part of their culture for a whole generation now. You don't eat People Food and give your developers Dog Food. Doing that is simply robbing your long-term platform value for short-term successes. Platforms are all about long-term thinking.

Google+ is a knee-jerk reaction, a study in short-term thinking, predicated on the incorrect notion that Facebook is successful because they built a great product. But that's not why they are successful. Facebook is successful because they built an entire constellation of products by allowing other people to do the work. So Facebook is different for everyone. Some people spend all their time on Mafia Wars. Some spend all their time on Farmville. There are hundreds or maybe thousands of different high-quality time sinks available, so there's something there for everyone.

Our Google+ team took a look at the aftermarket and said: "Gosh, it looks like we need some games. Let's go contract someone to, um, write some games for us." Do you begin to see how incredibly wrong that thinking is now? The problem is that we are trying to predict what people want and deliver it for them.

You can't do that. Not really. Not reliably. There have been precious few people in the world, over the entire history of computing, who have been able to do it reliably. Steve Jobs was one of them. We don't have a Steve Jobs here. I'm sorry, but we don't.

Larry Tesler may have convinced Bezos that he was no Steve Jobs, but Bezos realized that he didn't need to be a Steve Jobs in order to provide everyone with the right products: interfaces and workflows that they liked and felt at ease with. He just needed to enable third-party developers to do it, and it would happen automatically.

I apologize to those (many) of you for whom all this stuff I'm saying is incredibly obvious, because yeah. It's incredibly frigging obvious. Except we're not doing it. We don't get Platforms, and we don't get Accessibility. The two are basically the same thing, because platforms solve accessibility. A platform is accessibility. So yeah, Microsoft gets it. And you know as well as I do how surprising that is, because they don't "get" much of anything, really. But they understand platforms as a purely accidental outgrowth of having started life in the business of providing platforms. So they have thirty-plus years of learning in this space. And if you go to msdn.com, and spend some time browsing, and you've never seen it before, prepare to be amazed. Because it's staggeringly huge. They have thousands, and thousands, and THOUSANDS of API calls. They have a HUGE platform. Too big in fact, because they can't design for squat, but at least they're doing it.

Amazon gets it. Amazon's AWS (aws.amazon.com) is incredible. Just go look at it. Click around. It's embarrassing. We don't have any of that stuff.

Apple gets it, obviously. They've made some fundamentally non-open choices, particularly around their mobile platform. But they understand accessibility and

they understand the power of third-party development and they eat their dogfood. And you know what? They make pretty good dogfood. Their APIs are a hell of a lot cleaner than Microsoft's, and have been since time immemorial.

Facebook gets it. That's what really worries me. That's what got me off my lazy butt to write this thing. I hate blogging. I hate... plussing, or whatever it's called when you do a massive rant in Google+ even though it's a terrible venue for it but you do it anyway because in the end you really do want Google to be successful. And I do! I mean, Facebook wants me there, and it'd be pretty easy to just go. But Google is home, so I'm insisting that we have this little family intervention, uncomfortable as it might be.

After you've marveled at the platform offerings of Microsoft and Amazon, and Facebook I guess (I didn't look because I didn't want to get too depressed), head over to developers.google.com and browse a little. Pretty big difference, eh? It's like what your fifth-grade nephew might mock up if he were doing an assignment to demonstrate what a big powerful platform company might be building if all they had, resource-wise, was one fifth grader.

Please don't get me wrong here -- I know for a fact that the dev-rel team has had to FIGHT to get even this much available externally. They're kicking ass as far as I'm concerned, because they DO get platforms, and they are struggling heroically to try to create one in an environment that is at best platform-apathetic, and at worst often openly hostile to the idea.

I'm just frankly describing what developers.google.com looks like to an outsider. It looks childish. Where's the Maps APIs in there for Christ's sake? Some of the things in there are labs projects. And the APIs for everything I clicked were... they were paltry. They were obviously dog food. Not even good organic stuff.

Compared to our internal APIs it's all snouts and horse hooves.

And also don't get me wrong about Google+. They're far from the only offenders. This is a cultural thing. What we have going on internally is basically a war, with the underdog minority Platformers fighting a more or less losing battle against the Mighty Funded Confident Producters.

Any teams that have successfully internalized the notion that they should be externally programmable platforms from the ground up are underdogs -- Maps and Docs come to mind, and I know GMail is making overtures in that direction. But it's hard for them to get funding for it because it's not part of our culture.

Maestro's funding is a feeble thing compared to the gargantuan Microsoft Office programming platform: it's a fluffy rabbit versus a T-Rex. The Docs team knows they'll never be competitive with Office until they can match its scripting facilities, but they're not getting any resource love. I mean, I assume they're not, given that Apps Script only works in Spreadsheet right now, and it doesn't even have keyboard shortcuts as part of its API. That team looks pretty unloved to me.

Ironically enough, Wave was a great platform, may they rest in peace. But making something a platform is not going to make you an instant success. A platform needs a killer app. Facebook -- that is, the stock service they offer with walls and

friends and such -- is the killer app for the Facebook Platform. And it is a very serious mistake to conclude that the Facebook App could have been anywhere near as successful without the Facebook Platform.

You know how people are always saying Google is arrogant? I'm a Googler, so I get as irritated as you do when people say that. We're not arrogant, by and large. We're, like, 99% Arrogance-Free. I did start this post -- if you'll reach back into distant memory -- by describing Google as "doing everything right". We do mean well, and for the most part when people say we're arrogant it's because we didn't hire them, or they're unhappy with our policies, or something along those lines. They're inferring arrogance because it makes them feel better.

But when we take the stance that we know how to design the perfect product for everyone, and believe you me, I hear that a lot, then we're being fools. You can attribute it to arrogance, or naivete, or whatever -- it doesn't matter in the end, because it's foolishness. There IS no perfect product for everyone.

And so we wind up with a browser that doesn't let you set the default font size.

Talk about an affront to Accessibility. I mean, as I get older I'm actually going blind. For real. I've been nearsighted all my life, and once you hit 40 years old you stop being able to see things up close. So font selection becomes this life-or-death thing: it can lock you out of the product completely. But the Chrome team is flat-out arrogant here: they want to build a zero-configuration product, and they're quite brazen about it, and Fuck You if you're blind or deaf or whatever. Hit Ctrl+- on every single page visit for the rest of your life.

It's not just them. It's everyone. The problem is that we're a Product Company through and through. We built a successful product with broad appeal -- our search, that is -- and that wild success has biased us.

Amazon was a product company too, so it took an out-of-band force to make Bezos understand the need for a platform. That force was their evaporating margins; he was cornered and had to think of a way out. But all he had was a bunch of engineers and all these computers... if only they could be monetized somehow... you can see how he arrived at AWS, in hindsight.

Microsoft started out as a platform, so they've just had lots of practice at it.

Facebook, though: they worry me. I'm no expert, but I'm pretty sure they started off as a Product and they rode that success pretty far. So I'm not sure exactly how they made the transition to a platform. It was a relatively long time ago, since they had to be a platform before (now very old) things like Mafia Wars could come along.

Maybe they just looked at us and asked: "How can we beat Google? What are they missing?"

The problem we face is pretty huge, because it will take a dramatic cultural change in order for us to start catching up. We don't do internal service-oriented platforms, and we just as equally don't do external ones. This means that the "not getting it" is endemic across the company: the PMs don't get it, the engineers don't get it, the product teams don't get it, nobody gets it. Even if individuals do,

even if YOU do, it doesn't matter one bit unless we're treating it as an all-hands-on-deck emergency. We can't keep launching products and pretending we'll turn them into magical beautiful extensible platforms later. We've tried that and it's not working.

The Golden Rule of Platforms, "Eat Your Own Dogfood", can be rephrased as "Start with a Platform, and Then Use it for Everything." You can't just bolt it on later. Certainly not easily at any rate -- ask anyone who worked on platformizing MS Office. Or anyone who worked on platformizing Amazon. If you delay it, it'll be ten times as much work as just doing it correctly up front. You can't cheat. You can't have secret back doors for internal apps to get special priority access, not for ANY reason. You need to solve the hard problems up front.

I'm not saying it's too late for us, but the longer we wait, the closer we get to being Too Late.

I honestly don't know how to wrap this up. I've said pretty much everything I came here to say today. This post has been six years in the making. I'm sorry if I wasn't gentle enough, or if I misrepresented some product or team or person, or if we're actually doing LOTS of platform stuff and it just so happens that I and everyone I ever talk to has just never heard about it. I'm sorry.

But we've gotta start doing this right.

THE ELEVEN LAWS OF SHOWRUNNING

Javier Grillo-Marxuach

1.20.16

Upon finding this essay, any number of showrunners with whom I have worked in the past will assume it is a personal attack in the language of a management lesson. No matter that what follows is a distillation twenty years of experience – and has been in the works since I ran my first show, *The Middleman* – I expect to be excoriated by some who will believe I am writing out of envy, or to avenge some perceived slight, or was just too cowardly to say it to their faces.

It takes that level of ego to be a television writer/producer: the conviction that what you have to say matters so much that it is worth not only mastering the tropes of an entire medium, but also the risk that all the intermediaries required to create the finished product will ruin it all with some fatal blend of incomprehension, or incompetence.

For many, the undeniable triumph that is pitching a series idea, having a pilot ordered, successfully producing it, and then having it ordered to series is nothing less than a validation: not only of their voice and talent, but also their Way of Doing Things. This often translates to an intractable adherence to the notion that "my creative process" is so of the essence that all other concerns must be made subordinate lest the delicate alchemy that made success possible be snuffed.

This often leads to incompetent and – whether through ignorance or ego – abusive senior management. I'm not talking about "the lack of experienced showrunners" currently written about in industry publications, but rather that the management culture of television shows as represented by both experienced and novitiate showrunners is beset by a cult of idiosyncrasy over professionalism, and tolerance of toxic behavior; all enabled by the exigencies of getting the show on-air, and keeping it there by any means necessary.

This is exacerbated by there only being two sins for which a showrunner pays with a pink slip: wasting time and squandering money. However, these contingencies are amply prepared for in studio plans and budgets; and an entire army of dedicated professionals stands beneath the showrunner day in and out to ensure neither occurs.

Why? Because they depend on the show - and the perceived creative and managerial genius of the showrunner - for their living. So, once they have a show on the air, even the worst managers muddle through on something resembling time and budget: usually by the sweat of a lot of talented individuals doing everything humanly possible to keep the ship afloat.

One of the most jealously guarded secrets of TV is the reality that those who get their pilots made and show picked up on any given year are usually no more gifted, visionary, or prodigious, than the ones who did not. There are as many television writers who work regularly as there are professional NBA players at any given time - by that metric, we are all breathing rarefied air - but the process by which television shows are made and selected is by no means some mystical divination by which the artistry of very special snowflakes is empowered that it may elevate the art form as a whole.

Television is - quite simply - a business: with winners, losers, seasonal patterns, production schedules, budgets, and deliverables... just like any other business.

What we do is nothing more - or less - than hard work... hard work that is not exclusive to any one person, but helped along by scores of competent, experienced professionals whose job security is tied to the longevity of the endeavor... hard work that can be done efficiently, thoughtfully, and in a way that doesn't ask anyone involved to sacrifice their personal life, dignity, and - sometimes - personal safety.

Historically, there never was much of an apprenticeship/mentorship mentality in television. Writers are notoriously taciturn and parochial about their "creative process." However, when there were only three to five broadcast networks and a much longer queue to the top, someone who worked their way up from staff writer (the lowest and least paid position) to show creator/executive producer/showrunner could at least be reliably understood to have at least spent many years learning how to make the trains run on time under the tutelage of writer/producers who had endured the same trials.

Nowadays, programming outlets are as likely to buy television pilots from more junior writers, as well as playwrights, screenwriters, novelists, investigative journalists, and bloggers whose "my year of doing this and not that" article managed to break the Internet as they are from seasoned writer/producers -

and then put them in the position of having to manage what is essentially a start-up corporation with a budget in the eight figures and a hundred-plus employee workforce. More often than not, the weight of that responsibility sends both the experienced and inexperienced into the warm embrace of a mistaken belief that it was all put there to service their creative process and nothing else.

As special and wonderful as creativity and process may be, they are assets that can be channeled, managed, made to work on call, and sent to bed at a decent hour. Any television show – from the most formulaic, to the most genre-defining, medium-transforming phenomenon – can be made on time, on budget, and without demanding that any of the employees put more time at the mine than they absolutely have to, if the showrunners simply apply basic, commonsensical management strategy to their stewardship of the enterprise.

Why is it so hard for showrunners to implement simple strategies in the name of running the show efficiently and humanely?

The answer is that "simple" doesn't mean "easy". The simplest decisions are often hardest because they demand a painful concession to an unpleasant truth. Every one of the Eleven Laws asks for the same thing: the surrender of a quantum of attachment to a showrunner's idea of themselves as the fountainhead of the show's greatness to serve the show and those who work to make it.

It seems like a contradiction – to ask someone from whom visionary leadership is demanded to surrender their ego – but it isn't, because of...

THE FIRST LAW OF SHOWRUNNING **IT'S ALL ABOUT YOU STOP MAKING IT ALL ABOUT YOU**

You pitched an idea, sold a script, and got it made. Now you have sixty million dollars and thirteen hours of network airtime – with a strong possibility for much more – for a bully pulpit. Nothing goes in front of the lens that you do not approve. Nothing gets on the screen without your stamp. To the studio, network – and the general public – you and your show are one and the same.

Because it's all about you, you also need to face the truth that your staff works for you in exchange for a paycheck, not out of a genuflecting admiration of your genius. They will do whatever you

need done because they enter every conversation knowing that you can fire them. Their indenture is a given. Their loyalty is not.

It's on you to invest your staff in the vision of the show - in your vision - and turn them into true believers and dedicated workers who will go the extra mile. You can do that by giving them the opportunity to express themselves within the framework you have created.

You can also do that by instilling fear - of job insecurity, of the loss of political capital in the show's hierarchy, or simply the harsh judgment of a capricious father figure. You have the power to be either an enabler of your employees's creativity, or make them the enablers of your whims.

What will you do with that power? Will you garret yourself until you absolutely have to emerge to tell your staff what to do? Will you demand that everyone jockey for your favor in order to have the information they need to do their job... or will you provide that information freely so that creativity blooms because - and not in spite - of you?

Are you strong and secure enough in your talent and accomplishment to accept the possibility that other people - properly empowered by you - can actually enhance your genius... or will you cling to the idea that only you can be the source of that genius?

How you answer that question determines the leader you will be.

THE SECOND LAW OF SHOWRUNNING
KNOW YOUR SHOW AND TELL EVERYONE WHAT IT IS

It seems weird that someone would sell a show and then not really "know" what it is - or be unwilling to share that information. Kind of like Steve Jobs not telling his staff more about the iPod than that "it's white and needs a dial"... and yet, not knowing - or not telling - what the show is a common showrunner dysfunction.

Your employees need specific knowledge of the tone, texture, and technique of the show to do their jobs. Even after producing the pilot episode, most of that crucial information still remains in your head. The pilot episode was a prototype. Now you have to discern what it was that worked so well in the pilot and turn that into a reproducible result. You also have to figure out the

things that didn't work - with a certain amount of honesty and self-reflection - and then articulate to your team how you want them fixed. Most of your work as a showrunner is to communicate information to other people so that they can execute it within their field of expertise.

One of the great contradictions of the way we make television in the United States is that writers are given managerial control over the entire enterprise... but writers are very often bad communicators outside the page. Also, talking to people non-stop, all day, with great specificity about a project this size is hard, and tiring. That much said, there are seven words no competent showrunner should ever say:

"I'll know it when I see it."

When you're a showrunner, it is on you to define the tone, the story, and the characters. You are NOT a curator of other people's ideas. You are their motivator, their inspiration, and the person responsible for their implementation.

Bottom line: the creativity of your staff isn't for coming up with your core ideas for you, it's for making your core ideas bigger and better once you've come up with them. To say "I'll know it when I see it" is to abdicate the hard work of creation while hoarding the authority to declare what is or isn't good.

While anyone can say "I'll know it when I see it," it is the writer's ability to create that is the reason we are the showrunners in American television. To be effective, you have to articulate what Maya Lin referred to as "a strong, clear vision." You have to draw the boundaries of the sandbox with precision, detail, consistency, and integrity.

This is a difficult task that requires intellectual and creative rigor, a measure of non-solipsistic introspection, and that you make a discipline out of talking to other people and being on message at all times. As a showrunner, you must communicate your vision so that everyone understands it, and then preach it, day in and out, to the point of exhaustion until everyone feels it in their soul like a gospel. And here's the great part of successfully communicating a shared vision: your employees will love you for it.

Loyalty to an employer begins with the knowledge of what the job is. Loyalty comes from knowing that your bosses have your back

both in the form of giving out the information necessary to do what you do and do it right, and the empowerment to use your own abilities to improve on the baseline.

THE THIRD LAW OF SHOWRUNNING
ALWAYS DESCRIBE A PATH TO SUCCESS

Describing a path to success is the natural outgrowth of the Second Law. This advice was given to me by the non-writing Executive Producer on my show *The Middleman* – a very seasoned production executive who strove to create an environment where I could excel in communicating the goals of the show to all comers.

"Always Describe a Path to Success" means – in its most practical form – "Do not leave a meeting without letting everyone there know what they are expected to do/deliver next."

If you tell your staff how to please you, two out of three times they will come back with a way to do exactly what you want. If they can't, they will often come up with a number of better ideas out of a desire to address the spirit, if not the letter, of a clear directive.

Every clear directive you issue is a gift because it relieves your staff of the stress of having to divine your goals. A clear directive is an indication of trust: your way of saying "I have taken the time and effort to figure out our goal. I now acknowledge that you have the knowledge and resources to figure out the process."

To successfully define a path to success, you don't even have to know the exact hill to take. The grinding race that is television often means that you may not always know the next goal; but even if you articulate your order as "Help me figure out the next hill to take," or "Let me know what our resources are so that I can make an educated decision about where to attack next," that alone constitutes a directive with a defined outcome.

You will be amazed at how much even that measure of clarity will galvanize a team. When you define the problems, you not only control the direction of the enterprise, you also free your staff to do what they do best: dedicate their unique skills to their solution.

THE FOURTH LAW OF SHOWRUNNING
MAKE DECISIONS EARLY AND OFTEN

As the days, weeks, and months churn away, you will find that – whether you like it or not, and whether it's in your comfort zone or not – everyone constantly solicits decisions from you. Remember the First Law.

And yet, an aversion to making decisions is a massively common showrunning dysfunction. It comes out of an understandable insecurity: once you make a decision, the world knows where you stand. Once you say "This is what this is," you have made your taste and opinion clear: the world will judge you. Decision aversion can also be a stalling tactic designed to let you have it your way without ruffling too many feathers on an interpersonal and creative level. Wanting to be seen as "a nice person" and a "good employer" are understandable desires.

While "nice" can mean "affable" and "pleasant," a second definition of "nice" is also "precise and demanding careful attention." In my experience, nice people – and good bosses – rip off the Band-Aid early, make the case for their decision, hear out any remaining arguments, then shut down the discussion and send everyone off to get on with their work.

Avoiding decisions causes your staff to run themselves ragged coming up with contingencies and robs them of the time they need to properly execute your vision. There's also the sad – and very frustrating and demoralizing to your employees – truth that most decision-averse managers usually return to one of the first things they were pitched as their final answer.

Your job is to make ideas come to life. The first step is to commit. Commit early. Commit often. Make committing the same as breathing: you might as well do it now, because you will have to do it eventually.

Most importantly, the sooner you make a decision, the sooner you will know from your crew what is achievable, and the sooner they will be able to expand upon – and use their talents to – elevate it. The time you spent not deciding is time you rob from your staff's ability to make whatever the object of the decision the best it can be. The show simply cannot go on until you say what the show is.

THE FIFTH LAW OF SHOWRUNNING
DO NOT DEMAND A FINAL PRODUCT AT THE IDEA STAGE

When you sold your pilot, you didn't take an eight million dollar film of your script to the network meeting. You talked the executives through your idea for a series, the characters, and your story for the pilot, and they proceeded to entrust you with millions of dollars to fulfill your vision. Considering how much the creation of a TV series depends on a studio and network's ability to visualize a bunch of words coming out of some writer's mouth, it is surprising that many showrunners lack the skill to visualize story when pitched to them by their own staff.

Architects can see buildings off blueprints. That's their job. Yours is to see the gross anatomy of the stories the writers pitch you off the shorthand of the board, and to let them run with the details. The next step is to visualize even further down the line as the writers refine the muscular, circulatory, and nervous systems in the slightly more detailed treatment of the story, plot, and scenes in an outline, and - if you don't like the shape of the surface once the script come in - for you to give notes and rewrite if necessary.

If, as a showrunner, you repeatedly have to return stories to the board after they have been outlined or scripted - or find yourself sending your writers off to script and outline in frustration, only to then rewrite from page one, you need to consider doing some work on your own ability to create and discern story from the foundations up.

Not all writers have this ability, but it is something that can and should be learned - and which is crucial to making television - because the physical production of the scripts depends on the departments having consistent, and accurate communication from the writers office as to what is coming down the pike.

One of things increasingly lost as showrunners are no longer asked to work their way up the ranks in the television hierarchy is a comfort level with collaboration in the form of the writers room, and a knowledge of story - usually born of coming up with one story after another on other people's shows. It is from this longitudinal experience of collaboration and story generation that most showrunners learn how to visualize.

How, then, if you do not come from a lifetime of conference and teamwork, but find yourself forced into collusion with a writers

room - whom you need, if for no other reason, to generate the sheer volume of material the show demands - do you develop this skill? The answer is trust. You take the leap of faith that the professionals you hired can execute on the page what is shorthanded on the board. You trust that someone pitching you "meet cute" knows how to render that on the page given an adequate amount of time. You trust that other writers occasionally need to retire to their keyboards to do their job to the fullest... and understand that, because you will decide whether or not they have to be fired after they turn their draft, they are profoundly invested in doing a good job...

As showrunner, you have to divest yourself from the desire to be the audience. You are the chief designer and architect. Sure, you can demand to be "entertained" by work that feels complete in its gestational phase, but often, the inevitable product of that demand is that will you be bored by it by the time it reaches your desk because you will have effectively destroyed a crucial part of your staff's creative process.

Ironically, it's the part of the process that many dysfunctional showrunners guard jealously for themselves...

THE SIXTH LAW OF SHOWRUNNING **WRITE AND REWRITE QUICKLY**

Scripts are an expression of a writers soul... but that's not all they are. A script is also work order.

Without a complete script, no one can decide where they are going to take the trucks with all the lights and cameras and costumes, and for how long. Without a script, no one can figure out how much it's going to cost to make this episode of your series. Without a script, the actors can't prepare for their work in front of the camera.

A script is the most specific description of the work ahead of the production for weeks to come. If you procrastinate - or allow yourself to become precious - you are creating a void in which no one knows what their job is; especially your writing staff.

A studio has given you millions of dollars to hire a group of people whose mission is to learn how to produce work that reads and sounds like your voice. Reproducing that voice is the primary goal of your writing staff. The best and most efficient way they can do that is by reading your prose and dialogue. The faster you

write, the sooner they can integrate your idiosyncrasies into the process... and the faster you rewrite their work, the faster they can internalize your changes to their work into the matrix of that learning process.

For most competent writers working under the exigencies of a television season, a week to a week and a half is considered ample time to write the first draft of a script from a solid story break and outline... and yet, dysfunctional showrunners routinely avail themselves significantly longer spans of time to write their own scripts. This destroys morale - as your staff sees you taking liberties you would not give to any of them - and causes chaos in production. Your show's scripts, as written - or rewritten - by you are your most effective tool in your performance of the Second Law. You can't talk to everyone at all times, and eventually, you have a responsibility to take your talk from the theoretical to the real.

A script ultimately represents the concretization of your voice and gesture. A script is your proof of concept, and if its fate is to fail that proof, then you are better off knowing sooner rather than later, so that you - and all of your employees - can use the time to fix what's broken and right the ship while there is still time.

Scripts are how you talk to cast, crew, studio, and network. Write them quickly, rewrite them impassively and efficiently. Work your scripts until they are ready, but recognize that in a fast-moving business like television, most of the time they will only be ready enough.

Your best ideas will survive criticism, the worst ones... there's no amount of attachment that can keep them alive, and it may not be worth fighting so hard for your precious children: the horizon is full of other children, all of whom need your immediate attention and will quickly make you forget the ones you've had to leave behind.

THE SEVENTH LAW OF SHOWRUNNING **TRACK MULTIPLE TARGETS EFFICIENTLY BY DELEGATING RESPONSIBILITY**

In the 1980's, the members of the Berlin Symphony told joke about their imperious conductor, Herbert Von Karajan: The *maestro* gets into a taxi. The driver asks "Where to?" "It doesn't matter," Von Karajan declaims, "I'm needed EVERYWHERE!"

With or without the colossal arrogance, that is one of the essential truths of showrunner life. This is why understanding the First Law, and practicing the Second, are so important. At any given moment during the course of a season, there are six stories that have to be minded: the story in development on the board in the writers room, the story in outline, the story being scripted, the story being prepared for production, the story in production, and the story being completed in editing and post production.

That means meetings. Costume meetings, set decoration meetings, hair and make-up meetings, budget meetings, casting concept calls, network and studio notes calls on multiple drafts of multiple scripts, outlines, and stories, sound and special effects spotting in post-production... enough meetings to wear down even the most extroverted mass-communicator.

And yet, your job is to track all those targets. Because that is a manifestly impossible task, you have a secret weapon in your arsenal designed to combat the fatigue that comes from always having someone at your door who needs to be told What is What.

That weapon is, of course, your writers.

Though you don't realize it just yet, your writers are, in fact, your apostles. Yes: that motley bunch is a band of spiritual warriors ready to spread your Evangel to every corner of your show's domain.

The reason the ranking system of writers goes from staff writer, to story editor, to executive story editor, to co-producer, producer, supervising producer, and co-executive producer, is because you're not just running a show - you're also running a producer/showrunner academy. Even if you are woefully uninterested in teaching/under qualified to teach this discipline, this is the duty that fate has thrust upon you. The way you run a producer/showrunning academy is by making the writers in the room the privileged bearers of your knowledge of What The Show Is and then sending them off to all these meetings to give voice to your unique vision.

The reason the Second Law is so important is that, once you use it to empower your people to spread the Word, it actually takes stress and labor off your hands. TV production is a nigh-insurmountable, and ever-rising, Everest of work. It is for that reason that, over decades, a system evolved by which a team of

highly creative people were put in a privileged position of access to the seat of power and knowledge. All you have to do is share with your writer/producers/showrunners-in-training What You Want, then send them off to all the meetings and have them report back. You do not have to give up your command authority: remember the First Law, and remember that there will always be a final meeting on all these matters before the scenes are shot.

Why should you ask for this help and take yourself out of at least part of the loop? Because it all begins with the story: you need to focus your energy on making sure that the stories are developed to your satisfaction from the ground up. The writers room is the forge of your show's creation - the single most important place in the universe as far as you should be concerned - even though everything conspires to keep you away from it; jealously guarding your time in the writers room should be your prime target.

The more your stories represent the purest version of your vision, the more involved will be your writers's knowledge of that vision... and the better your scripts are going to convey the vision to everyone else involved with the production (as well as the outlying regions, like the people who cut your promos at the network, or the people who license the show for merchandising).

This is why conveying your vision clearly - making sure the work of the writers room reflects it first and foremost - and delegating the conveyance of that vision to others is so important. You are in the business of telling stories: you must strive to free your mental bandwidth to make sure they are your first, and final priority.

THE EIGHTH LAW OF SHOWRUNNING
RESIST THE SIREN CALL OF THE "SEXY GLAMOROUS JOBS"

In the business of entertaining people, many facets of the process of entertaining people are entertaining in and of themselves. Consider the costume designer's workshop. They have drawings of pretty girls on the walls, the costumers are frequently young and attractive - and have a great sense of style and design - and, every once in a while, beautiful actors come in and put on a fashion show for you.

The same applies for production design and prop fabrication - festooned as they are with blueprints, concept art, fabric

samples, and awesome gizmos in various stages of construction. And wait 'til you hit the VFX office, where the boffins will regale you with endless tales of pre-vis and fluid dynamics simulations.

Then there's casting. That's where you can hear actors come in and say your lines in every manner possible. That's right, pretty people come in, say your words back to you, and you get to JUDGE them with impunity!

These are "the sexy, glamorous jobs." You can convince yourself that your direct supervision of these tasks is of the essence... especially if you are stuck on a difficult story knot and the other writers keep telling you the direction you want to go isn't going to untangle it. But you're damaging the show by believing it.

There's another pernicious aspect to the siren song of the sexy glamorous jobs; the longer you spend with your other departments, the more you rob from them the time they need to actually do their job (the designing and construction of things that will look great before the camera and not just sound great in your conversation)... and, by and large, most of them will be too nice to tell you to go away and let them work.

So don't be a Time Bandit (or a "Time Vampire"). Tell people what you want concisely... and then leave... or better yet, tell one of your writer/producers, let them have the discussion with the different department heads first, and then make course corrections later when there's an adequate level of proof of concept.

All of this brings me to post-production. In the late twentieth century - thanks to advances in computer software and memory, and the development of the non-linear/non-destructive editing workflow - post-production changed from a fairly recondite and artisanal process to becoming the single most seductive time suck for showrunners. A showrunner can now go into the editing suite with a large leather couch and massive high-definition screens with a pipeline to the editing system, and watch an episode, a sequence, a scene - even a single sequence of shots - over and over again, and demand any change that enters his/her mind... and, thanks to the miracle of computerized cut-and-paste and endless levels of "undo" and "redo" see it all in real time, and continue to demand changes until every combination of every frame that was shot has been considered.

It feels like real work, but it isn't, I promise. More often than not, all of the consideration and reconsideration done by showrunners of the material in post-production is a distraction from the far less immediately rewarding work of the writers room. The trick to maintaining a healthy balance between the editing room and the writers room is to not fool yourself into thinking that post-production is where the show truly is. If you repeatedly find yourself "looking for the show" in post, it is because you most likely lost it in the writers room.

So how do you mitigate the siren call? By keeping your eye on the story, and by delegating to those who know the story best the task of making sure that the cut has been maximized toward the telling of the story before you step foot in post. Instead of going into the editing room to watch the first cut of the show from the leather couch - where you can be tempted to start taking things apart before the theme music plays - watch it in your office with the editor and the episode writer. Have a thorough discussion with them as to whether the scenes are telling the story (concerns of style and flair can wait until the story is solid) while an assistant takes notes, and then send the editor off to perform the notes.

When the editor is ready with the next iteration of the episode, do NOT look at it. Send the writer of the episode in to look at the next cut and let him or her decide whether the notes were addressed and give the next round of feedback: again, focussing on whether or not the film is telling the story. Only after you've allowed these steps to take place - maybe more than once - should you get on the leather couch and make it sing.

When you begin to work this way, you may feel like you're abandoning a child during a crucial developmental stage, but I promise you - what you are doing is giving the children being conceived a fighting chance at life.

Now, just because I am an advocate of delegating to your staff doesn't mean I am blind to the truth that all of your hires may be up to the tasks you assign for them, which leads to...

THE NINTH LAW OF SHOWRUNNING
EXPECT YOUR STAFF TO PERFORM AT VARYING LEVELS OF COMPETENCE

As I mentioned previously, you are not just running a corporation, but also a spoke of the apprentice-to-master wheel

which many of your writers will ride all the way to becoming senior level writer/producers themselves. Among the many keys to being a successful mentor is the understanding that - when you have a room full of writers of different ranks and levels of ability - they will all perform on the page, and in the writers room, differently.

The executive producer-level writer with twenty-five years of experience - who ran his or her own show last year and is now on your staff as your Number Two - should be reliably expected to turn in drafts in which the story and scene structure are solid, and the characters speak with a voice close to what you have established. You may not ultimately like this writer's execution - that part is subjective - but you should have no doubt that you are in the hands of a pro.

This is what your senior level writer/producer has been doing for twenty-five years: learning how to solve story problems in script, mastering the craft of creating scenes that have a discrete beginning, middle, and end, and figuring out how to weave the prosaic concerns of plot and theme into dialogue that conceals the storytelling machinery beneath.

The assistant whom you promoted to staff writer as a reward for loyalty, hard work, and support - and because you read a spec script that you don't really know how long they took to write (or how much input they had from others in its creation) - cannot be expected to deliver on that level. It's on you to not only budget your time and energy to both give them thoughtful notes and rewrite their material, but also to muster the *largesse* to judge their work leniently.

To most showrunners, this seems unfair... and it is, to be honest, something of a damned nuisance. Nevertheless, it's on you to help your junior staff up the long ladder to mastery. The more well-considered your feedback, the better the scripts your writers will produce. It isn't some glacial process: give your staff accurate and specific information about what you want, and constructive feedback as to the how and why (and yes, describing to them **WHAT** to write counts - don't think they will resent your telling them exactly what you want the scene to look/sound like), and you will see marked improvement from script to script.

It sounds simple, and yet, many showrunners can't wrap their heads around that concept. Sometimes it's just more expedient to

stall until you find the time to fix it yourself. It's also wrong. You hired them. You teach them.

The flip side of judging writers without considering their level of experience is the privileging of notes and feedback from "trusted" outsiders. I have seen every variation in this over twenty years, and have been called upon to perform notes given on scripts by the parents, spouses, and children of showrunners, as well as longtime assistant, and even the line cook of a restaurant (whom the showrunner believed was his link to staying "real").

Though it is the accepted wisdom in creative disciplines that "the best idea wins, regardless of where it came from," the most well-meaning attempts to enact this belief end often badly for all parties involved. Imagine a relatively benign version of this scenario: a showrunner asks an assistant to come in from the bullpen and pitch a script note to the twenty-five year veteran.

Here's a few of the reasons why this well-meaning gesture often ends in tears:

- A. By the time a pitch/outline/script comes to the showrunner, the writers room has undoubtedly discussed it to every possible endgame. The outsider's idea was most likely already tossed around, taken for a test drive, kicked on the tires, and judged wanting for reasons that you have not yet had the time to examine.
- B. You have told the more senior staffer - the one whom you should be trusting with the stewardship of your vision - that you trust them so little that you are looking for help anywhere you can get it.
- C. You have sent the message that it's OK for an inexperienced staffer to speak out against a superior. That's not necessarily a sin, but applied capriciously and frequently, it breeds an entitlement in which junior staffers hold back the process because they believe they have the right to veto marching orders from anyone but the showrunner.
- D. You have put a younger member of the hierarchy in the awkward position of being shut down in front of you by another one of his/her mentors. Everyone loses face.
- E. You are privileging the counsel of people whose power differential with yours is so steep that they will never question your decisions in a productive way.

Now let's say that someone who answers the phones in the front office comes to you with an idea that you do find undeniable. How do you present it to your staff without triggering the awkwardness described above? You give the note yourself without the staffer in the room: if it succeeds the tests, you then graciously give credit to the junior member, also preferably without them in the room, and then later let them know that their idea is being used and that everyone knows where it came from. If the idea is proven to have already been talked about and discarded - and you realize you yourself are behind the mainstream of the creative process in your own room by pitching it - you take the blame, shrug it off, and move on. You're the boss, it will not damage you.

Conversely, if you are the youngest/least experienced/lowest-ranked writer on a staff and have an objection to the work of a more senior writer (and I am giving this advice here because it behooves showrunners to teach this behavior), and have an idea as to how you might fix it, then run your criticism/idea by the next person from you in the hierarchy... and maybe then go with that person to the next person up. You build consensus, insure that the ground under your feet is solid, and then make your move.

These last two points do bring up one, frequently very difficult managerial issue: what do you do when your writers room truly includes a bad apple? Does that fall under the rubric of "expecting writers to behave at different levels of competence?"

Sometimes, yes: bad behavior is often the result of lack of experience and education, That doesn't mean you have to tolerate it, and there are a lot of very useful strategies to mitigate the damage done by negative actors in your staff.

These are the three most common kinds of bad apples that show up in writers rooms:

1. The "Doctor No" - A writer who responds to most ideas that are not theirs with "that sucks" and then lets everyone know how and why, usually without providing ideas about how to fix the problem.
2. The "Hostage Taker" - Sometimes, Doctor Noses cross the line into Hostage Taker, refusing to let the room move on until their objections have been addressed. In younger and less experienced staffers, this behavior is career-destroying. Another brand of hostage-taking comes from the writer who mistakes the open environment of the ideal room - to which its

participants should be able to bring their personal business, within the parameters of it being germane to the story - for their personal psychotherapy session/PhD thesis defense.

3. The Politician/Manipulator/Insulter - This refers to those who, through either tone-deafness, a desire to be heard and appreciated, or just plain malice, use information divulged in the open forum of the writers room to publicly or privately hurt, undermine, or make a punchline out of the other writers. This can be especially cancerous: the room runs on a certain amount of trust and sensitivity, and repairing that trust is an exponential investment of time from the speed with which it can be broken.

The strategies you need to correct these problems are simple and straightforward. Oftentimes the people doing these things do not realize that they are negative actors. Showrunners are often conflict-averse: many staffers will go through entire careers without ever being told they are behaving badly.

Here are the simplest ways of clearing the barrels of Bad Apples:

1. Throw the problem back at Doctor No - Doctor No tells you that they disapprove of something, you reply "You break it, you bought it." If you can pitch an objection, but not a solution, you have not earned the right to speak. As showrunner, you get to express that, first politely, then in escalating levels of exasperation until it sticks. More importantly, expressing this is an important part of your job as a teacher: the critical faculty develops earlier than the more craft-focused, patience-requiring, spade-and-trowel discipline of story generation and repair. If you don't correct Doctor No-ism early and often, you are causing yourself and other showrunners more trouble down the line.
2. Confront problems early, head on, and earnestly - If someone is chronically hijacking the room, tell them firmly, but politely (and preferably privately) that "You have a tendency to overshare, it's not always useful, and it undermines the times when what you have to say helps move the story forward," or "You need to watch the jokes about people's personal lives, they come across as hurtful," or (this was once said to me, and to this day, I thank the bearer of the bad news) "Your graphic descriptions of your self-loathing and body image issues are making the other writers uncomfortable, you may want to take your hand off the throttle." You don't have to be artful - or artfully impolite and cruel - to tell people what you need from them. If they push back, don't engage or become

- defensive, hear them out, and let them know that they have been heard but that - their defense notwithstanding - you have identified a problem and want it worked on. This is often a crucial aspect of problem-solving: many people need to know they are on the record, even if it doesn't change the outcome. Remember, you're not anyone's best friend: you're the boss.
3. Discuss the problem with your closest subordinate, have them deal with it in one of the ways described above, and save your intervention as a court of final appeal - The reason a twenty-five year veteran is being paid to be your right hand is because they bring the experience and weight to deal with problems like this. Use them: let them deal with the problem, have their back, and if the recalcitrant writer insists on not changing, use the power of your office to reinforce the message at a later time. If, in spite of all this, the pushback continues, then there's always the nuclear options:
 4. Exile - Some are so incorrigible that it eventually necessary to figure out a better use for their talent. Writers who perform well on the page but badly in the room can be used in draft writing and rewriting, and kept out of the room altogether. I have often seen Hostage Takers sent to perform producatorial services on the set. So much of what happens on the set is about clarifying - especially for the actors - the context of the work at hand, that the sort of fine tooth-combed discussion that can turn into hostage-taking in the room can serve a useful purpose. This is not an optimal solution: writers are paid to write, but some writers are so incompatible with the collaborative process that you may find yourself cornered into finding an alternate use for them.
 5. Firing - Sometimes, there's just no two ways about it. The merciful way (once you have dotted all your i's and crossed all your t's with the studio's HR) is to rip off the Band-Aid and be done with it, then everyone can move on.

Nothing above is easy or comfortable. The seduction of the "writing-staffs-as-democracies" fallacy - the desire to believe that you can abdicate your teaching responsibilities because everyone in the staff is "equal" - is aided by how tangential and time consuming these interactions feel. It is far easier to believe that everyone should have one voice and one vote. It is also very damaging.

A writer gains mastery over the form and function of television in the same way that chess players master their game: by studying old games, internalizing the patterns, and practicing, practicing, practicing. Lay-people mistake both chess and writing

as explosions of genius-level creativity: but where does the black powder for that explosion come from? Pattern recognition. That's why the twenty-five year veteran is usually so good at the job of breaking story, even if the younger writers demonstrate a greater flair for dialogue, or can render the rhythms of the current popular culture with greater fidelity. Veterans don't have to reinvent the wheel every time out. The veteran looks at the board and recognizes the ten different ways the game can go from that point to a win, or a draw, or a defeat.

There are only so many variations in chess and story telling - the reason you rely on the veteran is that they don't have to play every variation in order to predict how to reach the outcome you want. The art of writing is in how you disguise the mechanics of this assembly, just as the art of chess comes from fooling your opponent into not seeing your endgame thirty moves ahead.

You may be tempted by the idea of a cabinet of equals - with yourself as the first among them, of course - but your job is to lead and teach. You earn love by recognizing that everyone's gifts are different and giving your employees an environment in which it is safe to try, and both succeed and fail. Every member of a writing staff is on the hook for the education of the next person below them; recognizing that everyone is working at a different level is your first step toward building camaraderie.

Hierarchy is neither a dirty word, nor the sign of a hidebound mind that resists change and innovation. Hierarchy is not proof that you're a square and sell-out. Properly enacted, and thoughtfully maintained, hierarchy is the flak jacket that allows each member of your staff to reach their highest potential without being shredded by gunfire.

THE TENTH LAW OF SHOWRUNNING
DELIVER GOOD AND BAD NEWS EARLY AND OFTEN

TV shows are natural incubators for the sort of dramas that come along when you force a hundred or more temperamental people into close communion under the pressure of intense work performed under great stress. Invariably, drama comes from secrets. In my experience, secrets are poison - especially when you are exposed as their bearer. Sunlight is the best disinfectant.

The Tenth Law of showrunning is a close dependent of the Second. As the source of the show's vision and the one best qualified to say What It Is and What It Is not, make truth-telling your

business, rumor control your secondary vocation, and complete transparency your ultimate goal. Save the drama for the screen.

The reasons for this are of the essence of the First and Second Laws. You want and need to be the source of all that is true about your show - even if that truth is unpleasant. The worst position for a leader is as the bearer of bad news everyone already knows.

Any information that aids the speed and efficiency of creation - even if it temporarily hurts feelings - is worth exposing early, tactfully, and often... and if that information exposes you as the cause of a blunder, you are better off putting your pride aside and owning up than expecting everyone who works for you become the unwilling accomplices in - and hostages of - the protection of your own self-concept. Whenever a rumor, a lie, or a truth that you have not sanctioned takes on a life of its own, it undermines your own ability to set the tone, define the parameters, and describe a path to success.

Transparency is not just a moral imperative to the life of a showrunner; it's a necessary lifeline. If you need to devote one iota of your energy to deception tracking and maintenance, that's an iota that's not going to the work you need to accomplish in the writers room. Transparency streamlines your life. Being transparent before anyone can be transparent for you means you control the narrative. Giving bad news before they crash land means no one can claim surprise at a bad break.

Being transparent also helps to break down a commonplace fallacy in television: the idea that network and studio are your adversaries. In fact, these are your production partners and your financial backers - as invested in the success of the series as you are - and they deserve to have a clear picture of the process.

In short, when everyone knows the truth, no one can be surprised by its arrival. When it comes from you, no one can say that you lost control.

THE ELEVENTH LAW OF SHOWRUNNING SHARE CREDIT FOR SUCCESS TO A FAULT

The Eleventh Law of showrunning is the tail of the snake in the mouth of the First... never miss an opportunity to point out how another person's work has made you look good. It's your name on

the show and it's all about you anyway, so you lose nothing by sharing credit.

It sounds counter-intuitive. Most showrunners feel embattled in a job that is manifestly greater than any one person's ability to perform, and feel that - because of their daily marshaling of the resources necessary to commit to that level of intensity - they deserve to be recognized as the sole author of the production.

In truth, that recognition is already there. I'm not just talking about the First Law: the validation of your primacy comes weekly in the form of the largest check on the payroll, the biggest office in the suite, the parking spot closest to the front door, and the Executive Producer credit in the main titles of every episode of the show... along with your production company card after the end titles.

Everyone knows who and what you are. Everyone is hanging on your words.

The wonderful thing about credit is that it's not a finite resource. The more credit you give, the more credit you get - for being a genius and hiring a great staff, for being a good boss and a nice person (finally!) who can acknowledge the contributions of others, for fostering a positive work environment, and - most crucially - for being the kind of showrunner who protects their writers from the kinds of short term judgments that you have the liberty rethink in the long term.

By that I mean this: because of your feelings of embattlement, you will often be tempted to tell the studio or network about which writers are not performing to your expectations in order to explain a temporary stop in the script pipeline, or a missed deadline, or to assuage your own temporary feelings of annoyance. There are few things a showrunner can do that are less becoming of their station than to throw a staff member under the bus.

The first reason is that the road is long and you may find yourself discovering - as this writer does further work for you - that you actually quite like their writing. You have the liberty to change your mind, but a single bad remark (like a yawn from the emperor in *Amadeus*) can paint a writer's career at network or studio for far longer than you imagine. The second reason is that - when you impugn your own staff - it makes your own stewardship

of the show, your ability to communicate to your staff effectively, and your own hiring decisions appear suspect.

And yet there will be times when the studio or network will ask for a draft that you are not prepared to hand over because you need to do a lot of work on it because the writers didn't nail it. You know what you say? You say: "There's still work to be done." That's it - be honest but be fair to the writers and their process, even if it frustrates you.

If there is pushback from the studio or network, take the responsibility yourself: own it and revel in the truth that a blow that would cripple the career of someone of lesser rank is but a ding on your door.

The reason this is the final Law of Showrunning is not just that it feeds right back into the First Law, but also that it is the biggest test of character before you as someone who has just been handed something close to absolute power in the business.

How you deal with praise - and success, and all the concomitant slings and arrows thrown at you for your position - and whether you recognize that you have within you the strength to be that aforementioned flak jacket to your staff, is as true a test of your self-esteem and worth as a person as anything you will ever face.

EPILOGUE

It may be a gross generalization to say that leadership is not a defining characteristic of most writers, but in my experience, it is where we most often fall short. And when we fall - or see something brewing we do not want to face - the natural thing to do is seek refuge. The place where most of us find it is a vast and impregnable fortress called "my creativity." Surrounded by a crocodile-infested moat known as "my process," it is in this fortress that all other concerns are banished in the name of you doing "what I have to do" to be "brilliant on the page."

As a showrunner, this is about as far from a safe space as can exist. The symptoms addressed by the Eleven Laws swirl around this delusion like debris around that scientifically inaccurate black hole in the eponymous Disney sci-fi disaster from the late 70s. It is in this fortress that you think it's OK to excuse yourself your managerial shortcomings under the mistaken impression that - because you have gone there to find your muse - you are entitled to any accommodation, deferral of difficult

responsibility, or abdication of a human obligation, that you deem necessary.

All writers indulge this kind of magical thinking to some level: we cling to our depressions, darknesses, and deceptions thinking they are the source of our genius. We mistakenly believe that our creativity is a karmic recompense for whatever traumas we suffered in the past, and use the excuse of "my process" for any number of toxic activities that we believe service the creativity, but which only prolong misery.

For a showrunner, this clinging is toxic not just for the obvious reasons, but because it provides place to run away from all of the very real responsibilities of your position.

The price you pay to play to an audience of millions on the word stage is that you have to make concessions between the tempestuous *artiste* you idealized for yourself when your pain was something that pushed you toward self-expression. The cost of admission to the Majors is that you have people who depend on you: not just for their living, but also their creative, emotional - and, occasionally, physical - well-being... and, oh yes, you also have an audience that's waiting to be entertained.

As a showrunner, your reality is that you are a senior-level professional: someone who earns more for producing a single episode of television than most Americans do in a year, and has earned the power to either indulge their worst side, or aspire to their best.

Whether you choose to embrace this truth, you owe it to the people who have signed up to work for you to not visit upon them the traumas of your past because that is the only way you think you can perform on the page. You also owe it to them to come to reckoning with the truth that your creativity and your pain are not one and the same, and that the need to believe that in order to get the work done is incompatible with your current lot.

Facing this may be the hardest and most painful truth for any writer. While one certainly informs the other, your darkness and your writing come from different places... losing the former - or at least dispelling it long enough to be a fair leader to your employees - will not affect the latter. Your creativity is a renewable resource - just like praise, and credit, and is fed by everything around you - especially the great people you hired to facilitate this difficult undertaking. Your creativity is not

some finite thing that must be hoarded and protected with arcane devices and traps, but rather a gift that you should bestow on every one of your charges if you want them to succeed to the best of their ability.

And, if you don't have the time or energy to lay down your affectations, you can at least shield others from your insanity by building a scaffold of professionalism around yourself. Suffer for your art if you must - but make the effort to prevent others from becoming participants in your daily reenactment of your trauma. It will make your show a better workplace place for you and every member of your staff.

Of course, you don't have to take my word for this.

As I said previously, even the worst - and most abusive - of managers are generally propped up into functionality, not just by their writers, but by everyone who depends on their ability to perform for their profit. These may, then, be the only Laws that are not only completely optional, but - in all honesty - tangential to the most commonly accepted definition of success in this field.

Nothing I have described above will guarantee profit, fame, awards show recognition, and cultural currency and influence: but I can guarantee that, if you make a habit of practicing any number of these Laws, they will make your life, and your relationships - both in and out of the job - at least a little bit better.

So I will just leave them here - as they say in the business of show - "For Your Consideration."

What happens next is up to you.

COMPLETED STAFF WORK

"During the war, I left an operating squadron in the field and after a short schooling at the Staff School in Leavenworth, found myself thrown into a very large headquarters. The attached article called "Completed Staff Work" was circulated in the Pentagon during World War II. It was a considerable help to me and other officers in attempting to learn to do our jobs with Headquarters, Army Air Forces."

It seemed to me that some of the recommendations had quite a bearing on the operations of a business and I am passing this memo along so that all of you will have an opportunity of looking it over. You will have to overlook the military terminology, and it isn't our intention to start organizing HQ on a military basis, but I still thought the article worthwhile."

TJW, JR.

"Completed Staff 'Work" is the study of a problem, and presentation of a solution, by a staff officer, in such form that all that remains to be done on the part of the head of the staff division, or the commander, is to indicate his approval or disapproval of the completed action. The words "completed action" are emphasized because the more difficult the problem is, the more the tendency is to present the problem to the chief in piecemeal fashion. It is your duty as a staff officer to work out the details. You should not consult your chief in the determination of those details, no matter how perplexing they may be. You may and should consult other staff officers. The product, whether it involves the pronouncement of a new policy or affects an established one, should, when presented to the chief for approval or disapproval, be worked out in finished form.

The impulse which often comes to the inexperienced staff officer to ask the chief what to do, recurs more often when the problem is difficult. It is accompanied by a feeling of mental frustration. It is so easy to ask the chief what to do, and it appears so easy for him to answer. Resist that impulse! You will succumb to it only if you do not know your job. It is your job to advise your chief what he ought to do, not ask him what you ought to do. He needs answers, not questions. Your job is to study, write, restudy and rewrite until you have evolved a single proposed action -- the best one of all you have considered. Your chief merely approves and disapproves.

Do not worry your chief with long explanations and memoranda. Writing a memorandum to your chief does not constitute completed staff work, but writing a memorandum for your chief to send to someone else does. Your views should be placed before him in finished form so that he can make them his views simply by signing his name. In most instances, completed staff work results in a single document prepared for the signature of the chief without accompanying comment. If the proper result is reached, the chief will usually recognize it at once. If he wants comment or explanation, he will ask for it.

The theory of completed staff work does not preclude a "rough draft", but the rough draft must not be a half-baked idea. It must be completed in every respect except that it lacks the requisite number of copies and need not be neat. But a rough draft must not be used as an excuse for shifting to the chief the burden of formulating the action.

The completed staff work theory may result in more work for the staff officer, but it results in more freedom for the chief. This is as it should be. Further, it accomplishes two things:

1. The chief is protected from half-baked ideas, voluminous memoranda, and immature oral presentations.
2. The staff officer who has a real idea to sell is enabled more readily to find a market.

When you have finished your "completed staff work" the final test is this:

1. If you were the chief, would you be willing to sign the paper you have presented, and stake your professional reputation on its being right?
2. If the answer is in the negative, take it back and work it over, because it is not yet "completed staff work".

Microsoft Memo

To: Applications developers and testers
From: Chris Mason
Date: 6/20/89
Subject: Zero-defects code
Cc: Mike Maples, Steve Ballmer, Applications Business Unit managers and department heads

Zero defects

On May 12th and 13th, the applications development managers held a retreat with some of their project leads, Mike Maples, and other representatives of Applications and Languages. My discussion group¹ investigated techniques for writing code with no defects. This memo describes the conclusions which we reached.

Zero-defects code is the Holy Grail of programming. We are not suggesting that this phantasm is attainable on the first try, but we think we know how to get there. There is a crucial need to do this. In OBU, for example, Mac and PC Word were very late, and Win Word continues to be late, in each case because we had many more bugs than we anticipated. Large numbers of bugs at the end of a project make scheduling impossible for project leads and life unbearable for programmers and testers.

Zero defects has actually been achieved on software projects; it is not an impossible goal. Zero defects must be the new performance standard for development. A “defect” occurs when something that is labeled “done” does not conform to the requirements. We need to understand our methods, and strive to improve them in order to prevent defects from happening, or recover from them if they do happen. You’ll be able to measure your success by the reduced time from code complete to shipping.

You *can* improve the quality² of your code, and if you do, the rewards for yourself and for Microsoft will be immense. *The hardest part is to decide that you want to write perfect code.*

The problem

There are a lot of reasons why our products seem to get buggier and buggier. It’s a fact that they’re getting more complex, but we haven’t changed our methods to respond to that complexity.

The problems listed below are not an indictment. Some programmers write perfect code today, and the rest of us have good, honest reasons for coding the way we do. The point of enumerating our problems is to realize that our current methods, not our people, cause their own failure.

¹ Brian Arbogast, Dennis Canady, Jon DeVaan, Ed Johns, Doug Klunder, Brian MacDonald, Tom Reeve, Charles Simonyi.

² Dave Moore’s definition of quality: “Conforms to the requirements.” This means a feature works the way it was specified, at a given level of performance. Quality doesn’t mean the code is perfect or infinitely fast. Oftentimes exceeding the requirements is not worth the cost.

Minimal success

Our scheduling methods and Microsoft's culture encourage doing the minimum work necessary on a feature. When it works well enough to demonstrate, we consider it done, everyone else considers it done, and the feature is checked off the schedule. The inevitable bugs months later are seen as unrelated. By investing the minimum effort, we guarantee the minimum return.

We slip things because it's easier to postpone bad news than to face up to it when it happens. This is "mentally lazy and morally weak."

Schedules and other high winds

We forget that the schedule is not a product, it's a tool. Its purpose is to predict when we will finish, so that other people can schedule their own work accordingly. The schedule has nothing (directly) to do with the quality of the product.

When the schedule is jeopardized, we start cutting corners. We worry about getting features implemented quickly. We ignore warning signs that serious problems exist, or we cut "non-critical" items like size and speed tuning.

Missing the point

The reason that complexity breeds bugs is that we don't understand how the pieces will work together. This is true for new products as well as for changes to existing products.

I don't believe that any of our products are so complex that our programmers can't understand them. Code that is too complex to understand should probably be rewritten; complex code can still be straightforward. The real problem has two facets: we don't want to spend the time to understand exactly how a new feature will affect or be affected by the rest of the program, and too often we think we understand this but do not.

The wrong people write too much code

Imagine a well-intentioned programmer who gets a feature done very quickly, as requested, with minimal unit testing and almost no system testing, marks it off on the schedule, then starts on a new feature. Now imagine another programmer who also works quickly, but very carefully checks his assumptions, handles boundary cases, writes good test suites, verifies all the cases, and then checks it off on the schedule.

The first programmer gets to write more features than the second. The first programmer also gets to spend a lot of time, six months from now, working the bugs out of code he dimly remembers, while the second programmer will have little to do.

This is exactly the reverse of the ideal.

No commitment to completeness

No one is charged with the responsibility for ensuring the completeness of code. Development is too often concerned with *appearing* to make progress (my opinion of this should be clear by now), and with having a clean product *at ship time*. Testing can only verify that the product works as specified; this is a poor test of completeness. Program management, marketing, and user education concentrate on the schedule and a minimum usability level.

Development is at fault here. No one can know if the code is complete but the author or his peers. We have not been charged with this responsibility in the past, so we have not shouldered the burden.

"We'll do that later" doesn't work, because "later" you're going to be up to your neck in alligators trying to figure out how you got there.

Lack of ownership

Under pressure, we tend to hunker down and just try to get our part of the job done. But part of the job is to stand up and look around. Each developer should take the responsibility to consider the entire product, use common sense, and not just take the spec as gospel.

Over-confidence

This is perfectly natural, but wrong. Every programmer I know writes good code, looks at it in satisfaction, and declares that it should work. I have rarely seen new code that does so. (The occasions are easy to spot: people dancing and hooting in the halls.) What piece of code has withstood six months of testing with no bugs reported? Or been reviewed in the next version without a shudder?

“Bugs are inevitable”

This is an insidious idea. The fact that we must rid ourselves of this idea seems to contradict the implications I’ve been making, namely that we should anticipate bugs in our code and winnow them out early. There is no contradiction: when everyone feels that bugs will happen no matter what we do, we stop taking action to prevent *any* bugs from appearing.

In fact, bugs *are* inevitable. But if we act that way, we make it more horribly true.

The solution

First, I have to admit that there is no single solution. Every project team must evaluate itself and its product and determine what will help to achieve zero defects. It doesn’t matter whether we can actually achieve zero on the first attempt, but we should start *right now* and get closer on every project.

This section gives a broad overview of the solution. The following sections describe how to change your attitudes and work habits to reach that goal. A few of the ideas *must* be done or the whole thing will collapse, but for the most part each project should pick and choose what works best for them.

Zero bugs every day

I mean this literally: your goal should be to have a working, nearly-shippable product every day.

This doesn’t mean that when you go home every night you have removed all the bugs from work in progress. It simply means that when a programmer says a feature is complete, it is totally complete: all error and boundary cases work, all interactions with the rest of the product have been dealt with, test documentation or code to exercise the feature are checked in.

Your project should have a state or directory from which anyone can create a current “clean” copy of the product. One way to handle this is to stage the checkin. Modules can be checked in to a “working” directory for history and as insurance against hard disk failure, then checked in to the “clean” directory when the feature is complete.

Fix it now

Since human beings themselves are not fully debugged yet, there will be bugs in your code no matter what you do. When this happens, you must evaluate the problem and

resolve it immediately. Remember that the goal is to have a perfect “clean” copy at all times.

Testers shall not

Bob Matthews often says, “We should write quality into our products, not test it in.” Perhaps testing is a bad name for what our testing department should do. If our programmers ensure the quality of their work by the time testing sees it, then testing’s function is quality assurance, not finding bugs.

This doesn’t necessarily change the methods that testing uses, although testing’s function may evolve if we truly succeed in giving them high quality code. But it’s an important attitude shift, and in solving the problem of code quality, attitude is almost everything.

A new attitude

Zero defects is a strategy that can’t have results unless we decide to make it work. This section gives ideas for aligning yourself with the new attitude.

Think twice before you code

You make hundreds of assumptions when you write a new routine, from the mundane (parameters of called subroutines) to the grandiose (how the user will perceive the feature). Experience has shown that many of these are wrong.

Minor changes are even worse, because the investment in time to fully understand the context of the change seems to outweigh the magnitude of the change. When we make assumptions, we must explicitly state them (with asserts or checking code).

A related problem is not taking the time to think about various situations at all. Incomplete understanding is a huge source of bugs, and has a simple fix: investments in understanding and thinking about the context of a change *always* pay off.

Take the time

Programming speed is highly overrated. Speed with quality is a worthy goal, but quality usually suffers. Evidence suggests that you can spend your time thinking about side-effects and planning up front, or you can spend it patching fixes to bugs later on. These options take about the same amount of time, but the latter results in an inferior product and burnt-out programmers, and you can’t predict how long it will take.

Take the heat

Once you have committed yourself to zero-defects code, you’re going to encounter pressures to drop back to the old methods. Some of this will be temporary until other groups (user education and program management, for example) learn that the new method results in better products whose progress can be measured and predicted.

Don’t give in. Your first schedules will look infinitely padded, when in fact they will simply be true (a new thing in the world). Mike Maples has agreed to stand behind any schedule that can be defended as realistic.

If problems do occur, slip the schedule. Your goal should be to keep the schedule realistic (descriptive as well as prescriptive). It’s better to take the little heat now than the nova later on.

Be ashamed of bugs

If you think that there will be bugs in your code no matter what you do, and someone actually finds one (or a hundred), there's no cause for alarm: "I knew it." If you think that there won't be any bugs in your code, but someone finds them anyway, you probably react with resignation: "I guess I was wrong."

Both of these are counter-productive strategies for dealing with bugs. Plan carefully so they don't happen. If they happen anyway, you *should* be embarrassed, and find out why your plans failed. Then take action to prevent the same failures in the future.

Coding is the major way we spend our time. Writing bugs means we're failing in our major activity. Hundreds of thousands of individuals and companies rely on our products; bugs can cause a *lot* of lost time and money. We could conceivably put a company out of business with a bug in a spreadsheet, database, or word processor. We have to start taking this more seriously.

Reward quality

It's difficult to say what it is we're rewarding now. What we should be rewarding are people who do the job right the first time. If we can't find anyone like that, we should reward whoever comes closest. One means of reward is simply to let them do more of the fun stuff. The way you do that is to enforce the rule that if something is broken, it must be fixed right away.

Another means of reward is a better performance review, which in turn leads to monetary reward.

"Fat and slow" is a bug

Users measure our products by their speed (a major part of usability) as much as by their features. Our methods do not reveal this. We often let hand native, swap tuning, and other important optimizations slip until there's no time to do them.

Hand native should be done in parallel with the C from the start. This may seem to "waste" time, but you'll always know if the program is fast enough, and have time to correct it if it's not. Algorithmic optimization should *never* be postponed. Swap tuning is a difficult issue, especially under Windows and with the state of our current tools; each project lead should decide how to schedule it.

The intent is not to do unnecessary optimizations, but to schedule, *and never postpone*, known optimizations.

Code quality measures programmer performance

If we value quality, then quality should be a criterion in performance reviews: not the only criterion, but as important as any other.

A new way to work

All of the concrete suggestions in this section came from a few hours' discussion by nine people who had changed their attitude. These are ideas for how to implement a zero-defects strategy in your project. If you have others, please let everyone know.

Stop guessing

Here are ideas for making sure you do it right. Not all of these techniques will work for everyone, so pick and choose.

Cleanroom

This technique has been described by Harlan Mills³, and was once used unintentionally by Charles Simonyi. Both report good results in small- to medium-sized projects. One aspect of this approach is to do things in a more mathematical manner, leading to informal proofs of correctness.

To use the cleanroom technique, imagine that your hardware has not been delivered yet, so you can't debug your program. After designing and writing your code, you and your colleagues review it carefully and in detail, over and over if necessary until you're absolutely sure that it will run the first time. Mills' and Simonyi's experience is that it nearly will run the first time.

Code review

No group of more than two programmers can agree on the best format for code reviews, so we won't make a claim for a "best" format. We do think code reviews are critical. Here are some ideas.

The old-style presentation code review, in which the author walks through his code with his peers, does not catch any but the most superficial bugs. It is an excellent teaching tool, however, and we encourage its use for that purpose.

A more rigorous method is for the author to prepare an introduction to the code, including written documentation, and give a high-level walk-through of the code to one or more of his peers. The reviewers then use the author's materials to actually step through and test the code. A variation is for the reviewers to simply read the code thoroughly until they understand it. In both cases, the reviewers should be looking for missing logic, for how exception cases are handled, and for bad assumptions. Then the reviewers report their results to the author.

Another variation is for the reviewers to review the code privately and report whether or not they found problems, without saying what the problems were. The author must try to find the problems independently.

Don't trust anyone

Since so many problems are caused by misunderstandings, assume nothing without verification. This can take the form of asserts and state verification code that runs on demand or at idle time.

Debugging tools never find their way into the schedule—this has to change. Every development postmortem⁴ promises that more time will be spent on essential debug tools next time. Stop postponing it. PAs that can write code are a great way to get these done; almost all of the debugging tools in Mac Word 4 were done by a PA.

We all claim to use asserts, but almost all code could use more of them. Spend the time to identify what your assumptions are, then make the code prove that the assumptions are correct.

Document your design and interface

Each project should determine what level of documentation is adequate. Only one thing is certain: your current level of documentation is probably *inadequate*.

³ In "Cleanroom Software Engineering." Dave Moore can provide copies of the article.

⁴ OBU now calls these Project Epilogues.

Improvements may require nothing more than enforcing meaningful header comments on all routines. It would probably help to have at least a high-level document describing the basic logic and data structures for every major part of the product. Don't forget to schedule time to write these, and don't wait until after the product ships: by then it's too late to help anyone.

If you don't do this, people will continue to make bad assumptions about your code. The resulting bugs will be your fault.

Part of the documentation effort must be to simply talk to each other. Too often there is not enough communication even *within* a team. This turns you into a bug factory.

Training sessions

New people on the project (or on a feature) are a great source of bugs. You can avoid this by teaching them what they need to know. An orientation document is a great help; the Mac Word Fundamentals document has really helped.

Have regular meetings where someone presents the ideas behind part of the product. If you have a weekly development meeting, do it then. Discuss the basic logic of the code and how it interferes with the rest of the product. You may want to videotape the presentations so you can show them to new people later on.

Encourage everyone on the project to know the entire product well.

Write tests before debugging

This is critical. *Before* you start debugging, determine what you'll be looking for and *write it down*. If you can automate the tests, better yet. As you find cases you missed, add them to the script.

We don't want you to waste time managing unwieldy scripts, so keep them as brief as possible. But if you write down what you'll be testing, you get these benefits:

- You can give the script to testing when you check in the code. They'll have a better chance of verifying your code, or finding problems.
- You'll know for sure what you tested.
- You'll think of things you missed before anyone else even sees it.

Competing designs and implementations

This is a dark horse. One way to be sure you have the best design is to have two different teams develop a solution to the same problem independently, then accept the better design. You may want to take parts of each design for the final product. You can use the same technique for implementation: have two teams write the same feature.

This sounds expensive, and it is. But by simply doubling your cost, you guarantee a better product.

There is another problem: how do you tell which is better? Nathan Myrhvold suggests examples in which competing designs couldn't be distinguished until they were implemented. So, if you're thinking of trying this, you should plan on carrying the competition through the coding phase.

Self-validation

Before you call something done, you should convince yourself it is correct. Mathematical proofs suffer from Groucho's disease: they can only prove algorithms that are so simple we don't care. So try the techniques below.

Step in it

As in, “You don’t know it until you _”

A common technique for verifying the “correctness” of new code is to run it and see if it crashes. If it doesn’t crash, and it seems to produce the correct result, then it “works”.

Step in it means step through every line of code with a debugger. Stop at crucial points and examine important variables. Watch closely at important logic points.

In Mac Word 4, we stepped through code for two reasons: to verify the correctness of hand native, and because the profiler wasn’t giving us the right kind of information⁵. The result was extremely clean hand native, and a lot of insight into how the program *really* worked, which allowed us to improve its speed dramatically.

The only way to be sure code works is to watch it.

Code review

This must be said again. The educational benefits alone make code reviews worthwhile. But their real value is to get more than one person thinking about the code, and verifying it. Use whatever format works best for you, but schedule code reviews and then *do* them.

Glass box testing

Sometimes called white box testing. PAs would make great glass box testers. This is an interactive code review: having someone other than the author test the code with a listing open, looking again for missed cases, bad assumptions, or simple mistakes.

Presumed guilty

The U.S. judicial system is a terrible model for testing software. Assume that your code does not work (a good bet), and make it prove itself. This is where your scripts come in. Figure out before debugging how your code could be broken, then prove that it’s not.

This is a crucial change in attitude. We must stop writing code and then testing it to find the bugs. Instead, we need to write the code and convince ourselves that it works. Not finding bugs is not a proof of correctness.

Self-correction

When you’ve expended your best efforts, and you still find bugs in your code, don’t give up and don’t accept the situation. Do these instead.

Do not pass Go

Fix it right now.

Your commitment to zero bugs every day has broken down. Stop working on that jazzy new feature, forget about the schedule, and fix the problem.

Reassess and scream

Simply fixing the bug isn’t enough. Take a moment to figure out why the bug happened. Why didn’t your test scripts or asserts catch it earlier? What assumptions were wrong, what rules did you break?

⁵ The profiler can tell you how long was spent in the code that ran. It can’t tell you if the right code was run, for example if a cache eliminated unnecessary work.

If you find something, look hard for other instances—bugs travel in swarms. Then let everyone else on the project know. It's likely that someone else made the same wrong assumptions. Bring these up at the weekly development meetings.

Three strikes

When a lot of bugs have been found in the same area, there's something seriously wrong. Find out what it is. Perhaps someone isn't spending enough time to verify the code before checking it in. Perhaps there are serious design problems.

When design problems do occur, be ready to throw it out and start again. You can easily spend as much time trying to patch a bad design as you can fixing it right. Take the heat: adjust the schedule if necessary, but don't force users and your team to live with mistakes that could be corrected and will compound if they're not.

Reassign bugs

A possible extension of code reviews is to have someone other than the author fix some of the bugs in an area, especially problem areas. There are many variations: assign the bug to someone who has reviewed the code in question, or assign it to someone at random. You may find that getting a new perspective on the area will help to identify the larger problem.

Fix one, find one

Consider using a quota system: for every bug found in your area, you must find another bug and fix it. (This is not recursive: you're free after the second fix.)

The second bug doesn't have to be in the same area, or even in your code at all. This technique will motivate you to not create bugs, and it will also force you to examine the product more closely.

Projects in progress

Projects that are already well advanced can still use some of the concepts of zero defects.

- Do code reviews. Even if you're in crunch mode to fix bugs, *good* code reviews can find more problems and are worth the time.
- Step through new code, even small bug fixes.
- Add asserts and state verification code.
- Be very careful when fixing bugs. Examine assumptions and verify them. Stop and think about what else you're affecting.
- When an area is showing severe problems, consider throwing it out and doing it over.
- Update function header comments; stop and document areas that everyone uses but which are not well understood.
- Have training and discussion sessions.
- Have your PAs do glass box testing.
- Implement the fix one, find one scheme.

Benefits

Zero defects is a lofty goal, but it can have tangible results.

Predictability

The stabilization phase of the project is the hardest to schedule. The smaller that phase becomes, the better we can predict the entire project. If we always check in high-quality code, then we have a good idea how much time the remaining tasks will take, and everyone benefits.

Spread out the fun

Imagine that, late in the project, you're not fixing bugs for twelve hours a day! Instead, you're writing quality code that you're not going to have to come back to later and patch incessantly.

Put your time into thinking up front, and the fun stuff will last all through the project.

Less conflict

Between programmers and between groups.

Pride and productivity

When the quality of your code goes up, you'll feel a sense of pride and accomplishment *throughout* the project, not just when the good reviews come in. Also, Dave Moore has studies that show that when you think consciously about quality, and work to improve it, your productivity also increases. That's rewarding both for you and for the company.

Self-leveling

When projects follow zero-defects strategies, the people who write the best code will get to write more of it. This rewards the best coders and gives everyone a way to measure and improve themselves.

Learning together

This isn't the final word. If you find techniques that help you produce better-quality code, please tell Dave Moore, Doug Klunder, or myself so we can make everyone aware of them.



The Bitter Lesson

Rich Sutton

March 13, 2019

The biggest lesson that can be read from 70 years of AI research is that general methods that leverage computation are ultimately the most effective, and by a large margin. The ultimate reason for this is Moore's law, or rather its generalization of continued exponentially falling cost per unit of computation. Most AI research has been conducted as if the computation available to the agent were constant (in which case leveraging human knowledge would be one of the only ways to improve performance) but, over a slightly longer time than a typical research project, massively more computation inevitably becomes available. Seeking an improvement that makes a difference in the shorter term, researchers seek to leverage their human knowledge of the domain, but the only thing that matters in the long run is the leveraging of computation. These two need not run counter to each other, but in practice they tend to. Time spent on one is time not spent on the other. There are psychological commitments to investment in one approach or the other. And the human-knowledge approach tends to complicate methods in ways that make them less suited to taking advantage of general methods leveraging computation. There were many examples of AI researchers' belated learning of this bitter lesson, and it is instructive to review some of the most prominent.

In computer chess, the methods that defeated the world champion, Kasparov, in 1997, were based on massive, deep search. At the time, this was looked upon with dismay by the majority of computer-chess researchers who had pursued methods that leveraged human understanding of the special structure of chess. When a simpler, search-based approach with special hardware and software proved vastly more effective, these human-knowledge-based chess researchers were not good losers. They said that "brute force" search may have won this time, but it was not a general strategy, and anyway it was not how people played chess. These researchers wanted methods based on human input to win and were disappointed when they did not.

A similar pattern of research progress was seen in computer Go, only delayed by a further 20 years. Enormous initial efforts went into avoiding search by taking advantage of human knowledge, or of the special features of the game, but all those efforts proved irrelevant, or worse, once search was applied effectively at scale. Also important was the use of learning by self play to learn a value function (as it was in many other games and even in chess, although learning did not play a big role in the 1997 program that first beat a world champion). Learning by self play, and learning in general, is like search in that it enables massive computation to be brought to bear. Search and learning are the two most important classes of techniques for utilizing massive amounts of computation in AI research. In computer Go, as in computer chess, researchers' initial effort was directed towards utilizing human understanding (so that less search was needed) and only much later was much greater success had by embracing search and learning.

In speech recognition, there was an early competition, sponsored by DARPA, in the 1970s. Entrants included a host of special methods that took advantage of human knowledge---knowledge of words, of phonemes, of the human vocal tract, etc. On the other side were newer methods that were more statistical in nature and did much more computation, based on hidden Markov models (HMMs). Again, the statistical methods won out over the human-knowledge-based methods. This led to a major change in all of natural language processing, gradually over decades, where statistics and computation came to dominate the field. The recent rise of deep learning in speech recognition is the most recent step in this consistent direction. Deep learning methods rely even less on human knowledge, and use even more computation, together with learning on huge training sets, to produce dramatically better speech recognition systems. As in the games, researchers always tried to make systems that worked the way the researchers thought their own minds worked---they tried to put that knowledge in their systems---but it proved ultimately counterproductive, and a colossal waste of

researcher's time, when, through Moore's law, massive computation became available and a means was found to put it to good use.

In computer vision, there has been a similar pattern. Early methods conceived of vision as searching for edges, or generalized cylinders, or in terms of SIFT features. But today all this is discarded. Modern deep-learning neural networks use only the notions of convolution and certain kinds of invariances, and perform much better.

This is a big lesson. As a field, we still have not thoroughly learned it, as we are continuing to make the same kind of mistakes. To see this, and to effectively resist it, we have to understand the appeal of these mistakes. We have to learn the bitter lesson that building in how we think we think does not work in the long run. The bitter lesson is based on the historical observations that 1) AI researchers have often tried to build knowledge into their agents, 2) this always helps in the short term, and is personally satisfying to the researcher, but 3) in the long run it plateaus and even inhibits further progress, and 4) breakthrough progress eventually arrives by an opposing approach based on scaling computation by search and learning. The eventual success is tinged with bitterness, and often incompletely digested, because it is success over a favored, human-centric approach.

One thing that should be learned from the bitter lesson is the great power of general purpose methods, of methods that continue to scale with increased computation even as the available computation becomes very great. The two methods that seem to scale arbitrarily in this way are *search* and *learning*.

The second general point to be learned from the bitter lesson is that the actual contents of minds are tremendously, irredeemably complex; we should stop trying to find simple ways to think about the contents of minds, such as simple ways to think about space, objects, multiple agents, or symmetries. All these are part of the arbitrary, intrinsically-complex, outside world. They are not what should be built in, as their complexity is endless; instead we should build in only the meta-methods that can find and capture this arbitrary complexity. Essential to these methods is that they can find good approximations, but the search for them should be by our methods, not by us. We want AI agents that can discover like we can, not which contain what we have discovered. Building in our discoveries only makes it harder to see how the discovering process can be done.

December 13th, 1972

Mr. Charles N. Huggins, President,
See's Candy Shops, Inc.,
3423 Larchmont Boulevard,
Los Angeles, California. 90016.

Dear Chuck:

I was out at Brandeis a couple of days ago, and have a few strong impressions to pass along:

1. People are going to be affected not only by how our candy tastes but, obviously, by what they hear about it from others as well as the "retailing environment" in which it appears. The latter includes the class of store, the method of packaging, the condition in which it appears, and the surrounding merchandise. Just as the New Yorker creates a different "editorial environment" for a Lord & Taylor ad than does the Village Voice, so do the surroundings in which our candy is offered affect potential customers' mental - and even gastronomical - impression of our quality. You, of course, know this far better than I.
2. To date, we have always maintained an incredibly pure approach to distribution which undoubtedly contributes substantially to the public's image of our product.
3. At Brandeis, our product suffers in every comparative way against Stover's. They have an extremely well organized, well displayed and attractive area featuring nothing but their candy. Brandeis has taken a number of our boxes and placed them on a counter with 25 other offerings of cheap bulk candy, and other run-of-the-mill products. They have taken a standard card sign out of their own display department and put a few descriptive lines on it, which is not much different than the card next to it which might say "Jelly Beans, 99¢ a lb.". The one open package displaying the contents of our box has pieces out of place, empty wrappers, and generally presents a jumbled appearance.
4. In the case of the average customer at Brandeis, we are not maintaining an image but developing an image. It seems obvious to me that if we push further with department store distribution, we are going to

Mr. Charles N. Huggins
December 13th, 1972
Page #2

have to have very tight controls regarding merchandising conditions. They will have to be offered in a way that establishes them as something very special - and this probably means adequate display area insulated from inferior products, appropriate signs relating to the See's legend, and attractive open display boxes which are packaged so as to insure a first-class presentation.

All of this, of course, reflects the benefit of a first small scale test. If we decide to go ahead, we will have ample time to prepare for next year so that we can be sure we are represented only in quality stores in an absolutely quality manner.

When we get outside of our own territory, we may well want to have some descriptive material. Perhaps we could have a little booklet called "The Most Famous Kitchen in the World", or something of that sort. Coor's gets a lot of mileage out of the fact that all of their beer comes from one brewery, and I do think there is a certain mystique attached to products with a geographical uniqueness. Maybe grapes from one little eighty-acre vineyard in France are really the best in the whole world, but I have always had a suspicion that about 99% of it is in the telling and about 1% is in the drinking.

We might be able to tell quite a story about the little kitchen in California that has become the kitchen known 'round the world. If we prepare something along this line, it ought to be extremely well done and should form the basis of the legend that we eventually want to have permeate the country. Such a booklet, along with really classy display and appropriate advertising by Marshall Field's, Rich's, Jordan Marsh, etc., could well enhance our image rather than diminish it - which would be the case if we merchandised in the Brandeis manner. Incidentally, I also think we should put territorial limitations on the franchise. Younker's should not be allowed to come over to Omaha, nor Brandeis to go to Des Moines and sell the candy. It should be very hard to get, available only periodically, and then (to the consumer) apparently only in limited quantities.

With best personal regards,

Sincerely,

Warren E. Buffett

WEB/glk/

c c: Mr. J. P. Guerin
Mr. C. T. Munger

> To: Warren Buffett, Berkshire <

>

> Subject: Go Huskers!

> Date: Sunday, August 17, 1997 9:37 PM

>

> Warren, I apologize in advance for this being a long note. I do hope
> you find it interesting, and be certain I don't expect a long reply (or
> any reply at all for that matter). Perhaps sometime we'll get a few
> minutes where I can get your reaction to the thoughts on business below.

>

> Go Huskers!

>

> We're looking forward to seeing you in a few weeks for the Husker game.
> Please let me know if there is anything I can do to make your stay in
> Washington more enjoyable (and a little more Husker-oriented!), and I
> will also check with BillG on the plans and how I might help.

>

> I'm sad to say I'm very pessimistic about our prospects. You've
> probably noted that Washington is very highly ranked this year. They
> have Huard, arguably one of the top 2 or 3 pro-style quarterbacks in the
> country - and only a sophomore. And they have an outstanding defense.
> In the meantime, the Huskers are replacing eight starters on defense,
> and the spring game showed that Frost still can't throw the ball well
> enough. Without a balanced attack on offense, we'll have difficulty
> against their speed. And Huard has the potential to pick apart our
> secondary - we'll need an outstanding plan on pass rush, equivalent to
> the "Philadelphia Blitz" employed at the Nebraska vs. Florida Fiesta
> Bowl championship game.

>

> I hope you're hearing better news from fall practice. People here know
> I'm a huge Husker fan - I can't tell you how painful it would be for me
> to go through two more losses to the Huskies.

>

> The Making of An American Capitalist...

>

> Tricia and I took the kids to Disney World, followed by a short vacation
> to Nantucket and Cuttyhunk (a small island off Martha's Vineyard). I
> spent part of the vacation reading Lowenstein's book (The Making of an
> American Capitalist) - and really enjoyed it! On the way from Cuttyhunk
> to Boston/Logan airport, we drove down Cove Road in New Bedford trying
> to find the Berkshire-Hathaway mill. While I saw a few old mills, I'm
> not really sure which might have been the one - I was looking for the
> clock tower. Or perhaps it has been torn down.

>

> The book got me thinking about your golf tournament, the after-dinner
> "Talk with Warren", and the inevitable question - why don't you invest
> in Microsoft or high technology? The Lowenstein book provided some
> stimulus to ponder the question, and I thought it would be fun to share
> some thoughts with you on the subject. But I should emphasize my intent
> in doing so is not to try to change your viewpoint (though I hope it
> doesn't reinforce your view!). I just view this as a fun discussion or
> intellectual exercise. While many people would see our business as
> complicated or hard to understand, I am absolutely convinced an astute
> investor can learn our business in only 3 to 4 hours (and probably less
> than two hours if BillG explained it!).

>

> In some respects I see the business characteristics of Coca Cola or
> See's Candy as being very similar to Microsoft. I think you would love
> the simplicity of the operating system business. E.g. in FY96 there
> were 50 million PC's sold in the world, and about 80% of them were
> licensed for a Microsoft operating system. Although I would never write
> down the analogy of a "toll bridge", people outside our company might
> describe this business in that way. Those 40 million licenses averaged
> about \$45 per, for a total of about \$1.8B in revenue. By the way, the
> remaining 10M PC's were largely running Microsoft operating systems - we
> just didn't get paid for them. This problem - piracy - if reduced, is
> one of the key upsides to our business.

>

> In FY2000, there will be about 100M PC's sold. We think we can reduce
> piracy to 10% and license 90% or 90M of the PC's. But we also have
> "pricing discretion" - I think I heard this term used in conjunction
> with your pricing decisions on See's Candy. We will be transitioning
> the world to a new version of our operating system, Windows NT. Today,
> we get more than \$100 per system for NT, but only on a small percentage
> of the PC's. But NT will be on closer to 70% of the PC's sold in
> FY2000. We can achieve average license revenue of \$80. So 90M licenses
> at \$80 per license totals about \$7.2B, up from just under \$2B in 3 to 4
> years. And since there are effectively no COGs and a WW sales force of
> only 100-150 people this is a 90%+ margin business. There is an R&D
> charge to the business, but I'm sure the profits are probably as good as
> the syrup business!

>

> There is actually upside in the number of PC's sold. Similar to your
> analysis of Coca Cola, the penetration of PC's in International markets
> leaves a lot of room for growth. In the US, the number of PC's per 1000
> people is around 400 or so, but the number drops off rapidly to 100 or
> less in most countries, even in some of the European countries.
> (Unfortunately, I'm not in Seattle now so I don't have these numbers at

> my fingertips, but Steve Ballmer can recite them from memory.)

>

> The business described above is what we call the OEM (Original Equipment
> Manufacturer) business, meaning our revenue comes from the manufacturers
> of the PC's. The majority of the rest of the business is called the
> "finished goods" business. It consists of businesses or individuals
> buying office productivity software, educational or entertainment
> software, etc. Again the structure is very simple. A PC is just a
> razor that needs blades, and we measure our revenue on the basis of \$
> per PC. In FY96, nearly 50M PC's were purchased and Microsoft averaged
> about \$140 in software revenue per PC or \$7B. This amount is in
> addition to the OEM royalty business I described above. (Steve Ballmer
> can recite the number of PCs and \$ per PC to you off the top of his head
> for just about any country in the world; BillG can probably do the same
> though he doesn't spend as much time on that as Steve.)

>

> So in some sense that is it. There are a certain number of PC's that
> get sold, a growing amount of Microsoft software per PC, the power to
> use the brand to sell even more software, some pricing discretion,
> international market growth, and the opportunity to grow revenue by
> further reduction in piracy. Obviously I'm not going through all the
> details we'd discuss in a couple hour session, but that is the heart of
> the business. Of course there is the R&D invested to build the
> software, but that is similar to Disney continuing to produce new
> content, or Nebraska Furniture Mart continuing to keep their format
> fresh, and an investment that BillG manages very closely.

>

> Even some of the new "media" businesses are really not that new or
> different. Take our WebTV acquisition or the Comcast deal. I see
> articles covering those investments and describing Microsoft as becoming
> a media company. The real goal is to figure out a way to get an
> "operating system" royalty per TV. 10's of millions of TV's per year at
> \$10-\$20 per TV is a nice little "operating system" business.

>

> There is a tremendous strategic synergy between the "finished goods
> business" and the OEM operating system business. E.g. we have about 90%
> share of office productivity software with Microsoft Office, and that is
> a great business (about \$5B, also 85%+ operating margin). But also
> important is the fact that this software is heavily valued by the actual
> users (operating systems are a bit more invisible to the user), and they
> resist shifting brands. If we own the key "franchises" built on top of
> the operating system, we dramatically widen the "moat" that protects the
> operating system business. I.e. if I owned the most successful daily
> newspaper in Buffalo, I wouldn't want to leave it to my competitor to
> own the Sunday edition.

>

> Let's build on this analogy and the strategic synergy between the
> operating system and the software that runs on it. It helps explain the
> investments we are making in Pete Higgins business (Interactive Media,
> like MSN, MSNBC, Expedia, Sidewalk, etc.). Again, some newspaper and
> magazine articles would say that Microsoft is trying to become a media
> company. But I prefer to view it as investing in the potential "user
> franchises" that will help protect our operating systems businesses in
> the future. We hope to make a lot of money off these franchises, but
> even more important is that they should protect our Windows royalty per
> PC, and hopefully our royalty per TV. And success in those businesses
> will help increase the opportunity for future pricing discretion.

>

> So I really don't see our business as being significantly more difficult
> to understand than the other great businesses you've invested in. But
> there is one potential difference that worries me, and it is a key part
> of the reason I spent the time to share these thoughts with you. The
> difference I worry about is the "width of the moat." With Coca Cola,
> you can feel pretty confident that there won't be a fast shift in user
> preferences away from drinking sodas, and in particular Coke. In
> technology, we may more frequently see "paradigm shifts" where old
> leaders are displaced by new. Graphical user interface replaces
> character user interface, the Internet explodes, etc.

>

> In the absence of a paradigm shift in technology, market shares seldom
> change by more than a few points. With a paradigm shift, the shares can
> rapidly change by dozens of points. I spent my first ten years at

> Microsoft building Microsoft Office... We were way behind in share most
> of that time (less than 10%), but the shift to graphical user interface
> was the paradigm shift that allowed us to displace the old leaders
> (Lotus 1-2-3 and WordPerfect) and now be at 90% share. Of course key to
> this shift in share, was their failure to identify the computing
> paradigm shift and properly invest in it. They were the leaders and
> they could have chosen to cannibalize themselves. But they didn't act
> fast enough and were scared that investing in the new paradigm would
> open the door for us - ironically it was their slow pace that opened the
> door.
>
> I remember one of our very first conversations in 1991. You asked me my
> view on what happened to IBM. I don't remember exactly what I said. I
> think their addiction to the power they had in the previous generations
> of computing, really blindsided them from the paradigm shift of the PC
> and client-server computing.
>
> In technology, the moats may be narrower. It is amazing how fast the
> Internet exploded. Or how quickly Java gained notoriety. We have some
> great moats, but even so, 18 months ago analyst were questioning whether
> we could move quickly enough. (Obviously, that turned out to be a great
> time to buy Microsoft!)
>
> I am very confident about our business for the next 5 to 10 years. But
> I will admit it is easier to be confident about Coke's business for the
> next 10 years. In short, I've long had this sneaking suspicion that it
> is not that you don't understand this business. (In fact, BillG has
> probably already explained all of the above to you and I apologize for
> boring you with this, but it was fun and good for me to write it down.)
> My theory is that you don't invest in technology or Microsoft because
> you see the moats as narrower; too much risk and the potential for a
> fast paradigm shift that would too quickly undermine your equity
> position.
>
> Since Microsoft is the business I understand (i.e. I have a narrow
> circle of competence!) and I subscribe to your views on investments,
> well over 90% of my net worth is tied up there. (Thanks to BillG, I'm
> well into the nine digit range.) I feel fine about having 90%+ tied up
> in Microsoft. We have a "safety net" of tax free municipal bonds so I
> know the family will be OK if something happens. And we don't intend to
> leave much to the kids, so I'm simply building a huge pile of chits to
> someday turn back to society. I do wonder about the time period ten or
> twenty or more years down the road. If at some point then the outlook
> for Microsoft has changed, I hope I will have learned enough from your
> approach such that I will have the ability to identify new areas of
> intrinsic value and continue to grow the pile of chits at a high rate.
> But for now, I'm heads down selling more software...
>
> I'm curious as to what you think about the Lowenstein book. I'm sure it
> is difficult to have so much of your life spread across the pages, on
> the other hand, there are so many things for you to be proud of. It was
> great to gain an understanding of Graham's approach, and more
> importantly your significant advancement of the approach. I found the
> arguments of the EMT (efficient market theoreticians) just laughable.
> They should spend a few days at Disney World so they can observe crowd
> theory in action. Believe me, the longest lines don't necessarily
> translate into the best value! But the best part of the book was to
> learn more about your values, and in particular the discipline of
> character that leads to your success in investing. I wish there were a
> magic formula for teaching this to our children!
>
> This leaves me one final task for this note. I've done a very poor job
> of adequately thanking you for all the great things you've done for me -
> golf at Augusta, Seminole, the Buffett Classic, and in particular, the
> opportunity to listen in on great conversations and learn from you. I
> want you to know I've really appreciated your kindness, and if there is
> ever anything I might do to reciprocate, please let me know.
>
> Thanks. Jeff Raikes
>
>

From: Warren Buffett [
Sent: Thursday, August 21, 1997 3:13 PM
To: Jeff Raikes
Subject: Re: Go Huskers!

hi, jeff;

i have so few friends who use e-mail that i only look for it once a week or so (and usually find nothing) so excuse the slowness in responding. I am also reasonably fast at typing but poor in the accuracy department and fine it easier just to plow ahead rather than correct, knowing i am always writing to those who will find a little deciphering an interesting but easy challenge.

I am afraid you have the Husker-Husky situation correctly handicapped. We need a miracle and it's unlikely to happen in a stadium in which Frost will not be able to hear a word he shouts. I hope Osborne has had him working on hand signals all summer.

Your analysis of Microsoft, why i should invest in it, and why I dont could not be more on the money. In effect the company has a royalty on a communication stream that can do nothing but grow. It's as if you were getting paid for every gallon of water starting in a small stream but with added amounts received as tributaries turned the stream into an Amazon. The toughest question is how hard to push prices and I wrote a note to Bill on that after our December meeting last year. Bell should have anticipated Bill and let someone else put in the phone infrastructure while he collected by the minute and distance (and even importance of the call if he could have figured a wait to monitor it) in perpetuity.

Coke is now getting a royalty on swallows; probably 7.2 billion a day if these average gulp is one ounce. I feel 100% sure (perhaps mistakenly) that I know the odds of this continuing--again 100% as long as cola doesn't cause cancer. Bill has an even better royalty-one which I would never bet against but I dont feel i am capable of assessing probabilities about, except to the extent that with a gun to my head and forced to make a guess, I would go with it rather than against. But to calibrate whether my certainty is 80% or 55%, say, for a 20-year run would be folly. If I had to make such decisions, I would do my best but I prefer to structure investing as a no-called-strikes game and just wait for the fat one!

I watched Ted Williams on cable the other day and he referred to a book called the science of hitting which I then ran down. It has a drawing of the batters box in it that he had referred to on the show with lots of little squares in it, all parts of the strike zone. In his favorite spot, the box showed .400 reflecting what he felt he would hit if he only swung at pitches in that area. Low and outside, but still in the strike zone, he got down to .260. Of course, if he had two strikes on him, he was going to swing at that .260 pitch but otherwise he waited for one in the "happy zone" as he put it. I think the same approach makes sense in investing. Your happy zone, because of the business experience you have had, what you see every day, your natural talents, etc. is going to be different than mine. I am sure, moreover that you can hit balls better in my happy zone than I can in yours just because they are fatter pitches in general.

Lets talk more about this when we get together. As a beginner I always feel that when I send off any e-mail, it is going to vanish into the ether and I would hate to have that happen with everything I know. GO HUSKERS---warren

DID HE PITCH THIS CASE TO WASHINGTON?
WHY MR GO DIRECT TO NEWS?

The World's Largest Hedge Fund is a Fraud

EQUITY TRADING FUNDING?

November 7, 2005 Submission to the SEC
Madoff Investment Securities, LLC
www.madoff.com

Opening Remarks:

I am the original source for the information presented herein having first presented my rationale, both verbally and in writing, to the SEC's Boston office in May, 1999 before any public information doubting Madoff Investment Securities, LLC appeared in the press. There was no whistleblower or insider involved in compiling this report. I used the Mosaic Theory to assemble my set of observations. My observations were collected first-hand by listening to fund of fund investors talk about their investments in a hedge fund run by Madoff Investment Securities, LLC, a SEC registered firm. I have also spoken to the heads of various Wall Street equity derivative trading desks and every single one of the senior managers I spoke with told me that Bernie Madoff was a fraud. Of course, no one wants to take undue career risk by sticking their head up and saying the emperor isn't wearing any clothes but....

I am a derivatives expert and have traded or assisted in the trading of several billion \$US in options strategies for hedge funds and institutional clients. I have experience managing split-strike conversion products both using index options and using individual stock options, both with and without index puts. Very few people in the world have the mathematical background needed to manage these types of products but I am one of them. I have outlined a detailed set of Red Flags that make me very suspicious that Bernie Madoff's returns aren't real and, if they are real, then they would almost certainly have to be generated by front-running customer order flow from the broker-dealer arm of Madoff Investment Securities, LLC.

Due to the sensitive nature of the case I detail below, its dissemination within the SEC must be limited to those with a need to know. The firm involved is located in the New York Region.

As a result of this case, several careers on Wall Street and in Europe will be ruined. Therefore, I have not signed nor put my name on this report. I request that my name not be released to anyone other than the Branch Chief and Team Leader in the New York Region who are assigned to the case, without my express written permission. The fewer people who know who wrote this report the better. I am worried about the personal safety of myself and my family. Under no circumstances is this report or its contents to be shared with any other regulatory body without my express permission. This report has been written solely for the SEC's internal use.

As far as I know, none of the hedge fund, fund of funds (FOF's) mentioned in my report are engaged in a conspiracy to commit fraud. I believe they are naïve men and women with a notable lack of derivatives expertise and possessing little or no quantitative finance ability.

There are 2 possible scenarios that involve fraud by Madoff Securities:

1. Scenario # 1 (Unlikely): I am submitting this case under Section 21A(e) of the 1934 Act in the event that the broker-dealer and ECN depicted is actually providing the stated

returns to investors but is earning those returns by front-running customer order flow. Front-running qualifies as insider-trading since it relies upon material, non-public information that is acted upon for the benefit of one party to the detriment of another party. Section 21A(e) of the 1934 Act allows the SEC to pay up to 10% of the total fines levied for insider-trading. We have obtained approval from the SEC's Office of General Counsel, the Chairman's Office, and the bounty program administrator that the SEC is able and willing to pay Section 21A(e) rewards. This case should qualify if insider-trading is involved.

2. Scenario # 2 (**Highly likely**) Madoff Securities is the world's largest Ponzi Scheme. In this case there is no SEC reward payment due the whistle-blower so basically I'm turning this case in because it's the right thing to do. Far better that the SEC is proactive in shutting down a Ponzi Scheme of this size rather than reactive.

Who Does This Mean?

Who: The politically powerful Madoff family owns and operates a New York City based broker-dealer, ECN, and what is effectively the world's largest hedge fund. Bernard "Bernie" Madoff, the family patriarch started the firm.

According to the www.madoff.com website, "Bernard L. Madoff was one of the five broker-dealers most closely involved in developing the NASDAQ Stock Market. He has been chairman of the board of directors of the NASDAQ Stock Market as well as a member of the board of governors of the NASD and a member of numerous NASD committees. Bernard Madoff was also a founding member of the International Securities Clearing Corporation in London.

His brother, Peter B. Madoff has served as vice chairman of the NASD, a member of its board of governors, and chairman of its New York region. He also has been actively involved in the NASDAQ Stock Market as a member of its board of governors and its executive committee and as chairman of its trading committee. He also has been a member of the board of directors of the Security Traders Association of New York. He is a member of the board of directors of the Depository Trust Corporation.

What:

1. The family runs what is effectively the world's largest hedge fund with estimated assets under management of at least \$20 billion to perhaps \$50 billion, but no one knows exactly how much money BM is managing. That we have what is effectively the world's largest hedge fund operating underground is plainly put shocking. But then again, we don't even know the size of the hedge fund industry so none of this should be surprising. A super-sized fraud of this magnitude was bound to happen given the lack of regulation of these off-shore entities. My best guess is that approximately \$30 billion is involved.
2. However the hedge fund isn't organized as a hedge fund by Bernard Madoff (BM) yet it acts and trades exactly like one. BM allows third party Fund of Funds (FOF's) to private label hedge funds that provide his firm, Madoff Securities, with equity tranche funding. In return for equity tranche funding, BM runs a trading strategy, as agent, whose returns flow to the third party FOF hedge funds and their investors who put up equity capital to

for responsible?

fund BM's broker-dealer and ECN operations. BM tells investors it earns its fees by charging commissions on all of the trades done in their accounts.

*very/slow move
no > 1%
AS does > 1%
partly ok with us
is never*

Red Flag # 1: Why would a US broker-dealer organize and fund itself in such an unusual manner? Doesn't this seem to be an unseemly way of operating under the regulator's radar screens? Why aren't the commissions charged fully disclosed to investors? Can a SEC Registered Investment Advisor charge both commissions and charge a principle fee for trades? **MOST IMPORTANTLY**, why would BM settle for charging only undisclosed commissions when he could earn standard hedge fund fees of 1% management fee + 20% of the profits? Doing some simple math on BM's 12% average annual return stream to investors, the hedge fund, before fees, would have to be earning average annual returns of 16%. Subtract out the 1% management fee and investors are down to 15%. 20% of the profits would amount to 3% (.20 x 15% = 3% profit participation) so investors would be left with the stated 12% annual returns listed in Attachment 1 (Fairfield Sentry Ltd. Performance Data). Total fees to the third party FOF's would amount to 4% annually. Now why would BM leave 4% in average annual fee revenue on the table unless he were a Ponzi Scheme? Or, is he charging a whole lot more than 4% in undisclosed commissions?

*Does not care
to basic it
in funds
term advisory*

3. The third parties organize the hedge funds and obtain investors but 100% of the money raised is actually managed by Madoff Investment Securities, LLC in a purported hedge fund strategy. The investors that pony up the money don't know that BM is managing their money. That Madoff is managing the money is purposely kept secret from the investors. Some prominent US based hedge fund, fund of funds, that "invest" in BM in this manner include:
 - A. Fairfield Sentry Limited (Arden Asset Management) which had \$5.2 billion invested in BM as of May 2005; 11th Floor, 919 Third Avenue; New York, NY 10022; Telephone 212.319.606; The Fairfield Greenwich Group is a global family of companies with offices in New York, London and Bermuda, and representative offices in the U.S., Europe and Latin America. Local operating entities are authorized or regulated by a variety of government agencies, including Fairfield Greenwich Advisors LLC, a U.S. SEC registered investment adviser, Fairfield Heathcliff Capital LLC, a U.S. NASD member broker-dealer, and Fairfield Greenwich (UK) Limited, authorized and regulated by the Financial Services Authority in the United Kingdom.
 - B. Access International Advisors; www.aiagroup.com; a SEC registered investment advisor, telephone # 212.223.7167; Suite 2206; 509 Madison Avenue, New York, NY 10022 which had over \$450 million invested with BM as of mid-2002. The majority of this FOF's investors are European, even though the firm is US registered.
 - C. Broyhill All-Weather Fund, L.P. had \$350 million invested with BM as of March 2000.
 - D. Tremont Capital Management, Inc. Corporate Headquarters is located at 555 Theodore Fremd Avenue; Rye, New York 10580; T: (914) 925-1140 F: (914) 921-3499. Tremont oversees on an advisory and fully discretionary basis over \$10.5 billion in assets. Clients include institutional investors, public and private pension plans, ERISA plans, university endowments, foundations, and financial institutions, as well as high net worth individuals. Tremont is owned by Oppenheimer Funds Inc. which is owned by Mass Mutual Insurance Company so they should have sufficient reserves to make investors whole. Mass Mutual is currently under investigation by the Massachusetts Attorney General, the Department of Justice, and the SEC.

- NAPS?
- E. During a 2002 marketing trip to Europe every hedge fund FOF I met with in Paris and Geneva had investments with BM. They all said he was their best manager! A partial list of money managers and Private Banks that invest in BM is included at the end of this report in Attachment 3.
 - 4. Here's what smells bad about the idea of providing equity tranche funding to a US registered broker-dealer:
 - A. The investment returns passed along to the third party hedge funds are equivalent to BM borrowing money. These 12 month returns from 1990 – May 2005 ranged from a low of 6.23% to a high of 19.98%, with an average 12 month return during that time period of 12.00%. Add in the 4% in average annual management & participation fees and BM would have to be delivering average annual returns of 16% in order for the investors to receive 12%. No Broker-Dealer that I've ever heard of finances its operations at that high of an implied borrowing rate (source: Attachment 1; Fairfield Sentry Limited return data from December 1990 – May 2005). Ask around and I'm sure you'll find that BM is the only firm on Wall Street that pays an average of 16% to fund its operations.
 - B. BD's typically fund in the short-term credit markets and benchmark a significant part of their overnight funding to LIBOR plus or minus some spread. LIBOR + 40 basis points would seem a more realistic borrowing rate for a broker-dealer of BM's size.
 - C. *Red Flag # 2: why would a BD choose to fund at such a high implied interest rate when cheaper money is available in the short-term credit markets? One reason that comes to mind is that BM couldn't stand the due diligence scrutiny of the short-term credit markets. If Charles Ponzi had issued bank notes promising 50% interest on 3 month time deposits instead of issuing unregulated Ponzi Notes to his investors, the State Banking Commission would have quickly shut him down. The key to a successful Ponzi Scheme is to promise lucrative returns but to do so in an unregulated area of the capital markets. Hedge funds are not due to fall under the SEC's umbrella until February 2006.*
 - 5. The third party hedge funds and fund of funds that market this hedge fund strategy that invests in BM don't name and aren't allowed to name Bernie Madoff as the actual manager in their performance summaries or marketing literature. Look closely at Attachment 1, Fairfield Sentry Ltd.'s performance summary and you won't see BM's name anywhere on the document, yet BM is the actual hedge fund manager with discretionary trading authority over all funds, as agent.
Red Flag # 3: Why the need for such secrecy? If I was the world's largest hedge fund and had great returns, I'd want all the publicity I could garner and would want to appear as the world's largest hedge fund in all of the industry rankings. Name one mutual fund company, Venture Capital firm, or LBO firm which doesn't brag about the size of their largest funds' assets under management. Then ask yourself, why would the world's largest hedge fund manager be so secretive that he didn't even want his investors to know he was managing their money? Or is it that BM doesn't want the SEC and FSA to know that he exists?
 - 6. The third party FOF's never tell investors who is actually managing their money and describe the investment strategy as: This hedge fund's objective is long term growth on

Investor - US Equity

a consistent basis with low volatility. The investment advisor invests exclusively in the U.S. and utilizes a strategy often referred to as a "split-strike conversion." Generally this style involves purchasing a basket of 30 – 35 large-capitalization stocks with a high degree of correlation to the general market (e.g. American Express, Boeing, Citigroup, Coca-Cola, Dupont, Exxon, General Motors, IBM, Merck, McDonalds). To provide the desired hedge, the manager then sells out-of-the-money OEX index call options and buys out-of-the-money OEX index put options. The amount of calls that are sold and puts that are bought represent a dollar amount equal to the basket of shares purchases.

7. I personally have run split-strike conversion strategies and know that BM's approach is far riskier than stated in 6 above. His strategy is wholly inferior to an all index approach and is wholly incapable of generating returns in the range of 6.23% to 19.98%. BM's strategy should not be able beat the return on US Treasury Bills Due to the glaring weakness of the strategy:

A. Income Part of the strategy is to buy 30 – 35 large-cap stocks, sell out-of-the-money index call options against the value of the stock basket. There are three possible sources of income in this strategy.

- 1) We earn income from the stock's dividends. Let's attribute a 2% average return to this source of funds for the 14 ½ year time period. This explains 2% of the 16% average gross annual returns before fees and leaves 14% of the returns unexplained.
- 2) We earn income from the sale of OTC OEX index call options. Let's also assume that we can generate an additional 2% annual return via the sale of OTC out-of-the-money OEX index call options which leaves 12% of the 16% gross returns unexplained. On Friday, October 14, 2005 the OEX (S&P 100) index closed at 550.49 and there were only 163,809 OEX index call option contracts outstanding (termed the "open interest"). 163,809 call option calls outstanding x \$100 contact multiplier x 550.49 index closing price = \$9,017, 521,641 in stock equivalents hedged.
- 3) We can earn income from capital gains by selling the stocks that go up in price. This portion of the return stream would have to earn the lion's share of the hedge fund strategy's returns. We have 12% of the return stream unexplained so far. However, the OTC OEX index puts that we buy will cost AT LEAST <8%> per year (a lot more in most years but I'm giving BM the benefit of every doubt here). Therefore, BM's stock selection would have to be earning an average of 20% per year. That would mean that he's been the world's best stock-picker since 1990 beating out such luminaries as Warren Buffet and Bill Miller. Yet no one's ever heard of BM as being a stock-picker, much less the world's best stock-picker. Why isn't he famous if he was able to earn 20% average annual returns?

Red Flag # 4: *\$9,017 billion in total OEX listed call options outstanding is not nearly enough to generate income on BM's total amount of assets under management which I estimate to range between \$20 - \$50 billion. Fairfield Sentry Ltd. alone has \$5.1 billion with BM. And, while BM may say he only uses Over-the-Counter(OTC) index options, there is no way that this is*

possible. The OTC market should never be several times larger than the exchange listed market for this type of plain vanilla derivative.

- B. Protection Part of the strategy is to buy out-of-the-money OEX index put options. This costs you money each and every month. This hurts your returns and is the main reason why BM's strategy would have trouble earning 0% average annual returns much less the 12% net returns stated in Fairfield Sentry Ltd.'s performance summary. Even if BM earns a 4% return from the combination of 2% stock dividends and 2% from the sale of call options, the cost of the puts would put this strategy in the red year in and year out. No way he can possibly be delivering 12% net to investors. The math just doesn't support this strategy if he's really buying index put options.
- Red Flag # 5:** *BM would need to be purchasing at-the-money put options because he has only 7 small monthly losses in the past 14 ½ years. His largest monthly loss is only <0.55%>, so his puts would have to be at-the-money. At-the-money put options are very, very expensive. A one-year at-the-money put option would cost you <8%> or more, depending upon the market's volatility. And <8%> would be a cheap price to pay in many of the past 14 ½ years for put protection!! Assuming BM only paid <8%> per year in put protection, and assuming he can earn +2% from stock dividends plus another +2% from call option sales, he's still under-water <4%> performance wise. <8%> put cost + 2% stock dividends + 2% income from call sales = <4%>. And, I've proven that BM would need to be earning at least 16% annually to deliver 12% after fees to investors. That means the rest of his returns would have to be coming from stock selection where he picked and sold winning stocks to include in his 35-stock basket of large-cap names. Lots of luck doing that during the past stock market crises like 1997's Asian Currency Crises, the 1998 Russian Debt / LTCM crises, and the 2000-2002 killer bear market. And index put option protection was a lot more expensive during these crises periods than 8%. Mathematically none of BM's returns listed in Attachment 1 make much sense. They are just too unbelievably good to be true.*
- C. The OEX index (S&P 100) closed at 550.49 on Friday, October 14, 2005 meaning that each put option hedged \$55,049 dollars worth of stock (\$100 contract multiplier x 550.49 OEX closing index price = \$55,049 in stock hedged). As of that same date, the total open interest for OEX index put options was 307,176 contracts meaning that a total of \$16,909,731,624 in stock was being hedged by the use of OEX index puts (307,176 total put contracts in existence as of Oct 14th x \$55,049 hedge value of 1 OEX index put = \$16,909,731,624 in stock hedged). Note: I excluded a few thousand OEX LEAP index put options from my calculations because these are long-term options and not relevant for a split-strike conversion strategy such as BM's.
- Red Flag # 6:** *At my best guess level of BM's assets under management of \$30 billion, or even at my low end estimate of \$20 billion in assets under management, BM would have to be over 100% of the total OEX put option contract open interest in order to hedge his stock holdings as depicted in the third party hedge funds marketing literature. In other words, there are not enough index option put contracts in existence to hedge the way BM says he is hedging! And there is no*

way the OTC market is bigger than the exchange listed market for plain vanilla S&P 100 index put options.

- D. Mathematically I have proven that BM cannot be hedging using listed index put and call options. One hedge fund FOF has told me that BM uses only Over-the-Counter options and trades exclusively thru UBS and Merrill Lynch. I have not called those two firms to check on this because it seems implausible that a BD would trade \$20 - \$50 billion worth of index put options per month over-the-counter thru only 2 firms. That plus the fact that if BM was really buying OTC index put options, then there is no way his average annual returns could be positive!! At a minimum, using the cheapest way to buy puts would cost a fund <8%> per year. To get the put cost down to <8%>, BM would have to buy a one-year at-the-money put option and hold it for one-year. No way his call sales could ever hope to come even fractionally close to covering the cost of the puts.

Red Flag # 7: The counter-party credit exposures for UBS and Merrill would be too large for these firms credit departments to approve. The SEC should ask BM for trade tickets showing he has traded OTC options thru these two firms. Then the SEC should visit the firms' OTC derivatives desks, talk to heads of trading and ask to see BM's trade tickets. Then ask the director of operations to verify the tickets and ask to see the inventory of all of the stock and listed options hedging the OTC puts and calls. If these firms can't show you the off-setting hedged positions then they are assisting BM as part of a conspiracy to commit fraud. If any other brokerage firm's equity derivatives desk is engaged in a conspiracy to cover for BM, then this scandal will be a doozy when it hits the financial press but at least investors would have firms with deep pockets to sue.

Red Flag # 8: OTC options are more expensive to trade than listed options. You have to pay extra for the customization features and secrecy offered by OTC options. Trading in the size of \$20 - \$50 billion per month would be impossible and the bid-ask spreads would be so wide as to preclude earning any profit whatsoever. These Broker/Dealers would need to offset their short OTC index put option exposure to a falling stock market by hedging out their short put option risk by either buying listed put options or selling short index futures and the derivatives markets are not deep and liquid enough to accomplish this without paying a penalty in prohibitively expensive transaction costs.

Red Flag # 9: Extensive and voluminous paperwork would be required to keep track of and clear each OTC trade. Plus, why aren't Goldman, Sachs and Citigroup involved in handling BM's order flow? Both Goldman and Citigroup are a lot larger in the OTC derivatives markets than UBS or Merrill Lynch.

- E. My experience with split-strike conversion trades is that the best a good manager is likely to obtain using the strategy marketed by the third-party FOF's is T-bills less management fees. And, if the stock market is down by more than 2%, the return from this strategy will range from a high of zero return to a low of a few percent depending upon your put's cost and how far out-of-the-money it is.
- F. In 2000 I ran a regression of BM's hedge fund returns using the performance data from Fairfield Sentry Limited. BM had a .06 correlation to the equity market's return which confirms the .06 Beta that Fairfield Sentry Limited lists in its return numbers.

WMB

Red Flag # 10: *It is mathematically impossible for a strategy using index call options and index put options to have such a low correlation to the market where its returns are supposedly being generated from. This makes no sense! The strategy depicted retains 100% of the single-stock downside risk since they own only index put options and not single stock put options. Therefore if one or more stocks in their portfolio were to tank on bad news, BM's index put would offer little protection and their portfolio should feel the pain. However, BM's performance numbers show only 7 extremely small losses during 14 ½ years and these numbers are too good to be true. The largest one month loss was only -55 basis points (-0.55%) or just over one-half of one percent! And BM never had more than a one month losing streak! Either BM is the world's best stock and options manager that the SEC and the investing public has never heard of or he's a fraud. You would have to figure that at some point BM owned a WorldCom, Enron, GM or HealthSouth in their portfolio when bad or really bad news came out and caused these stocks to drop like a rock.*

8. **Red Flag # 11** *Two press articles, which came to print well after my initial May 1999 presentation to the SEC, do doubt Bernie Madoff's returns and they are:*
 - A. The May 7, 2001 edition of Barron's, in an article entitled, "**Don't Ask, Don't Tell; Bernie Madoff is so secretive, he even asks his investors to keep mum,**" written by Erin Arvedlund, published an expose about Bernie Madoff a few years ago with no resulting investigation by any regulators. Ms. Arvedlund has since left Barron's. I have attached a copy of the Barrons' article which lists numerous red flags.
 - B. Michael Ocrant, formerly a reporter for MAR Hedge visited Bernie Madoff's offices and wrote a very negative article that doubted the source of BM's returns. He reported to a colleague that he saw some very unusual things while at Madoff's offices. The SEC should contact him. Michael Ocrant is currently serving as the Director of Alternative Investments; Institutional Investor; New York, NY 10001; Telephone # 212-224-3821 or 212-213-6202; Email: mocrant@iiconferences.com
9. Fund of funds with whom I have spoken to that have BM in their stable of funds continually brag about their returns and how they are generated thanks to BM's access to his broker-dealer's access to order flow. They believe that BM has perfect knowledge of the market's direction due to his access to customer order flow into his broker-dealer.
Red Flag # 12: *Yes, BM has access to his customer's order flow thru his broker-dealer but he is only one broker out of many, so it is impossible for him to know the market's direction to such a degree as to only post monthly losses once every couple of years. All of Wall Street's big wire houses experience trading losses on a more regular frequency than BM. Ask yourself how BM's trading experience could be so much better than all of the other firms on Wall Street. Either he's the best trading firm on the street and rarely ever has large losing months unlike other firms or he's a fraud.*
10. **Red Flag # 13:** *I believe that BM's returns can be real ONLY if they are generated from front-running his customer's order flow. In other words, yes, if he's buying at a penny above his customer's buy orders, he can only lose one penny if the stock drops but can*

make several pennies if the stock goes up. For example, if a customer has an order to buy 100,000 shares of IBM at \$100, BM can put in his own order to buy 100,000 share of IBM at \$100.01. This is what's known as a right-tail distribution and is very similar to the payoff distribution of a call option. Doing this could easily generate returns of 30% - 60% or more per annum. He could be doing the same thing by front-running customer sell orders. However, if BM's returns are real but he's generating them from front-running there are two problems with this:

- A. Problem # 1: front-running is one form of insider-trading and is illegal*
- B. Problem # 2: generating real returns from front-running but telling hedge fund investors that you are generating the returns via a complex (but unworkable) stock and options strategy is securities fraud.*

Some time ago, during different market conditions, I ran a study using the Black-Scholes Option Pricing Model to analyze the value of front-running with the goal of putting a monetary value on front-running where the insider knew the customer's order and traded ahead of it. When I ran the study the model inputs were valued at: OEX component stocks annualized volatility on a cap-weighted basis was 50% (during a bear market period), the T-bill rate was 5.80%, and the average stock price was \$46. I then calculated the value of an at-the-money call options over time intervals of 1 minute, 5 minutes, 10 minutes, and 15 minutes. I used a 253 trading day year. The SEC should be able to duplicate these results:

1 minute option = 3 cents worth of trade information value
5 minute option = 7 cents worth of trade information value
10 minute option = 10 cents worth of trade information value
15 minute option = 12 cents worth of trade information value

Conclusion: Bernie Madoff used to advertise in industry trade publications that he would pay 1 cent per share for other broker's order flow. If he was paying 1 cent per share for order flow and front-running these broker's customers, then he could easily be earning returns in the 30% - 60% or higher annually. In all time intervals ranging from 1 minute to 15 minutes, having access to order flow is the monetary equivalent of owning a valuable call option on that order. The value of these implicit call options ranges between 3 - 12 times the one penny per share paid for access to order flow. If this is what he's doing, then the returns are real but the stated investment strategy is illegal and based solely on insider-trading.

NOTE: I am pretty confident that BM is a Ponzi Scheme, but in the off chance he is front-running customer orders and his returns are real, then this case qualifies as insider-trading under the SEC's bounty program as outlined in Section 21A(e) of the 1934 Act. However, if BM was front-running, a highly profitable activity, then he wouldn't need to borrow funds from investors at 16% implied interest. Therefore it is far more likely that BM is a Ponzi Scheme. Front-running is a very simple fraud to commit and requires only access to inside information. The elaborateness of BM's fund-raising, his need for secrecy, his high 16% average cost of funds, and reliance on a derivatives investment scheme that few investors (or regulators) would be capable of comprehending lead to a weight of the evidence conclusion that this is a Ponzi Scheme.

David Madoff

11. **Red Flag # 14:** *Madoff subsidizes down months! Hard to believe (and I don't believe this) but I've heard two FOF's tell me that they don't believe Madoff can make money in big down months either. They tell me that Madoff "subsidizes" their investors in down months, so that they will be able to show a low volatility of returns. These types of stories are commonly found around Ponzi Schemes. These investors tell me that Madoff only books winning tickets in their accounts and "eats the losses" during months when the market sells off hard. The problem with this is that it's securities fraud to misstate either returns or the volatility of those returns. These FOF professionals who heard BM tell them that he subsidizes losses were professionally negligent in not turning BM into the SEC, FSA and other regulators for securities fraud.*

Red Flag # 15: *Why would a fund of funds investor believe any broker-dealer that commits fraud in a few important areas – such as misstating returns and misstating volatility of returns – yet believe him in other areas? I'd really like to believe in the tooth fairy, but I don't after catching my mother putting a quarter underneath my pillow one night.*

12. **Red Flag # 16:** *Madoff has perfect market-timing ability. One investor told me, with a straight face, that Madoff went to 100% cash in July 1998 and December 1999, ahead of market declines. He said he knows this because Madoff faxes his trade tickets to his firm and the custodial bank. However, since Madoff owns a broker-dealer, he can generate whatever trade tickets he wants. And, I'll bet very few FOF's ask BM to fax them trade tickets. And if these trade tickets are faxed, have the FOF's then matched them to the time and sales of the exchanges? For example, if BM says he bot 1 million shares of GM, sold \$1 million worth of OTC OEX calls and bot \$1 million worth of OTC OEX puts, we should see prints somewhere. The GM share prints would show on either the NYSE or some other exchange while the broker-dealers he traded OTC options thru would show prints of the hedges they traded to be able to provide BM with the OTC options at the prices listed on BM's trade tickets.*

*One more fraud
The Fund - No*

13. **Red Flag # 17:** *Madoff does not allow outside performance audits. One London based hedge fund, fund of funds, representing Arab money, asked to send in a team of Big 4 accountants to conduct a performance audit during their planned due diligence. They were told "No, only Madoff's brother-in-law who owns his own accounting firm is allowed to audit performance for reasons of secrecy in order to keep Madoff's proprietary trading strategy secret so that nobody can copy it. Amazingly, this fund of funds then agreed to invest \$200 million of their client's money anyway, because the low volatility of returns was so attractive!! Let's see, how many hedge funds have faked an audited performance history?? Wood River is the latest that comes to mind as does the Manhattan Fund but the number of bogus hedge funds that have relied upon fake audits has got to number in the dozens.*

14. **Red Flag # 18:** *Madoff's returns are not consistent with the one publicly traded option income fund with a history as long as Madoff's. In 2000, I analyzed the returns of Madoff and measured them against the returns of the Gateway Option Income Fund (Ticker GATEX). During the 87 month span analyzed, Madoff was down only 3 months versus GATEX being down 26 months. GATEX earned an annualized return of 10.27% during the period studied vs. 15.62% for Bernie Madoff and 19.58% for the S&P 500. GATEX has a more flexible investment strategy than BM, so GATEX's returns should be*

superior to BM's but instead they are inferior. This makes no sense. How could BM be better using an inferior strategy?

- 15. Red Flag # 19:** *There have been several option income funds that went IPO since August 2004. None of them have the high returns that Bernie Madoff has. How can this be? They use similar strategies only they should be making more than BM in up months because most of these option income funds don't buy expensive index put options to protect their portfolios. Thus the publicly traded option income funds should make more money in up markets and lose more than Madoff in down markets. Hmm....that Madoff's returns are so high yet he buys expensive put options is just another reason to believe he is running the world's largest Ponzi Scheme. A good study for the SEC would be to compare 2005 performance of the new option income funds to Bernie Madoff while accounting for the cost of Bernie's index put option protection. There's no way Bernie can have positive returns in 2005 given what the market's done and where volatility is.*
- 16. Red Flag # 20:** *Madoff is suspected of being a fraud by some of the world's largest and most sophisticated financial services firms. Without naming names, here's an abbreviated tally:*

- A. A managing director at Goldman, Sachs prime brokerage operation told me that his firm doubts Bernie Madoff is legitimate so they don't deal with him.
- B. From an Email I received this past June 2005 I now suspect that the end is near for BM. All Ponzi Schemes eventually topple of their own weight once they become too large and it now appears that BM is having trouble meeting redemptions and is attempting to borrow sizeable funds in Europe.

*JAN RBC
DS RBC*
ABCDEF GH and I had dinner with a savvy European investor that studies the HFOF market. He stated that both RBC and Socgen have removed Madoff some time ago from approved lists of individual managers used by investors to build their own tailored HFOFs.

More importantly, Madoff was turned down, according to this source, for a borrowing line from a Euro bank, I believe he said Paribas. Now why would Madoff need to borrow more funds? This Euro Investor said that Madoff was in fact running "way over" our suggested \$12-14 billion (Fairfield Sentry is running \$5.3 BB by themselves!). Madoff's 12 month returns is about 7% net of the feeder fund's fees. Looks like he is stepping down the pay out.

- C. An official from a Top 5 money center bank's FOF told me that his firm wouldn't touch Bernie Madoff with a ten foot pole and that there's no way he's for real.
- 17. Red Flag # 21:** *ECN's didn't exist prior to 1998. Madoff makes verbal claims to his third party hedge FOF's that he has private access to ECN's internal order flow, which Madoff pays for, and that this is a substantial part of the return generating process. If this is true, then where did the returns come from in the years 1991 – 1997, prior to the ascendance of the ECN's? Presumably, prior to 1998, Madoff only had access to order flow on the NASDAQ for which he paid 1 cent per share for. He would have no such advantage pre-1998 on the large-cap, NYSE listed stocks the marketing literature says he buys (Exxon, McDonalds, American Express, IBM, Merck, etc...).*

- 18. Red Flag # 22:** *The Fairfield Sentry Limited Performance Chart (Attachment 1) depicted for Bernie Madoff's investment strategy are misleading. The S&P 500 return line is accurate because it is moving up and down, reflecting positive and negative returns. Fairfield Sentry's performance chart is misleading, it is almost a straight line rising at a 45 degree angle. This chart cannot be cumulative in the common usage of the term for reporting purposes, which means "geometric returns." The chart must be some sort of arithmetic average sum, since a true*

cumulative return line, given the listed monthly returns would be exponentially rising (i.e. curving upward at an increasing rate). My rule of thumb is that if the manager misstates his performance, you can't trust him. Yet somehow Madoff is now running the world's largest, most clandestine hedge fund so clearly investors aren't doing their due diligence. And why does he provide the S&P 500 as his benchmark when he is actually managing using a S&P 100 strategy? Shouldn't the performance line presented be the S&P 100's (OEX) performance?

19. Red Flag # 23: *Why is Bernie Madoff borrowing money at an average rate of 16.00% per annum and allowing these third party hedge fund, fund of funds to pocket their 1% and 20% fees bases upon Bernie Madoff's hard work and brains? Does this make any sense at all? Typically FOF's charge only 1% and 10%, yet BM allows them the extra 10%. Why? And why do these third parties fail to mention Bernie Madoff in their marketing literature? After all he's the manager, don't investors have a right to know who's managing their money?*

20. Red Flag # 24: *Only Madoff family members are privy to the investment strategy. Name one other prominent multi-billion dollar hedge fund that doesn't have outside, non-family professionals involved in the investment process. You can't because there aren't any. Michael Ocrant, the former MAR Hedge Reporter listed above saw some highly suspicious red flags during his visit to Madoff's offices and should be interviewed by the SEC as soon as possible.*

21. Red Flag # 25: *The Madoff family has held important leadership positions with the NASD, NASDAQ, SIA, DTC, and other prominent industry bodies therefore these organizations would not be inclined to doubt or investigate Madoff Investment Securities, LLC. The NASD and NASDAQ do not exactly have a glorious reputation as vigorous regulators untainted by politics or money.*

22. Red Flag # 26: *BM goes to 100% cash for every December 31st year-end according to one FOF invested with BM. This allows for "cleaner financial statements" according to this source. Any unusual transfers or activity near a quarter-end or year-end is a red flag for fraud. Recently, the BD REFCO Securities engaged in "fake borrowing" with Liberty, a hedge fund, that made it appear that Liberty owed REFCO over \$400 million in receivables. This allowed REFCO to mask its true debt position and made all of their equity ratios look better than they actually were. And of course, Grant Thornton, REFCO's external auditor missed this \$400 million entry. As did the two lead underwriters who were also tasked with due-diligence on the IPO - CSFB and Goldman Sachs. BM uses his brother-in-law as his external auditor, so in this case there isn't even the façade of having an independent and vigilant auditor verifying the accounting entries.*

23. Red Flag # 27: *Several equity derivatives professionals will all tell you that the split-strike conversion strategy that BM runs is an outright fraud and cannot possibly achieve 12% average annual returns with only 7 down months during a 14 ½ year time period. Some derivatives experts that the SEC should call to hear their opinions of how and why BM is a fraud and for some insights into the mathematical reasons behind their belief, the SEC should call:*

- a. Leon Gross, Managing Director of Citigroup's world-wide equity derivatives research unit; 3rd Floor, 390 Greenwich Street; New York, NY 10013: Tel# 800.492.9833 or 212.723.7873 or leon.j.gross@citigroup.com [Leon can't believe that the SEC hasn't shut down Bernie Madoff yet. He's also amazed that FOF's actually believe this stupid options strategy is capable of earning a positive return much less a 12% net average annual return. He thinks the strategy would have trouble earning 1% net much less 12% net. Leon is a free spirit, so if you ask him he'll tell you but you'd understand it better if you met him at his

workplace in a private conference room and tell him he won't need to have Citigroup lawyers present, you're just there for some friendly opinions. He talks derivatives at a high level, so ask simple "yes or no" type questions to start off the interview then drill down.]

- b. Walter "Bud" Haslett, CFA; Write Capital Management, LLC; Suite 455; 900 Briggs Road; Mount Laurel, NJ 08065; Tel#: 856.727.1700 or bud.haslett@writecapital.com www.writecapital.com [Bud's firm runs \$ hundreds of millions in options related strategies and he knows all of the math.]
- c. Joanne Hill, Ph.D.; Vice-President and global head of equity derivatives research, Goldman Sachs (NY), 46th Floor; One New York Plaza, New York, NY 10004; Tel# 212.902.2908 [Again, make sure she doesn't lawyer up or this conversation will be useless to you. Tell her you want her opinion and no one will hold her to it or ever tell she gave the SEC an opinion without legal counsel present.]

24. **Red Flag # 28:** *BM's Sharpe Ratio of 2.55 (Attachment 1: Fairfield Sentry Ltd. Performance Data) is UNBELIEVABLY HIGH compared to the Sharpe Ratios experienced by the rest of the hedge fund industry. The SEC should obtain industry hedge fund rankings and see exactly how outstanding Fairfield Sentry Ltd.'s Sharpe Ratio is. Look at the hedge fund rankings for Fairfield Sentry Ltd. and see how their performance numbers compare to the rest of the industry. Then ask yourself how this is possible and why hasn't the world come to acknowledge BM as the world's best hedge fund manager?*
25. **Red Flag # 29:** *BM tells the third party FOF's that he has so much money under management that he's going to close his strategy to new investments. However, I have met several FOF's who brag about their "special access" to BM's capacity. This would be humorous except that too many European FOF's have told me this same seductive story about their being so close to BM that he'll waive the fact that he's closed his funds to other investors but let them in because they're special. It seems like every single one of these third party FOF's has a "special relationship" with BM.*

Conclusions:

1. I have presented 174 months (14 ½ years) of Fairfield Sentry's return numbers dating back to December 1990. Only 7 months or 4% of the months saw negative returns. Classify this as "definitely too good to be true!" No major league baseball hitter bats .960, no NFL team has ever gone 96 wins and only 4 losses over a 100 game span, and you can bet everything you own that no money manager is up 96% of the months either. It is inconceivable that BM's largest monthly loss could only be -0.55% and that his longest losing streaks could consist of 1 slightly down month every couple of years. Nobody on earth is that good of a money manager unless they're front-running.
2. There are too many red flags to ignore. REFCO, Wood River, the Manhattan Fund, Princeton Economics, and other hedge fund blow ups all had a lot fewer red flags than Madoff and look what happened at those places.
3. Bernie Madoff is running the world's largest unregistered hedge fund. He's organized this business as "hedge fund of funds private labeling their own hedge funds which Bernie Madoff **secretly** runs for them using a split-strike conversion strategy getting paid only trading commissions which are not disclosed." If this isn't a regulatory dodge, I don't know what is. This is back-door marketing and financing scheme that is opaque and rife with hidden fees (he charges only commissions on the trades). If this product isn't marketed correctly, what is the chance that it is managed correctly? In my financial industry experience, I've found that wherever there's one cockroach in plain sight, many more are lurking behind the corner out of plain view.
4. Mathematically this type of split-strike conversion fund should never be able to beat US Treasury Bills much less provide 12.00% average annual returns to investors net of fees. I and other derivatives professionals on Wall Street will swear up and down that a split-strike conversion strategy cannot earn an average annual return anywhere near the 16% gross returns necessary to be able to deliver 12% net returns to investors.
5. BM would have to be trading more than 100% of the open interest of OEX index put options every month. And if BM is using only OTC OEX index options, it is guaranteed that the Wall Street firms on the other side of those trades would have to be laying off a significant portion of that risk in the exchange listed index options markets. Every large derivatives dealer on Wall Street will tell you that Bernie Madoff is a fraud. Go ask the heads of equity derivatives trading at Morgan Stanley, Goldman Sachs, JP Morgan and Citigroup their opinions about Bernie Madoff. They'll all tell the SEC that they can't believe that BM hasn't been caught yet.
6. The SEC is slated to start overseeing hedge funds in February 2006, yet since Bernie Madoff is not registered as a hedge fund but acting as one but via third party shields, the chances of Madoff escaping SEC scrutiny are very high. If I hadn't written this report, there's no way the SEC would have known to check the facts behind all of these third party hedge funds.

Potential Fall Out if Bernie Madoff turns out to be a Ponzi Scheme:

1. If the average hedge fund is assumed to be levered 4:1, it doesn't take a rocket scientist to realize that there might be anywhere from a few hundred billion on up in selling pressure in the wake of a \$20 - \$50 billion hedge fund fraud. With the hedge fund market estimated to be \$1 trillion, having one hedge fund with 2% - 5% of the industry's assets under management suddenly blow up, it is hard to predict the severity of the resulting shock wave. You just know it'll be unpleasant for anywhere from a few days to a few weeks but the fall out shouldn't be anywhere near as great as that from the Long Term Capital Management Crises. Using the hurricane scale with which we've all become quite familiar with this year, I'd rate BM turning out to be a Ponzi Scheme as a Category 2 or 3 hurricane where the 1998 LTCM Crises was a Category 5.
2. Hedge fund, fund of funds with greater than a 10% exposure to Bernie Madoff will likely be faced with forced redemptions. This will lead to a cascade of panic selling in all of the various hedge fund sectors whether equity related or not. Long-short and market neutral managers will take losses as their shorts rise and their longs fall. Convertible arbitrage managers will lose as the long positions in underlying bonds are sold and the short equity call options are bought to close. Fixed income arbitrage managers will also face losses as credit spreads widen. Basically, most hedge funds categories with two exceptions will have at least one big down month thanks to the unwinding caused by forced redemptions. Dedicated Short Funds and Long Volatility Funds are the two hedge fund categories that will do well.
3. The French and Swiss Private Banks are the largest investors in Bernie Madoff. This will have a huge negative impact on the European capital markets as several large fund of funds implode. I figure one-half to three-quarters of Bernie Madoff's funds come from overseas. The unwinding trade will hurt all markets across the globe but it is the Private European Banks that will fare the worst.
*We told US
An early warning
for us*
4. European regulators will be seen as not being up to the task of dealing with hedge fund fraud. Hopefully this scandal will serve as a long overdue wake-up call for them and result in increased funding and staffing levels for European Financial Regulators.
5. In the US Fairfield Sentry, Broyhill, Access International Advisors, Tremont and several other hedge fund, fund of funds will all implode. There will be a call for increased hedge fund regulation by scared and battered high net worth investors.
6. The Wall Street wire house FOF's are not invested in Madoff's strategy. As far as I know the wire house's internal FOF's all think he's a fraud and have avoided him like the plague. But these very same wire houses often own highly profitable hedge fund prime brokerage operations and these operations will suffer contained, but painful nonetheless, losses from loans to some hedge funds that go bust during the panic selling. As a result, I predict that some investment banks will pull out of the prime brokerage business deeming it too volatile from an earnings standpoint. Damage to Wall Street will be unpleasant in that hedge funds and FOF's are a big source of trading revenues. If the

hedge fund industry fades, Wall Street will need to find another revenue source to replace them.

7. US Mutual fund investors and other long-term investors in main stream investment products will only feel a month or two's worth of pain from the selling cascade in the hedge fund arena but their markets should recover afterwards.
8. Congress will be up in arms and there will be Senate and House hearings just like there were for Long Term Capital Management.
9. The SEC's critics who say the SEC shouldn't be regulating private partnerships will be forever silenced. Hopefully this leads to expanded powers and increased funding for the SEC. Parties that opposed SEC entry into hedge fund regulation will fall silent. The SEC will gain political strength in Washington from this episode but only if the SEC is proactive and launches an immediate, full scale investigation into all of the Red Flags surrounding Madoff Investment Securities, LLC. Otherwise, it is almost certain that NYAG Elliot Spitzer will launch his investigation first and once again beat the SEC to the punch causing the SEC further public embarrassment.
10. Hedge funds will face increased due diligence from regulators, investors, prime brokers and counter-parties which is a good thing and long overdue.

Potential Fall Out if Bernie Madoff is found out to be front-running customer order flow:

1. This would be just one more black eye among many for the brokerage industry and the NYSE and NASDAQ. At this point the reputations of both the NYSE and NASDAQ are already at rock bottom, so there's likely little downside left for these two troubled organizations.
2. The industry wouldn't miss a beat other than for the liquidation of Madoff Investment Securities, LLC. Figure it will be similar to REFCO's demise only there won't be a buyer of the firm given that they cheated customers who would all be embarrassed to remain customers once the news they've been ripped off is on the front-pages. These former customers are more likely to sue for damages than remain customers. Unsecured lenders would face losses but other than that the industry would be better off.
3. At least the returns are real, in which case determining restitution could keep the courts busy for years. The Class Action Bar would be thrilled. A lot of the FOF's are registered offshore in places where the long arm of the law might not reach. My guess is that the fight for the money off-shore would keep dozens of lawyers happily employed for many years.
4. The FOF's would suffer little in the way of damage. All could be counted on to say "*We didn't know the manager was generating returns illegally. We relied upon the NYSE and NASDAQ to regulate their markets and prevent front-running therefore we see no reason to return any funds.*"

Attachments:

1. 2 page Summary of Fairfield Sentry Ltd with performance data from December 1990 – May 2005
2. Copy of the May 7, 2001 Barrons' article, "*Don't Ask, Don't Tell; Bernie Madoff is so secretive, he even asks his investors to keep mum,*" written by Erin E. Arvedlund.
3. Partial list of French and Swiss money-managers and private banks with investments in Bernie Madoff's hedge fund. Undoubtedly there are dozens more European FOF's and Private Banks that are invested with BM.
4. 2 page offering memorandum, faxed March 29, 2001, for an investment in what I believe is Fairfield Sentry Ltd., one of several investment programs run by Madoff Investment Securities, LLC for third party hedge fund, fund of funds. I do not know who the source was who faxed this document since the fax heading is blank. The document number listed at the bottom of the page appears to read I:\Data\WPDOCS\AG_94021597

ATTACHMENT 1: Fairfield Sentry Performance Data

Fairfield Sentry Ltd

Fund Category(s):
Long/Short Equity

Strategy Description:

The Fund seeks to obtain capital appreciation of its assets principally through the utilization of a nontraditional options trading strategy described as "split strike conversion", to which the Fund allocates the predominant portion of its assets. This strategy has defined risk and profit parameters, which may be ascertained when a particular position is established. Set forth below is a description of the "split strike conversion" strategies ("SSC Investments"). The establishment of a typical position entails (i) the purchase of a group or basket of equity securities that are intended to highly correlate to the S&P 100 Index, (ii) the sale of out-of-the-money S&P 100 Index call options in an equivalent contract value dollar amount to the basket of equity securities, and (iii) the purchase of an equivalent number of out-of-the-money S&P 100 Index put options. An index call option is out-of-the-money when its strike price is greater than the current price of the index; an index put option is out-of-the-money when the strike price is lower than the current price of the index. The basket typically consists of approximately 35 to 45 stocks in the S&P 100. The logic of this strategy is that once a long stock position has been established, selling a call against such long position will increase the standstill rate of return, while allowing upward movement to the short call strike price. The purchase of an out-of-the-money put, funded with part or all of the call premium, protects the equity position from downside risk. A bullish or bearish bias of the positions can be achieved by adjustment of the strike prices in the S&P 100 puts and calls. The further away the strike prices are from the price of the S&P 100, the more bullish the strategy. However, the dollar value underlying the put options always approximates the value of the basket of stocks.

Contact Info		Fees & Structure	
Fund: Fairfield Sentry Ltd General Partner: Arden Asset Management Address: 919 Third Avenue 11th th Floor New York NY 10022 USA Tel: 212-319-6060 Fax: Email: fairfieldfunds@fggus.com Contact Person: Fairfield Funds Portfolio Manager:		Fund Assets: \$5100.00million Strategy Assets: \$5300.00million Firm Assets: \$8300million Min. Investment: \$ 0.10million Management Fee: 1.00% Incentive Fee: 20.00% Hurdle Rate: High Water Mark: Yes Additions: Monthly Redemptions: Monthly Lockup: Inception Date: Dec-1990 Money Invested In: United States Open to New Investments: Yes	

Annual Returns																
1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	
2.83%	18.58%	14.67%	11.68%	11.49%	12.95%	12.99%	14.00%	13.40%	14.18%	11.55%	10.68%	9.33%	8.21%	7.07%	2.52%	



Year To Date:	2.52%
Highest 12 Month Return:	19.98%
Lowest 12 Month Return:	6.23%
Average Annual Return:	12.01%
Average Monthly Return:	0.96%
Highest Monthly Return:	3.36%
Lowest Monthly Return:	-0.55%
Average Gain:	1.01%
Average Loss:	-0.24%
Exponent Percentile:	95.00%
Compounded Monthly Return:	0.96%
Longest Consecutive Gain:	120
Maximum Drawdown:	-0.55%

Sharpe Ratio (Rolling 12):	2.56
Sharpe Ratio (Annualized):	2.56
Std. Dev. (Monthly):	0.75%
Std. Dev. (Rolling 12):	2.74%
Beta:	0.06
Alpha:	0.91
R:	0.30
R Squared:	0.09

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1990	N/A	2.83% E										
1991	3.08% E	1.46% E	0.59% E	1.39% E	1.88% E	0.37% E	2.04% E	1.07% E	0.80% E	2.82% E	0.08% E	1.63% E
1992	0.49% E	2.79% E	1.01% E	2.86% E	1.05% E	1.29% E	0.00% E	0.92% E	0.40% E	1.40% E	1.42% E	1.43% E
1993	0.00% E	1.93% E	1.86% E	0.06% E	1.72% E	0.86% E	0.09% E	1.78% E	0.35% E	1.77% E	0.26% E	0.45% E
1994	2.18% E	1.52% E	1.52% E	1.82% E	0.51% E	0.29% E	1.78% E	0.42% E	0.82% E	1.88% E	1.05% E	0.66% E
1995	0.92% E	0.76% E	0.84% E	1.69% E	1.72% E	0.50% E	1.08% E	1.02% E	1.70% E	1.60% E	0.51% E	1.10% E
1996	1.49% E	0.73% E	1.23% E	0.64% E	1.41% E	0.22% E	1.92% E	0.27% E	1.22% E	1.10% E	1.58% E	0.48% E
1997	2.45% E	0.73% E	0.86% E	1.17% E	0.63% E	1.34% E	0.75% E	0.35% E	2.39% E	0.55% E	1.56% E	0.42% E
1998	0.91% E	1.29% E	1.75% E	0.42% E	1.76% E	1.28% E	0.83% E	0.28% E	1.04% E	1.93% E	0.84% E	0.33% E
1999	2.06% E	0.17% E	2.29% E	0.36% E	1.51% E	1.76% E	0.43% E	0.94% E	0.73% E	1.11% E	1.61% E	0.39% E
2000	2.20% E	0.20% E	1.84% E	0.34% E	1.37% E	0.80% E	0.65% E	1.32% E	0.25% E	0.92% E	0.68% E	0.43% E
2001	2.21% E	0.14% E	1.13% E	1.32% E	0.32% E	0.23% E	0.44% E	1.01% E	0.73% E	1.28% E	1.21% E	0.19% E
2002	0.03% E	0.60% E	0.46% E	1.16% E	2.12% E	0.26% E	3.36% E	1.00% E	0.13% E	0.73% E	0.16% E	0.06% E
2003	0.22% E	0.04% E	1.97% E	0.10% E	0.95% E	1.00% E	1.44% E	0.22% E	0.93% E	1.32% E	0.99% E	0.32% E
2004	0.94% E	0.50% E	0.05% C	0.43% C	0.66% C	1.28% C	0.08% C	1.33% E	0.53% E	0.03% E	0.79% E	0.24% E
2005	0.51% E	0.37% E	0.85% C	0.14% C	0.63% C	N/A						

END ATTACHMENT #1A RE HEDGED SENTRY LTD. PERFORMANCE DATA

Attachment 2: Barron's Article dated May 7, 2001

"Don't Ask, Don't Tell"

Bernie Madoff is so secretive, he even asks investors to keep mum

By ERIN E. ARVEDLUND
Barron's | Monday, May 7, 2001

Two years ago, at a hedge-fund conference in New York, attendees were asked to name some of their favorite and most-respected hedge-fund managers. Neither George Soros nor Julian Robertson merited a single mention. But one manager received lavish praise: Bernard Madoff.

Folks on Wall Street know Bernie Madoff well. His brokerage firm, Madoff Securities, helped kick-start the Nasdaq Stock Market in the early 1970s and is now one of the top three market makers in Nasdaq stocks. Madoff Securities is also the third-largest firm matching buyers and sellers of New York Stock Exchange-listed securities. Charles Schwab, Fidelity Investments and a slew of discount brokerages all send trades through Madoff.

Some folks on Wall Street think there's more to how Madoff (above) generates his enviable stream of investment returns than meets the eye. Madoff calls these claims "ridiculous."

But what few on the Street know is that Bernie Madoff also manages \$6 billion-to-\$7 billion for wealthy individuals. That's enough to rank Madoff's operation among the world's three largest hedge funds, according to a May 2001 report in MAR Hedge, a trade publication.

What's more, these private accounts, have produced compound average annual returns of 15% for more than a decade. Remarkably, some of the larger, billion-dollar Madoff-run funds have never had a down year.

When Barron's asked Madoff Friday how he accomplishes this, he said, "It's a proprietary strategy. I can't go into it in great detail."

Nor were the firms that market Madoff's funds forthcoming when contacted earlier. "It's a private fund. And so our inclination has been not to discuss its returns," says Jeffrey Tucker, partner and co-founder of Fairfield Greenwich, a New York City-based hedge-fund marketer. "Why Barron's would have any interest in this fund I don't know." One of Fairfield Greenwich's most sought-after funds is Fairfield Sentry Limited. Managed by Bernie Madoff, Fairfield Sentry has assets of \$3.3 billion.

A Madoff hedge-fund offering memorandums describes his strategy this way: "Typically, a position will consist of the ownership of 30-35 S&P 100 stocks, most correlated to that index, the

sale of out-of-the-money calls on the index and the purchase of out-of-the-money puts on the index. The sale of the calls is designed to increase the rate of return, while allowing upward movement of the stock portfolio to the strike price of the calls. The puts, funded in large part by the sale of the calls, limit the portfolio's downside."

Among options traders, that's known as the "split-strike conversion" strategy. In layman's terms, it means Madoff invests primarily in the largest stocks in the S&P 100 index -- names like General Electric, Intel and Coca-Cola. At the same time, he buys and sells options against those stocks. For example, Madoff might purchase shares of GE and sell a call option on a comparable number of shares -- that is, an option to buy the shares at a fixed price at a future date. At the same time, he would buy a put option on the stock, which gives him the right to sell shares at a fixed price at a future date.

The strategy, in effect, creates a boundary on a stock, limiting its upside while at the same time protecting against a sharp decline in the share price. When done correctly, this so-called market-neutral strategy produces positive returns no matter which way the market goes.

Using this split-strike conversion strategy, Fairfield Sentry Limited has had only four down months since inception in 1989. In 1990, Fairfield Sentry was up 27%. In the ensuing decade, it returned no less than 11% in any year, and sometimes as high as 18%. Last year, Fairfield Sentry returned 11.55% and so far in 2001, the fund is up 3.52%.

Those returns have been so consistent that some on the Street have begun speculating that Madoff's market-making operation subsidizes and smooths his hedge-fund returns.

How might Madoff Securities do this? Access to such a huge capital base could allow Madoff to make much larger bets -- with very little risk -- than it could otherwise. It would work like this: Madoff Securities stands in the middle of a tremendous river of orders, which means that its traders have advance knowledge, if only by a few seconds, of what big customers are buying and selling. By hopping on the bandwagon, the market maker could effectively lock in profits. In such a case, throwing a little cash back to the hedge funds would be no big deal.

When Barron's ran that scenario by Madoff, he dismissed it as "ridiculous."

Still, some on Wall Street remain skeptical about how Madoff achieves such stunning double-digit returns using options alone. The recent MAR Hedge report, for example, cited more than a dozen hedge fund professionals, including current and former Madoff traders, who questioned why no one had been able to duplicate Madoff's returns using this strategy. Likewise, three option strategists at major investment banks told Barron's they couldn't understand how Madoff churns out such numbers. Adds a former Madoff investor: "Anybody who's a seasoned hedge-fund investor knows the split-strike conversion is not the whole story. To take it at face value is a bit naïve."

Madoff dismisses such skepticism. "Whoever tried to reverse-engineer \, he didn't do a good job. If he did, these numbers would not be unusual." Curiously, he charges no fees for his money-management services. Nor does he take a cut of the 1.5% fees marketers like Fairfield

Greenwich charge investors each year. Why not? "We're perfectly happy to just earn commissions on the trades," he says.

Perhaps so. But consider the sheer scope of the money Madoff would appear to be leaving on the table. A typical hedge fund charges 1% of assets annually, plus 20% of profits. On a \$6 billion fund generating 15% annual returns, that adds up to \$240 million a year.

The lessons of Long-Term Capital Management's collapse are that investors need, or should want, transparency in their money manager's investment strategy. But Madoff's investors rave about his performance -- even though they don't understand how he does it. "Even knowledgeable people can't really tell you what he's doing," one very satisfied investor told Barron's. "People who have all the trade confirmations and statements still can't define it very well. The only thing I know is that he's often in cash" when volatility levels get extreme. This investor declined to be quoted by name. Why? Because Madoff politely requests that his investors not reveal that he runs their money.

"What Madoff told us was, 'If you invest with me, you must never tell anyone that you're invested with me. It's no one's business what goes on here,'" says an investment manager who took over a pool of assets that included an investment in a Madoff fund. "When he couldn't explain \ how they were up or down in a particular month," he added, "I pulled the money out."

For investors who aren't put off by such secrecy, it should be noted that Fairfield and Kingate Management both market funds managed by Madoff, as does Tremont Advisers, a publicly traded hedge-fund advisory firm.

URL for this article:

<http://online.barrons.com/article/SB989019667829349012.html>

[REDACTED]

Attachment 3

Partial List of French & Swiss money-managers / Private Banks invested with Bernie Madoff who are likely to become insolvent if this is a Ponzi Scheme. More are out there.

Paris & Paris suburbs

1. AGF Asset Management; Mr. Jean Francois Bert; 14 Rue Havelly 75009
2. Alterinvest; Mr. Etienne Bernier; 42 Avenue Montaigne; Tel # 33 1 53 67 53 27
3. Altigest; Mr. Lescoat; 23 Rue d'Antin 75002; Tel # 33 1 42 66 15 43
4. GT Finances; Mr. Moreau; 16 Place De La Madeleine; Tel # 33 1 53 43 20 41
5. John Locke Investments; Mr. Bertrand Savatier; Cyrille Finances; 2 Rue des Italiens
6. Oddo Asset Management; Mr. Philippe Oddo; 12 Boulevard De La Madeline 75009; Tel # 33 1 44 51 83 83
7. SV International; Mr. Voisin; 64 Bd Pereire 75017; Tel # 33 1 40 54 80 00
8. Tethys; Mr. Jean Paul Delattre; 5 Rue Du 8 Mai 1945; Clichy; Tel # 33 1 47 56 87 46

Geneva, Switzerland

1. Aforge; Mr. Henrvieux Causse; 7 Rue Francois Versonnex; 41 22 7078240
2. Banque Piguet; Mr. Tosi; 5 Place De L'universite; Tel # 41 22 3112700
3. Dexia Asset Management; Mr. Jean Sebastien Debusschere; 2 Rue Jargommant 1207
Tel # 41 22 7079011
4. Fund Invest; Mr. Roer Galor; 22 Rue de Villereuse; Tel # 41 5929212
5. Fix Family Office; Mademoiselle Ayca Pars; 7-9 Rue De La Croix D'or;
Tel # 41 22 3178866
6. SCS Alliance; Mr. Saba; 11 Roue de Florissant; Tel # 41 22 8390100

Notes:

1. French and Swiss money-managers and Private Banks are Bernie Madoff's largest investors because they lack quantitative finance skills.
2. I estimate that between 50% - 75% of Bernie Madoff's assets are European based.

ATTACHMENT 4

Copy of a Fax dated March, 21, 2001 3:57 p.m. from an unknown sender (I forgot who sent it) that explains the Use of Proceeds and Investment Program offered by Fairfield Sentry Ltd but managed by Bernie Madoff. The fax machine header reads NO.880 _____ P.1 _____ so it is impossible for me to identify the source at this time. This looks to be pages 6 and 7 of an offering memorandum. I would be happy to turn over my original fax copy to the SEC. The document number listed on both pages is a bit blurry but appears to read
I:\DATA\WPDOCS\AG_\94021597

USE OF PROCEEDS

The entire net proceeds from the sale of the interests will be available to the Partnership. The Partnership incurred approximately \$5,000 in connection with the initial offering of Interests for the admission of Limited Partners (such costs consisting primarily of legal fees and blue sky filing fees. The General Partners do no intent to pay any commissions or fees to broker-dealers in connection with the offering. However, in the event any fees or commissions are paid, they will be paid by the General Partners rather than the Partnership. The General Partners have not established any maximum amounts for such fees and commissions, none of which have been paid or earned to date.

The Partnership's funds are allocated to an account at Bernard L. Madoff Investment Securities (see "INVESTMENT PROGRAM"). Funds not so allocated will be maintained in cash. Bernard L. Madoff Securities is employed solely as an agent of the Partnership. It has no ownership interest in the Partnership and no role in the overall management of the Partnership.

The Partnership will not make any loans to affiliated entities nor will it invest in any foreign government securities.

INVESTMENT PROGRAM

The Partnership seeks to obtain capital appreciation of its assets through the utilization of nontraditional options trading strategies. The General Partners have established a discretionary account for the Partnership at Bernard L. Madoff Investment Securities ("BLM"), a registered broker-dealer in New York, New York, which utilizes a strategy described as a "split strike conversion". This strategy has defined risk and profit parameters which may be ascertained when a particular position is established. All investment decisions in the account at BLM are effected by persons associated with BLM. The firm, which employs approximately 150 people, acts primarily as a market maker in stocks and convertible securities. Most of the stocks for which it acts as a market maker are also listed on the New York Stock Exchange. Set forth below is a description of the "split strike conversion strategies.

The establishment of a typical position entails (i) the purchase of equity shares, (ii) the sale of a related out of the money call option representing an amount of underlying shares equal to the number of equity shares purchased, and (iii) the purchase of a related put option which is at or out of the money. A call option is sold out of the money when its strike price is greater than

the current price of the stock; a put option is out of the money when the strike price is lower than the current price of the stock.

The logic of this strategy is that once a long stock position has been established, selling a call against such along position will increase the standstill rate of return, while allowing upward movement to the short call strike price. The purchase of an at or out of the money put, funded with part or all of the call premium, protects the equity position from downside risk.

Equity index options are also utilized in this trading methodology. Such a strategy involves buying a group of equity securities that together will highly correlate to the S&P 100 Index ("the OEX"). Equivalent contract value dollar amounts of out of the money OEX call options are sold, and out of the money OEX put options are purchased, against the basket of stocks. The basket typically consists of approximately 35 stocks in the S&P 100 Index.

A bullish or bearish bias of the positions can be achieved by adjustment of the strike prices in the OEX puts and calls. The further away the strike prices are from the price of the S&P 100 Index, the more bullish the strategy. However, the dollar value underlying the put options always approximates the value of the basket of stocks.

The Partnership bears the cost of all brokerage fees and commissions charged in connection with the account at BLM. All interest earned on credit balances is credited to the Partnership.

BLM acts as principal in connection with its sale of securities to the Partnership, and the purchase of securities from the Partnership. BLM acts as a market-maker in the stocks purchased and sold by the Partnership. These market making activities enable BLM to trade with the Partnership as principal. See "CERTAIN RISK FACTORS".

The options transactions executed ~~for the benefit of Security~~ are effected, primarily, in the over-the-counter, not on a registered options exchange.

There can be no assurance that the investment objectives of the Partnership will be achieved. THE PARTNERSHIP'S INVESTMENT PROGRAM IS SPECULATIVE AND ENTAILS SUBSTANTIAL RISKS. MARKET RISKS ARE INHERENT IN ALL SECURITIES TO VARYING DEGREES. NO ASSURANCE CAN BE GIVEN THAT THE PARTNERSHIP'S INVESTMENT OBJECTIVE WILL BE REALIZED. (SEE "CERTAIN RISK FACTORS".)

Washington and Lee University School of Law
Washington & Lee University School of Law Scholarly
Commons

Powell Memorandum: Attack On American Free
Enterprise System

Powell Papers

8-23-1971

The Memo

Lewis F. Powell Jr.

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/powellmemo>

Recommended Citation

Powell, Lewis F. Jr., "The Memo" (1971). *Powell Memorandum: Attack On American Free Enterprise System*. 1.
<https://scholarlycommons.law.wlu.edu/powellmemo/1>

This Book is brought to you for free and open access by the Powell Papers at Washington & Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Powell Memorandum: Attack On American Free Enterprise System by an authorized administrator of Washington & Lee University School of Law Scholarly Commons. For more information, please contact lawref@wlu.edu.

CONFIDENTIAL MEMORANDUM

ATTACK ON AMERICAN FREE ENTERPRISE SYSTEM

TO: Mr. Eugene B. Sydnor, Jr. DATE: August 23, 1971
Chairman
Education Committee
U.S. Chamber of Commerce

FROM: Lewis F. Powell, Jr.

This memorandum is submitted at your request as a basis for the discussion on August 24 with Mr. Booth and others at the U.S. Chamber of Commerce. The purpose is to identify the problem, and suggest possible avenues of action for further consideration.

Dimensions of the Attack

No thoughtful person can question that the American economic system is under broad attack.* This varies in scope, intensity, in the techniques employed, and in the level of visibility.

There always have been some who opposed the American system, and preferred socialism or some form of statism

*Variously called: the "free enterprise system", "capitalism", and the "profit system". The American political system of democracy under the rule of law is also under attack, often by the same individuals and organizations who seek to undermine the enterprise system.

(communism or fascism). Also, there always have been critics of the system, whose criticism has been wholesome and constructive so long as the objective was to improve rather than to subvert or destroy.

But what now concerns us is quite new in the history of America. We are not dealing with episodic or isolated attacks from a relatively few extremists or even from the minority socialist cadre. Rather, the assault on the enterprise system is broadly based and consistently pursued. It is gaining momentum and converts.

Sources of the Attack

The sources are varied and diffused. They include, not unexpectedly, the Communists, New Leftists and other revolutionaries who would destroy the entire system, both political and economic. These extremists of the left are far more numerous, better financed, and increasingly are more welcomed and encouraged by other elements of society, than ever before in our history. But they remain a small minority, and are not yet the principal cause for concern.

The most disquieting voices joining the chorus of criticism, come from perfectly respectable elements of society: from the college campus, the pulpit, the media, the intellectual

and literary journals, the arts and sciences, and from politicians. In most of these groups the movement against the system is participated in only by minorities. Yet, these often are the most articulate, the most vocal, the most prolific in their writing and speaking.

Moreover, much of the media - for varying motives and in varying degrees - either voluntarily accords unique publicity to these "attackers", or at least allows them to exploit the media for their purposes. This is especially true of television, which now plays such a predominant role in shaping the thinking, attitudes and emotions of our people.

One of the bewildering paradoxes of our time is the extent to which the enterprise system tolerates, if not participates in, its own destruction.

The campuses from which much of the criticism emanates are supported by (i) tax funds generated largely from American business, and (ii) contributions from capital funds controlled or generated by American business. The Boards of Trustees of our universities overwhelmingly are composed of men and women who are leaders in the system.

Most of the media, including the national TV systems, are owned and theoretically controlled by corporations which

depend upon profits, and the enterprise system to survive.

Tone of the Attack

This memorandum is not the place to document in detail the tone, character, or intensity of the attack. The following quotations will suffice to give one a general idea:

William Kunstler, warmly welcomed on campuses and listed in a recent student poll as the "American lawyer most admired", incites audiences as follows:

"You must learn to fight in the streets, to revolt, to shoot guns. We will learn to do all of the things that property owners fear".*

The New Leftists who heed Kunstler's advice increasingly are beginning to act - not just against military recruiting offices and manufacturers of munitions, but against a variety of businesses:

"Since February 1970, branches (of Bank of America) have been attacked 39 times, 22 times with explosive devices and 17 times with fire bombs or by arsonists".**

Although New Leftist spokesmen are succeeding in radicalizing thousands of the young, the greater cause for concern is the hostility of respectable liberals and social reformers.

*Richmond News-Leader, June 8, 1970. Column of William F. Buckley, Jr.

**N. Y. Times Service article, reprinted Richmond Times-Dispatch, May 17, 1971.

It is the sum total of their views and influence which could indeed fatally weaken or destroy the system.

A chilling description of what is being taught on many of our campuses was written by Stewart Alsop:

"Yale, like every other major college, is graduating scores of bright young men who are practitioners of 'the politics of despair'. These young men despise the American political and economic system . . . (their) minds seem to be wholly closed. They live, not by rational discussion, but by mindless slogans".*

A recent poll of students on 12 representative campuses reported that:

"Almost half the students favored socialization of basic U.S. industries".**

A visiting professor from England at Rockford College gave a series of lectures entitled "The Ideological War Against Western Society", in which he documents the extent to which members of the intellectual community are waging ideological warfare against the enterprise system and the values of western society. In a foreword to these lectures, famed Dr. Milton Friedman of Chicago warned:

"It (is) crystal clear that the foundations of our free society are under wide-ranging and powerful attack - not by Communist or any

*Stewart Alsop, Yale and the Deadly Danger, Newsweek, May 18, 1970.

**Editorial, Richmond Times Dispatch, July 7, 1971.

other conspiracy but by misguided individuals parroting one another and unwittingly serving ends they would never intentionally promote".*

Perhaps the single most effective antagonist of American business is Ralph Nader who - thanks largely to the media - has become a legend in his own time and an idol of millions of Americans. A recent article in Fortune speaks of Nader as follows:

"The passion that rules in him - and he is a passionate man - is aimed at smashing utterly the target of his hatred, which is corporate power. He thinks, and says quite bluntly, that a great many corporate executives belong in prison - for defrauding the consumer with shoddy merchandise, poisoning the food supply with chemical additives, and willfully manufacturing unsafe products that will maim or kill the buyer. . . . He emphasizes that he is not talking just about 'fly-by-night hucksters' but the top management of blue-chip business".**

A frontal assault was made on our government, our system of justice, and the free enterprise system by Yale professor Charles Reich in his widely publicized book: "The Greening of America", published last winter.

*Dr. Milton Friedman, Prof. of Economics, U. of Chicago, writing a Foreword to Dr. Arthur A. Shenvield's Rockford College lectures entitled "The Ideological War Against Western Society", copyrighted 1970 by Rockford College.

**Fortune, May 1971, p. 145. This Fortune analysis of the Nader influence includes a reference to Nader's visit to a college where he was paid a lecture fee of \$2,500 for "denouncing America's big corporations in venomous language . . . bringing (rousing and spontaneous) bursts of applause" when he was asked when he planned to run for President.

The foregoing references illustrate the broad, shotgun attack on the system itself. There are countless examples of rifle shots which undermine confidence and confuse the public. Favorite current targets are proposals for tax incentives through changes in depreciation rates and investment credits. These are usually described in the media as "tax breaks", "loop holes", or "tax benefits" for the benefit of business. As viewed by a columnist in the Post, such tax measures would benefit "only the rich, the owners of big companies".*

It is dismaying that many politicians make the same argument that tax measures of this kind benefit only "business", without benefit to "the poor". The fact that this is either political demagoguery or economic illiteracy, is of slight comfort. This setting of the "rich" against the "poor", of business against the people, is the cheapest and most dangerous kind of politics.

The Apathy and Default of Business

What has been the response of business to this massive assault upon its fundamental economics, upon its philosophy, upon its right to continue to manage its own affairs, and indeed upon its integrity?

*The Washington Post, Column of William Raspberry, June 28, 1971.

The painfully sad truth is that business, including the boards of directors and the top executives of corporations great and small and business organizations at all levels, often have responded - if at all - by appeasement, ineptitude and ignoring the problem. There are, of course, many exceptions to this sweeping generalization. But the net effect of such response as has been made is scarcely visible.

In all fairness, it must be recognized that businessmen have not been trained or equipped to conduct guerrilla warfare with those who propagandize against the system, seeking insidiously and constantly to sabotage it. The traditional role of business executives has been to manage, to produce, to sell, to create jobs, to make profits, to improve the standard of living, to be community leaders, to serve on charitable and educational boards, and generally to be good citizens. They have performed these tasks very well indeed.

But they have shown little stomach for hard-nose contest with their critics, and little skill in effective intellectual and philosophical debate.

A column recently carried by the Wall Street Journal was entitled: "Memo to GM: Why Not Fight Back?"* Although addressed to GM by name, the article was a warning to all American business. Columnist St. John said:

*Jeffrey St. John, The Wall Street Journal, May 21, 1971

"General Motors, like American business in general, is 'plainly in trouble' because intellectual bromides have been substituted for a sound intellectual exposition of its point of view".

Mr. St. John then commented on the tendency of business leaders to compromise with and appease critics. He cited the concessions which Nader wins from management, and spoke of "the fallacious view many businessmen take toward their critics. He drew a parallel to the mistaken tactics of many college administrators:

"College administrators learned too late that such appeasement serves to destroy free speech, academic freedom and genuine scholarship. One campus radical demand was conceded by university heads only to be followed by a fresh crop which soon escalated to what amounted to a demand for outright surrender".

One need not agree entirely with Mr. St. John's analysis. But most observers of the American scene will agree that the essence of his message is sound. American business "plainly is in trouble"; the response to the wide range of critics has been ineffective, and has included appeasement; the time has come - indeed, it is long overdue - for the wisdom, ingenuity and resources of American business to be marshaled against those who would destroy it.

Responsibility of Business Executives

What specifically should be done? The first essential - a prerequisite to any effective action - is for businessmen to confront this problem as a primary responsibility of corporate management.

The overriding first need is for businessmen to recognize that the ultimate issue may be survival - survival of what we call the free enterprise system, and all that this means for the strength and prosperity of America and the freedom of our people.

The day is long past when the chief executive officer of a major corporation discharges his responsibility by maintaining a satisfactory growth of profits, with due regard to the corporation's public and social responsibilities. If our system is to survive, top management must be equally concerned with protecting and preserving the system itself. This involves far more than an increased emphasis on "public relations" or "governmental affairs" - two areas in which corporations long have invested substantial sums.

A significant first step by individual corporations could well be the designation of an executive vice president (ranking with other executive VP's) whose responsibility is

to counter - on the broadest front - the attack on the enterprise system. The public relations department could be one of the fundations assigned to this executive, but his responsibilities should encompass some of the types of activities referred to subsequently in this memorandum. His budget and staff should be adequate to the task.

Possible Role of the Chamber of Commerce

But independent and uncoordinated activity by individual corporations, as important as this is, will not be sufficient. Strength lies in organization, in careful long-range planning and implementation, in consistency of action over an indefinite period of years, in the scale of financing available only through joint effort, and in the political power available only through united action and national organizations.

Moreover, there is the quite understandable reluctance on the part of any one corporation to get too far out in front and to make itself too visible a target.

The role of the National Chamber of Commerce is therefore vital. Other national organizations (especially those of various industrial and commercial groups) should join in the effort, but no other organizations appears to be as well situated as the Chamber. It enjoys a strategic position, with a fine

reputation and a broad base of support. Also - and this is of immeasurable merit - there are hundreds of local Chambers of Commerce which can play a vital supportive role.

It hardly need be said that before embarking upon any program the Chamber should study and analyze possible courses of action and activities, weighing risks against probable effectiveness and feasibility of each. Considerations of cost, the assurance of financial and other support from members, adequacy of staffing and similar problems will all require the most thoughtful consideration.

The Campus

The assault on the enterprise system was not mounted in a few months. It has gradually evolved over the past two decades, barely perceptible in its origins and benefitting from a gradualism that provoked little awareness much less any real reaction.

Although origins, sources and causes are complex and interrelated, and obviously difficult to identify without careful qualification, there is reason to believe that the campus is the single most dynamic source. The social science faculties usually include members who are unsympathetic to the enterprise system. They may range from a Herbert Marcuse, Marxist faculty

member at the University of California at San Diego, and convinced socialists, to the ambivalent liberal critic who finds more to condemn than to commend. Such faculty members need not be in a majority. They are often personally attractive and magnetic; they are stimulating teachers, and their controversy attracts student following; they are prolific writers and lecturers; they author many of the textbooks; and they exert enormous influence - far out of proportion to their numbers - on their colleagues and in the academic world.

Social science faculties (the political scientist, economist, sociologist and many of the historians) tend to be liberally oriented, even when leftists are not present. This is not a criticism per se, as the need for liberal thought is essential to a balanced viewpoint. The difficulty is that "balance" is conspicuous by its absence on many campuses, with relatively few members being of conservative or moderate persuasion and even the relatively few often being less articulate and aggressive than their crusading colleagues.

This situation extending back many years and with the imbalance gradually worsening, has had an enormous impact on millions of young American students. In an article in Barron's weekly, seeking an answer to why so many young people are disaffected even to the point of being revolutionaries, it was said:

"Because they were taught that way".*

Or, as noted by columnist Stewart Alsop, writing about his alma mater:

Yale, like every other major college, is graduating scores of bright young men . . . who despise the American political and economic system".

As these "bright young men", from campuses across the country, seek opportunities to change a system which they have been taught to distrust - if not, indeed "despise" - they seek employment in the centers of the real power and influence in our country, namely: (i) with the news media, especially television; (ii) in government, as "staffers" and consultants at various levels; (iii) in elective politics; (v) as lecturers and writers; and (v) on the faculties at various levels of education.

Many do enter the enterprise system - in business and the professions - and for the most part they quickly discover the fallacies of what they have been taught. But those who eschew the mainstream of the system, often remain in key positions of influence where they mold public opinion and often shape governmental action. In many instances, these "intellectuals"

*Barron's National Business and Financial Weekly, "The Total Break with America, The Fifth Annual Conference of Socialist Scholars", Sept. 15, 1969.

end up in regulatory agencies or governmental departments with large authority over the business system they do not believe in.

If the foregoing analysis is approximately sound, a priority task of business - and organizations such as the Chamber - is to address the campus origin of this hostility.

Few things are more sanctified in American life than academic freedom. It would be fatal to attack this as a principle. But if academic freedom is to retain the qualities of "openness", "fairness" and "balance" - which are essential to its intellectual significance - there is a great opportunity for constructive action. The thrust of such action must be to restore the qualities just mentioned to the academic communities.

What Can Be Done About the Campus

The ultimate responsibility for intellectual integrity on the campus must remain on the administrations and faculties of our colleges and universities. But organizations such as the Chamber can assist and activate constructive change in many ways, including the following:

Staff of Scholars

The Chamber should consider establishing a staff of highly qualified scholars in the social sciences who do believe

in the system. It should include several of national reputation, whose authorship would be widely respected - even when disagreed with.

Staff of Speakers

There also should be a staff of speakers of the highest competency. These might include the scholars, and certainly those who speak for the Chamber would have to articulate the product of the scholars.

Speaker's Bureau

In addition to full time staff personnel, the Chamber should have a Speaker's Bureau which should include the ablest and most effective advocates from the top echelons of American business.

Evaluation of Textbooks

The staff of scholars (or preferably a panel of independent scholars) should evaluate social science textbooks, especially in economics, political science and sociology. This should be a continuing program.

The objective of such evaluation should be oriented toward restoring the balance essential to genuine academic

freedom. This would include assurance of fair and factual treatment of our system of government and our enterprise system, its accomplishments, its basic relationship to individual rights and freedoms, and comparisons with the systems of socialism, fascism and communism. Most of the existing textbooks have some sort of comparisons, but many are superficial, biased and unfair.

We have seen the civil rights movement insist on rewriting many of the textbooks in our universities and schools. The labor unions likewise insist that textbooks be fair to the viewpoints of organized labor. Other interested citizens groups have not hesitated to review, analyze and criticize textbooks and teaching materials. In a democratic society, this can be a constructive process and should be regarded as an aid to genuine academic freedom and not as an intrusion upon it.

If the authors, publishers and users of textbooks know that they will be subjected - honestly, fairly and thoroughly - to review and critique by eminent scholars who believe in the American system, a return to a more rational balance can be expected.

Equal Time on the Campus

The Chamber should insist upon equal time on the college speaking circuit. The FBI publishes each year a list of speeches

made on college campuses by avowed Communists. The number in 1970 exceeded 100. There were, of course, many hundreds of appearances by leftists and ultra liberals who urge the types of viewpoints indicated earlier in this memorandum. There was no corresponding representation of American business, or indeed by individuals or organizations who appeared in support of the American system of government and business.

Every campus has its formal and informal groups which invite speakers. Each law school does the same thing. Many universities and college officially sponsor lecture and speaking programs. We all know the inadequacy of the representation of business in these programs.

It will be said that few invitations would be extended to Chamber speakers.* This undoubtedly would be true unless the Chamber aggressively insisted upon the right to be heard - in effect, insisted upon "equal time". University administrators and the great majority of student groups and committees would not welcome being put in the position publicly of refusing a forum to diverse views. Indeed, this is the classic excuse for allowing Communists to speak.

The two essential ingredients are (i) to have attractive, articulate and well-informed speakers; and (ii) to exert whatever

*On many campuses freedom of speech has been denied to all who express moderate or conservative viewpoints.

degree of pressure - publicly and privately - may be necessary to assure opportunities to speak. The objective always must be to inform and enlighten, and not merely to propagandize.

Balancing of Faculties

Perhaps the most fundamental problem is the imbalance of many faculties. Correcting this is indeed a long-range and difficult project. Yet, it should be undertaken as a part of an overall program. This would mean the urging of the need for faculty balance upon university administrators and boards of trustees.

The methods to be employed require careful thought, and the obvious pitfalls must be avoided. Improper pressure would be counterproductive. But the basic concepts of balance, fairness and truth are difficult to resist, if properly presented to boards of trustees, by writing and speaking, and by appeals to alumni associations and groups.

This is a long road and not one for the fainthearted. But if pursued with integrity and conviction it could lead to a strengthening of both academic freedom on the campus and of the values which have made America the most productive of all societies.

Graduate Schools of Business

The Chamber should enjoy a particular rapport with the increasingly influential graduate schools of business. Much that has been suggested above applies to such schools.

Should not the Chamber also request specific courses in such schools dealing with the entire scope of the problem addressed by this memorandum? This is now essential training for the executives of the future.

Secondary Education

While the first priority should be at the college level, the trends mentioned above are increasingly evidenced in the high schools. Action programs, tailored to the high schools and similar to those mentioned, should be considered. The implementation thereof could become a major program for local chambers of commerce, although the control and direction - especially the quality control - should be retained by the National Chamber.

What Can Be Done About the Public?

Reaching the campus and the secondary schools is vital for the long-term. Reaching the public generally may be more important for the shorter term. The first essential is to

establish the staffs of eminent scholars, writers and speakers, who will do the thinking, the analysis, the writing and the speaking. It will also be essential to have staff personnel who are thoroughly familiar with the media, and how most effectively to communicate with the public. Among the more obvious means are the following:

Television

The national television networks should be monitored in the same way that textbooks should be kept under constant surveillance. This applies not merely to so-called educational programs (such as "Selling of the Pentagon"), but to the daily "news analysis" which so often includes the most insidious type of criticism of the enterprise system.* Whether this criticism results from hostility or economic ignorance, the result is the gradual erosion of confidence in "business" and free enterprise.

This monitoring, to be effective would require constant examination of the texts of adequate samples of programs. Complaints - to the media and to the Federal Communications Commission - should be made promptly and strongly when programs are unfair or inaccurate.

*It has been estimated that the evening half-hour news programs of the networks reach daily some 50,000,000 Americans.

Equal time should be demanded when appropriate. Efforts should be made to see that the forum-type programs (the Today show, Meet the Press, etc.) afford at least as much opportunity for supporters of the American system to participate as these programs do for those who attack it.

Other Media

Radio and the press are also important, and every available means should be employed to challenge and refute unfair attacks, as well as to present the affirmative case through these media.

The Scholarly Journals.

It is especially important for the Chamber's "faculty of scholars" to publish. One of the keys to the success of the liberal and leftist faculty members has been their passion for "publication" and "lecturing". A similar passion must exist among the Chamber's scholars.

Incentives might be devised to induce more "publishing" by independent scholars who do believe in the system.

There should be a fairly steady flow of scholarly articles presented to a broad spectrum of magazines and

periodicals - ranging from the popular magazines (Life, Look, Reader's Digest, etc.) to the more intellectual ones (Atlantic, Harper's, Saturday Review, New York, etc.)*, and to the various professional journals.

Books, Paperbacks and Pamphlets

The news stands - at airports, drugstores and elsewhere - are filled with paperback and pamphlets advocating everything from revolution to erotic free love. One finds almost no attractive, well-written paperbacks or pamphlets on "our side". It will be difficult to compete with an Eldridge Cleaver or even a Charles Reich for reader attention, but unless the effort is made - on a large enough scale and with appropriate imagination to assure some success - this opportunity for educating the public will be irretrievably lost.

Paid Advertisements

Business pays hundreds of millions of dollars to the media for advertisements. Most of this supports specific products;

*One illustration of the type of article which should not go unanswered appeared in the popular "New York" of July 19, 1971. This was entitled "A Populist Manifesto" by ultra liberal Jack Newfield - who argued that "the root need in our country is 'to redistribute wealth'".

much of its supports institutional image making; and some fraction of it does support the system. But the latter has been more or less tangential, and rarely part of a sustained, major effort to inform and enlighten the American people.

If American business devoted only 10% of its total annual advertising budget to this overall purpose, it would be a statesman-like expenditure.

The Neglected Political Arena

In final analysis, the payoff - short of revolution - is what government does. Business has been the favorite whipping-boy of many politicians for many years. But the measure of how far this has gone is perhaps best found in the anti-business views now being expressed by several leading candidates for President of the United States.

It is still Marxist doctrine that the "capitalist" countries are controlled by big business. This doctrine, consistently a part of leftist propaganda all over the world, has a wide public following among Americans.

Yet, as every business executive knows, few elements of American society today have as little influence in government as the American businessmen, the corporation, or even the millions of corporate stockholders. If one doubts this, let him

undertake the role of "lobbyist" for the business point of view before Congressional Committees. The same situation obtains in the legislative halls of most states and major cities. One does not exaggerate to say that, in terms of political influence with respect to the course of legislation and government action, the American business executive is truly the "forgotten man".

Current examples of the impotency of business, and of the near-contempt with which businessmen's views are held, are the stampedes by politicians to support almost any legislation related to "consumerism" or to the "environment".

Politicians reflect what they believe to be majority views of their constituents. It is thus evident that most politicians are making the judgment that the public has little sympathy for the businessman or his viewpoint.

The educational programs suggested above would be designed to enlighten public thinking - not so much about the businessman and his individual role as about the system which he administers, and which provides the goods, services and jobs on which our country depends.

But one should not postpone more direct political action, while awaiting the gradual change in public opinion to be effected through education and information. Business must learn the lesson, long ago learned by Labor and other self-interest

groups. This is the lesson that political power is necessary; that such power must be assiduously cultivated; and that when necessary, it must be used aggressively and with determination - without embarrassment and without the reluctance which has been so characteristic of American business.

As unwelcome as it may be to the Chamber, it should consider assuming a broader and more vigorous role in the political arena.

Neglected Opportunity in the Courts

American business and the enterprise system have been affected as much by the courts as by the executive and legislative branches of government. Under our constitutional system, especially with an activist-minded Supreme Court, the judiciary may be the most important instrument for social, economic and political change.

Other organizations and groups, recognizing this, have been far more astute in exploiting judicial action than American business. Perhaps the most active exploiters of the judicial system have been groups ranging in political orientation from "liberal" to the far left.

The American Civil Liberties Union is one example. It initiates or intervenes in scores of cases each year, and

it files briefs amicus curiae in the Supreme Court in a number of cases during each term of that court. Labor unions, civil rights groups and now the public interest law firms are extremely active in the judicial arena. Their success, often at business' expense, has not been inconsequential.

This is a vast area of opportunity for the Chamber, if it is willing to undertake the role of spokesman for American business and if, in turn, business is willing to provide the funds.

As with respect to scholars and speakers, the Chamber would need a highly competent staff of lawyers. In special situations it should be authorized to engage, to appear as counsel amicus in the Supreme Court, lawyers of national standing and reputation. The greatest care should be exercised in selecting the cases in which to participate, or the suits to institute. But the opportunity merits the necessary effort.

Neglected Stockholder Power

The average member of the public thinks of "business" as an impersonal corporate entity, owned by the very rich and managed by over-paid executives. There is an almost total failure to appreciate that "business" actually embraces - in one way or another - most Americans. Those for whom business provides jobs, constitute a fairly obvious class. But the 20 million

stockholders - most of whom are of modest means - are the real owners, the real entrepreneurs, the real capitalists under our system. They provide the capital which fuels the economic system which has produced the highest standard of living in all history. Yet, stockholders have been as ineffectual as business executives in promoting a genuine understanding of our system or in exercising political influence.

The question which merits the most thorough examination is how can the weight and influence of stockholders - 20 million voters - be mobilized to support (i) an educational program and (ii) a political action program.

Individual corporations are now required to make numerous reports to shareholders. Many corporations also have expensive "news" magazines which go to employees and stockholders. These opportunities to communicate can be used far more effectively as educational media.

The corporation itself must exercise restraint in undertaking political action and must, of course, comply with applicable laws. But is it not feasible - through an affiliate of the Chamber or otherwise - to establish a national organization of American stockholders and give it enough muscle to be influential?

A More Aggressive Attitude

Business interests - especially big business and their national trade organizations - have tried to maintain low profiles, especially with respect to political action.

As suggested in the Wall Street Journal article, it has been fairly characteristic of the average business executive to be tolerant - at least in public - of those who attack his corporation and the system. Very few businessmen or business organizations respond in kind. There has been a disposition to appease; to regard the opposition as willing to compromise, or as likely to fade away in due time.

Business has shunted confrontation politics. Business, quite understandably, has been repelled by the multiplicity of non-negotiable "demands" made constantly by self-interest groups of all kinds.

While neither responsible business interests, nor the United States Chamber of Commerce, would engage in the irresponsible tactics of some pressure groups, it is essential that spokesmen for the enterprise system - at all levels and at every opportunity - be far more aggressive than in the past.

There should be no hesitation to attack the Naders, the Marcuses and others who openly seek destruction of the system.

There should be not the slightest hesitation to press vigorously in all political arenas for support of the enterprise system. Nor should there be reluctance to penalize politically those who oppose it.

Lessons can be learned from organized labor in this respect. The head of the AFL-CIO may not appeal to businessmen as the most endearing or public-minded of citizens. Yet, over many years the heads of national labor organizations have done what they were paid to do very effectively. They may not have been beloved, but they have been respected - where it counts the most - by politicians, on the campus, and among the media.

It is time for American business - which has demonstrated the greatest capacity in all history to produce and to influence consumer decisions - to apply ~~its~~ great talents vigorously to the preservation of the system itself.

The Cost

The type of program described above (which includes a broadly based combination of education and political action), if undertaken long term and adequately staffed, would require far more generous financial support from American corporations than the Chamber has ever received in the past. High level

management participation in Chamber affairs also would be required.

The staff of the Chamber would have to be significantly increased, with the highest quality established and maintained. Salaries would have to be at levels fully comparable to those paid key business executives and the most prestigious faculty members. Professionals of the great skill in advertising and in working with the media, speakers, lawyers and other specialists would have to be recruited.

It is possible that the organization of the Chamber itself would benefit from restructuring. For example, as suggested by union experience, the office of President of the Chamber might well be a full-time career position. To assure maximum effectiveness and continuity, the chief executive officer of the Chamber should not be changed each year. The functions now largely performed by the President could be transferred to a Chairman of the Board, annually elected by the membership. The Board, of course, would continue to exercise policy control.

Quality Control is Essential

Essential ingredients of the entire program must be responsibility and "quality control". The publications, the articles, the speeches, the media programs, the advertising,

the briefs filed in courts, and the appearances before legislative committees - all must meet the most exacting standards of accuracy and professional excellence. They must merit respect for their level of public responsibility and scholarship, whether one agrees with the viewpoints expressed or not.

Relationship to Freedom

The threat to the enterprise system is not merely a matter of economics. It also is a threat to individual freedom.

It is this great truth - now so submerged by the rhetoric of the New Left and of many liberals - that must be reaffirmed if this program is to be meaningful.

There seems to be little awareness that the only alternatives to free enterprise are varying degrees of bureaucratic regulation of individual freedom - ranging from that under moderate socialism to the iron heel of the leftist or rightist dictatorship.

We in America already have moved very far indeed toward some aspects of state socialism, as the needs and complexities of a vast urban society require types of regulation and control that were quite unnecessary in earlier times. In some areas, such regulation and control already have seriously impaired the freedom of both business and labor, and indeed of the public generally. But most of the essential freedoms

remain: private ownership, private profit, labor unions, collective bargaining, consumer choice, and a market economy in which competition largely determines price, quality and variety of the goods and services provided the consumer.

In addition to the ideological attack on the system itself (discussed in this memorandum), its essentials also are threatened by inequitable taxation, and - more recently - by an inflation which has seemed uncontrollable.* But whatever the causes of diminishing economic freedom may be, the truth is that freedom as a concept is indivisible. As the experience of the socialist and totalitarian states demonstrates, the contraction and denial of economic freedom is followed inevitably by governmental restrictions on other cherished rights. It is this message, above all others, that must be carried home to the American people.

Conclusion

It hardly need be said that the views expressed above are tentative and suggestive. The first step should be a thorough study. But this would be an exercise in futility unless

*The recent "freeze" of prices and wages may well be justified by the current inflationary crisis. But if imposed as a permanent measure the enterprise system will have sustained a near fatal blow.

the Board of Directors of the Chamber accepts the fundamental premise of this paper, namely, that business and the enterprise system are in deep trouble, and the hour is late.

L.F.P., Jr.

51/167

S E C R E T.

W.P.(G)(40) 211.

COPY NO. 51

9TH AUGUST, 1940.

WAR CABINET.

BREVITY.

Memorandum by the Prime Minister.

To do our work, we all have to read a mass of papers. Nearly all of them are far too long. This wastes time, while energy has to be spent in looking for the essential points.

I ask my colleagues and their staffs to see to it that their Reports are shorter.

- (i) The aim should be Reports which set out the main points in a series of short, crisp paragraphs.
- (ii) If a Report relies on detailed analysis of some complicated factors, or on statistics, these should be set out in an Appendix.
- (iii) Often the occasion is best met by submitting not a full-dress Report, but an Aide-memoire consisting of headings only, which can be expanded orally if needed.
- (iv) Let us have an end of such phrases as these: "It is also of importance to bear in mind the following considerations.....", or "Consideration should be given to the possibility of carrying into effect.....". Most of these woolly phrases are mere padding, which can be left out altogether, or replaced by a single word. Let us not shrink from using the short expressive phrase, even if it is conversational.

Reports drawn up on the lines I propose may at first seem rough as compared with the flat surface of officialese jargon. But the saving in time will be great, while the discipline of setting out the real points concisely will prove an aid to clearer thinking.

W.S.C.

10, Downing Street.

9TH AUGUST, 1940.

Founders Online

FROM GEORGE WASHINGTON TO THE STATES, 8 JUNE 1783

(Circular)

Head Quarters Newburgh June 8-21st

Sir

1783

The great object, for which I had the honor to hold an Appointment in the service of my Country being accomplished, I am now preparing to resign it into the hands of Congress, and to return to that domestic retirement; which it is well known I left with the greatest reluctance, a retirement for which I have never ceased to sigh through a long and painfull absence, and in which (remote from the noise and trouble of the World) I meditate to pass the remainder of life, in a state of undisturbed repose: But before I carry this resolution into effect, I think is a duty incumbent on me, to make this my last official communication, to congratulate you on the glorious events which Heaven has been pleased to produce in our favor, to offer my sentiments respecting some important subjects which appear to me to be intimately connected with the tranquility of the United States, to take my leave of your Excellency as a public Character, and to give my final blessing to that Country, in whose service I have spent the prime of my life, for whose sake I have consumed so many anxious days and watchful nights, and whose happiness, being extremely dear to me, will always constitute no inconsiderable part of my own.

Impressed with the liveliest sensibility on this pleasing occasion, I will claim the indulgence of dilating the more copiously on the subjects of our mutual felicitation—When we consider the magnitude of the prize we contended for, the doubtful nature of the Contest, and the favorable manner in which it has terminated, we shall find the greatest possible reason for gratitude and rejoicing—This is a theme that will afford infinite delight to every benevolent & liberal Mind, whether the event in contemplation be considerd as the source of present enjoyment or the parent of future happiness; and we shall have equal occasion to felicitate ourselves, on the lot which Providence has assigned us, whether we view it in a natural, a political, or a moral point of light.

The Citizens of America, placed in the most enviable condition, as the sole Lords and Proprietors of a vast tract of Continent, comprehending all the various Soils and Climates of the World and abounding with all the necessaries and conveniences of life, are now, by the late satisfactory pacification, acknowledged to be possessed of absolute freedom and Independancy—They are from this period to be considered as the Actors, on a most conspicuous Theatre, which seems to be peculiarly designated by Providence for the display of human greatness and felicity, here they are not only surrounded with every thing which can contribute to the completion of private and domestic enjoyment, but Heaven has crowned all its other blessings by giving a fairer opportunity for political happiness, than any other Nation has ever been favored with—Nothing can illustrate these observations more forcibly than a recollection of the happy conjuncture of times and circumstances under which our Republic assumed its Rank among the Nations—the foundation of our Empire was not laid in the gloomy Age of ignorance and superstition, but at an Epocha when the rights of Mankind were better understood and more clearly defined, than at any former period—The researches of the human Mind after social happiness have been carried to a great extent, the treasures of knowledge acquired by the labours of Philosophers, Sages and Legislators, through a long succession of years, are laid open for our use and their collected wisdom may be happily applied in the establishment of our forms of Government. The free cultivation of letters, the unbounded extension of Commerce, the progressive Refinement of manners, the growing liberality of sentiment, and, above all, the pure and benign light of Revelation, have had a meliorating influence on Mankind and encreased the blessings of Society. At this Auspicious period the United States came into existence as a Nation, and if their Citizens should not be completely free & happy, the fault will be entirely their own.

Such is our situation, and such are our prospects: but notwithstanding the Cup of blessing is thus reached out to us, notwithstanding happiness is ours if we have a disposition to seize the occasion and make it our own, yet it appears to me there is an option still left to the United States of America; that it is in their choice and depends upon their conduct, whether they will be respectable and prosperous or contemptible and Miserable as a Nation. This is the time of their political probation: this is the moment when the eyes of the whole World are turned upon them—This is the moment to establish or ruin their National Character for ever—This is the favorable moment to give such a tone to our federal Government, as will

enable it to answer the ends of its institution—or this may be the ill fated moment for relaxing the powers of the Union, annihilating the cement of the Confederation and exposing us to become the sport of European Politicks, which may play one State against another, to prevent their growing importance and to serve their own interested purposes; for according to the System of Policy the States shall adopt at this moment, they will stand or fall, and by their confirmation or lapse, it is yet to be decided whether the Revolution must ultimately be considered as a blessing or a curse: a blessing or a curse, not to the present Age alone, for with our fate will the destiny of unborn Millions be involved.

With this conviction of the importance of the present Crisis, silence in me would be a crime; I will therefore speak to your Excellency the language of freedom and sincerity without disguise. I am aware, however, that those who differ from me in political sentiment may perhaps remark I am stepping out of the proper line of my duty, and they may possibly ascribe to arrogance or ostentation what I know is alone the result of the purest intention; but the rectitude of my own heart, which despairs such unworthy motives; the part I have hitherto acted in life; the determination I have formed of not taking any share in public business hereafter; the ardent desire I feel and shall continue to manifest of quietly enjoying in private life, after all the toils of War, the benefits of a wise and liberal Government, will, I flatter myself, sooner or later convince my Country men that I could have no sinister views in delivering, with so little Reserve, the opinions contained in this address.

There are four things, which I humbly conceive are essential to the well being, I may even venture to say to the existence, of the United States as an independent Power.

1st An indissoluble Union of the States under one federal Head.

2ndly A sacred regard to public Justice.

3dly The adoption of a proper Peace Establishment—and

4thly The prevalence of that pacific and friendly disposition among the people of the United States, which will induce them to forget their local prejudices and policies, to make those mutual concessions which are requisite to the general prosperity, and, in some instances, to sacrifice their individual advantages to the interest of the community.

These are the pillars on which the glorious fabrick of our Independancy and National Character must be supported — Liberty is the basis—and whoever would dare to sap the foundation or overturn the Structure under whatever specious pretexts he may attempt it, will merit the bitterest execration and the severest punishments which can be inflicted by his injured Country.

On the three first Articles I will make a few observations, leaving the last to the good sense and serious consideration of those immediately concerned.

Under the first head, altho it may not be necessary or proper for me in this place to enter into a particular disquisition of the principles of the Union and to take up the great question which has been frequently agitated, whether it be expedient and requisite for the States to delegate a larger proportion of Power to Congress or not, yet it will be a part of my duty, and that of every true Patriot; to assert without reserve and to insist upon the following positions—That unless the States will suffer Congress to exercise those prerogatives they are undoubtedly invested with by the Constitution, every thing must very rapidly tend to Anarchy and confusion—that it is indispensable to the happiness of the individual States that there should be lodged somewhere, a supreme power to regulate and govern the general concerns of the confederated Republic, without which the Union cannot be of long duration—That there must be a faithfull and pointed compliance on the part of every State with the late proposals and demands of Congress, or the most fatal consequences will ensue; that whatever measures have a tendency to dissolve the Union, or contribute to violate or lessen the Sovereign Authority, ought to be considered as hostile to the Liberty and Independancy of America and the Authors of them treated accordingly; and lastly, that unless we can be enabled, by the concurrence of the States, to participate of the fruits of the Revolution, and enjoy the essential benefits of civil Society, under a form of Government so free and uncorrupted, so happily guarded against the danger of oppression as has been devised and adopted by the Articles of Confederation, it will be a subject of regret that so much blood and treasure have been lavished for no purpose; that so many sufferings have been encounter'd, without a compensation and that so many sacrifices have been made in vain.

Many other considerations might here be adduced to prove, that without an entire conformity to the spirit of the Union we cannot exist—as an independant Power. It will be sufficient for my purpose, to mention but one or two which seem to me of the greatest importance. It is only in our United Character, as an Empire, that our Independance is acknowledged, that our

power can be regarded or our Credit supported among foreign Nations—the Treaties of the European Powers with the United States of America will have no validity on a dissolution of the Union. We shall be left nearly in a State of Nature, or we may find by our own unhappy experience, that there is a natural and necessary progression from the extreme of Anarchy to the extreme of Tyranny, and that arbitrary power is most easily established on the ruins of Liberty abused to Licentiousness.

As to the second Article, which respects the performance of public justice, Congress have in their late address to the United States almost exhausted the Subject, they have explained their ideas so fully and have enforced the obligations the States are under to render compleat justice to all the public Creditors, with so much dignity and energy, that in my opinion no real friend to the honour and Independancy of America, can hesitate a single moment respecting the propriety of complying with the just and honorable measures proposed—If their Arguments do not produce conviction, I know of nothing that will have greater influence, especially when we recollect that the System referred to, being the result of the collected wisdom of the Continent, must be esteemed, if not perfect, certainly the least objectionable of any that could be devised, and that if it shall not be carried into immediate execution, a National bankruptcy, with all its deplorable consequences, will take place before any different plan can possibly be proposed and adopted, so pressing are the present circumstances! and such is the alternative now offerd to the States!

The ability of the Country to discharge the debts which have been incurred in its defence, is not to be doubted, an inclination I flatter myself will not be wanting: the path of our duty is plain before us—honesty will be found on every experiment to be the best and only true policy—let us then as a Nation be just—let us fulfill the public Contracts which Congress had undoubtedly a right to make for the purpose of carrying on the War, with the same good faith we suppose ourselves bound to perform our private engagements; in the mean time let an attention to the chearfull performance of their proper business as individuals and as members of Society be earnestly inculcated on the Citizens of America—then will they strengthen the hands of Government & be happy under its protection, every one will reap the fruit of his Labours, every one will enjoy his own acquisitions without molestation and without danger.

In this state of absolute freedom and perfect security, who will grudge to yield a very little of his property to support the common interests of Society and ensure the protection of Government? who does not remember the frequent declarations at the commencement of the War that we should be completely satisfied, if at the expence of one half, we could defend the remainder of our possessions! where is the Man to be found who wishes to remain indebted for the defence of his own person and property to the exertions, the bravery and the blood of others, without making one generous effort to repay the debt of honor and of gratitude? In what part of the Continent shall we find any Man or body of Men who would not blush to stand up and propose measures purposely calculated to rob the Soldier of his Stipend and the public Creditor of his due and were it possible that such a flagrant instance of injustice could ever happen, would it not excite the general indignation and tend to bring down upon the authors of such measures the aggravated vengeance of Heaven?

If after all, a spirit of disunion or a temper of obstinacy and perverseness should manifest itself in any of the States; if such an ungracious disposition should attempt to frustrate all the happy effects that might be expected to flow from the Union; if there should be a refusal to comply with the Requisitions for funds to discharge the annual Interest of the public Debts and if that refusal should revive again all those jealousies and produce all those evils which are now happily removed, Congress, who have, in all their transactions, shewn a great degree of magnanimity and justice, will stand justified in the sight of God and Man and the State alone which puts itself in opposition to the aggregate wisdom of the Continent and follows such mistaken and pernicious councils, will be responsible for all the Consequences.

For my own part, conscious of having acted, while a servant of the public, in the manner I conceived best suited to promote the real interests of my Country, having in consequence of my fixed belief, in some measure, pledged myself to the Army that their Country would finally do them compleat and ample Justice and not wishing to conceal any instance of my official conduct from the eyes of the World, I have thought proper to transmit to your Excellency the inclosed collection of papers relative to the half-pay & commutation granted by Congress to the Officers of the Army. From these communications my decided sentiment will be clearly comprehended, together with the conclusive reasons which induced me, at an early period, to recommend the adoption of this measure in the most earnest and serious manner. As the proceedings of Congress, the Army and myself are open to all and contain in my opinion sufficient information to remove the prejudices and errors which may have been entertained by any, I think it unnecessary to say anything more, than just to observe, that the resolutions of Congress now alluded to, are undoubtedly as absolutely binding upon the United States, as the most solemn

Acts of Confederation or Legislation. As to the idea which, I am informed, has in some instances prevailed, that the half pay and Commutation are to be regarded merely in the odious Light of a pension, it ought to be exploded forever—that provision should be viewed as it really was, a reasonable compensation offerd by Congress at a Time when they had nothing else to give to the Officers of the Army for services then to be performed. It was the only means to prevent a total dereliction of the Service—it was a part of their hire, I may be allowed to say, it was the price of their blood and of your Independancy—it is therefore more than a common debt, it is a debt of honor—it can never be considered as a pension or gratuity nor be cancelled untill it is fairly discharged.

With regard to a distinction between Officers and Soldiers, it is sufficient that the uniform experience of every Nation of the World combined with our own, proves the utility and propriety of the discrimination—Rewards in proportion to the Aids the Public derives from them, are unquestionably due to all its Servants—In some Lines, the Soldiers have perhaps generally had as ample a compensation for their Services, by the large bounties which have been paid them, as their Officers will receive in the proposed commutation; in others, if besides the donation of Lands, the payment of Arrearages of Cloathing and Wages (in which Articles all the component parts of the Army must be on the same footing) we take into the estimate the bounties many of the Soldiers have received and the gratuity of one years full pay which is promised to all, possibly their situation (every circumstance being duly considered) will not be deemed less eligible than that of the Officers, should a farther Reward however be judged equitable, I will venture to assert no one will enjoy greater satisfaction than myself, on seeing an exemption from Taxes for a limitted time (which has been petitioned for in some instances) or any other adequate compensation or immunity, granted to the brave defenders of their Countrys cause; but neither the adoption or rejection of this proposition, will in any manner affect, much less militate against, the Act of Congress by which they have offer'd five Years full pay in lieu of half pay for life, which had been before promised to the Officers of the Army.

Before I conclude the Subject of public justice, I cannot omit to mention the obligations this Country is under to that meritorious class of veteran non Commission'd Officers and Privates who have been discharged for inability, in consequence of the resolution of Congress of the 23d April 1782, on an annual pension for life; their peculiar sufferings, their singular merits and claims to that provision, need only be known, to interest all the feelings of humanity in their behalf; nothing but a punctual payment of their annual allowance, can rescue them from the most complicated misery, and nothing could be a more melancholy and distressing sight, than to behold those who have shed their blood or lost their limbs in the service of their Country, without a shelter, without a friend and without the means of obtaining any of the necessaries of life or comforts of life compelled to beg their daily bread from door to door! Suffer me to recommend those of this description belonging to your State to the warmest patronage of your Excellency and your Legislature.

It is necessary to say but a few words on the third topic which was proposed and which regards particularly the defence of the Republic—As there can be little doubt but Congress will Recommend a proper Peace Establishment for the United States in which a due attention will be paid to the importance of placing the Militia of the Union upon a regular and respectable footing—if this should be the case, I would beg leave to urge the great advantage of it in the strongest terms—the Militia of this Country must be considerd as the Palladium of our security and the first effectual resort, in case of hostility; It is essential therefore, that the same system should pervade the whole—that the formation & discipline of the Militia of the Continent should be absolutely uniform and the same species of Arms, Accoutrements & Military Apparatus should be introduced in every part of the United States. No one, who has not learned it from experience, can conceive the difficulty, expence & confusion which result from a contrary System, or the vague Arrangements which have hitherto prevailed.

If in treating of political points, a greater latitude than usual has been taken in the course of this address—the importance of the Crisis and the magnitude of the objects in discussion, must be my apology—It is, however, neither my wish or expectation, that the preceding observations should claim any regard, except so far as they shall appear to be dictated by a good intention, consonant to the immutable rules of Justice—calculated to produce a liberal system of Policy and founded on what ever experience may have been acquired by a long and close Attention to public business—Here I might speak with the more confidence, from my actual observations and if it would not swell this Letter (already too prolix) beyond the bounds I had prescribed myself, I could demonstrate to every mind open to conviction, that in less time & with much less expence than has been incurred, the War might have been brought to the same happy, conclusion if the resources of the Continent could have been properly drawn forth—that the distresses and disappointments, which have very often occurred, have in too many instances resulted more from a want of energy in the Continental Government, than a deficiency of means in the particular

States—That the inefficacy of measures, arising from the want of an adequate authority in the supreme Power, from a partial compliance with the requisitions of Congress in some of the States and from a failure of punctuality in others, while it tended to damp the Zeal of those which were more willing to exert themselves, served also to accumulate the expences of the War and to frustrate the best concerted plans; and that the discouragement, occasioned by the complicated difficulties & embarrassments in which our affairs were by this means involved, would have long ago produced the dissolution of any Army, less patient, less virtuous and less persevering than that which I have had the honor to Command. But while I mention these things, which are notorious facts, as the defects of our Federal Constitution, particularly in the prosecution of a War, I beg it may be understood, that as I have ever taken a pleasure in gratefully acknowledging the assistance and support I have derived from every class of Citizens, so shall I always be happy to do justice to the unparralled exertions of the individual States on many interesting occasions.

I have thus freely disclosed, what I wished to make known, before I surrendered up my Public trust to those who committed it to me—the task is now accomplished—I now bid adieu to your Excellency, as the Chief Magistrate of your State at the same time I bid a last farewell to the cares of Office and all the employments of public life.

It remains then to be my final and only request, that your Excellency will communicate these sentiments to your legislature at their next meeting and that they may be considered as the Legacy of one who has ardently wished on all occasions to be usefull to his Country and who even in the shade of Retirement will not fail to implore the divine benediction upon it.

I now make it my earnest prayer, that God would have you and the State over which you preside, in his holy protection that he would incline the hearts of the Citizens to cultivate a spirit of subordination & obedience to Government, to entertain a brotherly affection and love for one another, for their fellow Citizens of the United States at large and particularly for their brethren who have served in the field—and finally that he would most graciously be pleas'd to dispose us all to do Justice, to love mercy and to demean ourselves, with that Charity, humility & pacific temper of mind, which were the Characteristicks of the Divine Author of our blessed Religion & without an humble immitation of whose example in these things, we can never hope to be a happy Nation. With the greatest regard and esteem, I have the honor to be Sir Your Excellency's Most Obedient and most humble Servant

Go: Washington

NNPM.

[Back to top](#)

SOURCE PROJECT	Washington Papers
TITLE	From George Washington to The States, 8 June 1783
AUTHOR	Washington, George
RECIPIENT	The States
DATE	8 June 1783
CITE AS	<p>“From George Washington to The States, 8 June 1783,”</p> <p><i>Founders Online</i>, National Archives,</p> <p>https://founders.archives.gov/documents/Washington/99-01-02-11404. [This is an Early Access document from The Papers of George Washington. It is not an authoritative final version.]</p>

The [National Historical Publications and Records Commission \(NHPRC\)](#) is part of the National Archives. Through its grants program, the NHPRC supports a wide range of activities to preserve, publish, and encourage the use of documentary sources, relating to the history of the United States, and research and development projects to bring historical records to the public.

Founders Online is an official website of the U.S. government, administered by the National Archives and Records Administration through the NHPRC, in partnership with the University of Virginia Press, which is hosting this website.

Pliny the Younger was governor of Pontus/Bithynia from 111-113 AD. We have a whole set of exchanges of his letters with the emperor Trajan on a variety of administrative political matters. These two letters are the most famous, in which P. encounters Christianity for the first time.

Pliny, Letters 10.96-97

Pliny to the Emperor Trajan

It is my practice, my lord, to refer to you all matters concerning which I am in doubt. For who can better give guidance to my hesitation or inform my ignorance? I have never participated in trials of Christians. I therefore do not know what offenses it is the practice to punish or investigate, and to what extent. And I have been not a little hesitant as to whether there should be any distinction on account of age or no difference between the very young and the more mature; whether pardon is to be granted for repentance, or, if a man has once been a Christian, it does him no good to have ceased to be one; whether the name itself, even without offenses, or only the offenses associated with the name are to be punished.

Meanwhile, in the case of those who were denounced to me as Christians, I have observed the following procedure: I interrogated these as to whether they were Christians; those who confessed I interrogated a second and a third time, threatening them with punishment; those who persisted I ordered executed. For I had no doubt that, whatever the nature of their creed, stubbornness and inflexible obstinacy surely deserve to be punished. There were others possessed of the same folly; but because they were Roman citizens, I signed an order for them to be transferred to Rome.

Soon accusations spread, as usually happens, because of the proceedings going on, and several incidents occurred. An anonymous document was published containing the names of many persons. Those who denied that they were or had been Christians, when they invoked the gods in words dictated by me, offered prayer with incense and wine to your image, which I had ordered to be brought for this purpose together with statues of the gods, and moreover cursed Christ--none of which those who are really Christians, it is said, can be forced to do--these I thought should be discharged. Others named by the informer declared that they were Christians, but then denied it, asserting that they had been but had ceased to be, some three years before, others many years, some as much as twenty-five years. They all worshipped your image and the statues of the gods, and cursed Christ.

They asserted, however, that the sum and substance of their fault or error had been that they were accustomed to meet on a fixed day before dawn and sing responsively a hymn to Christ as to a god, and to bind themselves by oath, not to some crime, but not to commit fraud, theft, or adultery, not falsify their trust, nor to refuse to return a trust when called upon to do so. When this was over, it was their custom to depart and to assemble again to partake of food--but ordinary and innocent food. Even this, they affirmed, they had ceased to do after my edict by which, in accordance with your instructions, I had forbidden political associations. Accordingly, I judged it all the more necessary to find out what the truth was by torturing two female slaves who were called deaconesses. But I discovered nothing else but depraved, excessive superstition.

I therefore postponed the investigation and hastened to consult you. For the matter seemed to me to warrant consulting you, especially because of the number involved. For many persons of every age, every rank, and also of both sexes are and will be endangered. For the contagion of this superstition has spread not only to the cities but also to the villages and farms. But it seems possible to check and cure it. It is certainly quite clear that the temples, which had been almost deserted, have begun to be frequented, that the established religious rites, long neglected, are being resumed, and that from everywhere sacrificial animals are coming, for which until now very few purchasers could be found. Hence it is easy to imagine what a multitude of people can be reformed if an opportunity for repentance is afforded.

Trajan to Pliny

You observed proper procedure, my dear Pliny, in sifting the cases of those who had been denounced to you as Christians. For it is not possible to lay down any general rule to serve as a kind of fixed standard. They are not to be sought out; if they are denounced and proved guilty, they are to be punished, with this reservation, that whoever denies that he is a Christian and really proves it--that is, by worshiping our gods--even though he was under suspicion in the past, shall obtain pardon through repentance. But anonymously posted accusations ought to have no place in any prosecution. For this is both a dangerous kind of precedent and out of keeping with the spirit of our age.

**Memorandum of conversation between M. S. Gorbachev and U.S. Secretary of State
G. Shultz. Excerpt.
October 23, 1987**

Gorbachev: First of all, I would like to extend a warm welcome to you, Mr. Secretary of State. Taking into account the fact that you came here soon after your meeting with E. A. Shevardnadze in Washington, maybe we can say that our relations are becoming more dynamic. We welcome this. The main thing now is the substance. And here, as it appears to us, something is emerging.

Shultz: We always want to concentrate our attention on the substance. At the same time, it is true that more and more active contacts at the upper levels help move the work on the substance of important issues further. Therefore, a certain interconnectedness exists between the process of our interaction and progress on the concrete issues. I think we can make note of considerable progress on the substantive issues. In my toast at breakfast yesterday, I said that in ten years history will register the fact that in Reykjavik we achieved more than at any other summit in the past.

Gorbachev: I agree with you. I would say that an intellectual breakthrough took place in Reykjavik, and that it was very powerful, that it had a shocking effect, resembling a reaction at a stock exchange. Later, when many things calmed down, and when people figured things out, it became generally accepted that Reykjavik opened a new, very important stage in the political dialogue between our countries, especially on the most important issues of security.

I would like to welcome Mr. Carlucci, who arrived with you. We are hoping that he will make a positive contribution to our search for resolutions on the issues under discussion.

Shevardnadze: Mr. Carlucci made a constructive contribution to our work in Washington.

Gorbachev: Why don't we do the same here?

Shultz: I have worked with Mr. Carlucci since the 1970s, when he was with the government's Office of Economic Opportunity—the organization, which works on helping to solve such problems as poverty, assistance to the poor, and so on. Then he worked with me at the Office of Management and Budget. That is the organization whose members constantly reject requests for resources from other government bureaus. Overall, Mr. Carlucci has more extensive experience in various government bureaus than perhaps anybody else. He has worked in the departments of Defense and State, in intelligence, and on issues of domestic policy. He has rich experiences and we always work well together.

Gorbachev: Then he should know well that there cannot be any agreement if the interests of the partner in a negotiation are not taken into account. I say this because S. F. Akhromeev and P. Nitze, who are present here, act differently: they want to bargain for

better conditions for their side, to achieve superiority for the Soviet Union and for the USA, respectively.

Shultz: I am sure this does not characterize Akhromeev. It does characterize Nitze.

Akhromeev: We were able to agree with him on many issues.

Gorbachev: I think that the fact that the military takes part in our meetings is also very important. It shows that our relations have reached a new stage. If we don't intend to fight each other and, more than that, if we are going to disarm, —then our militaries should also know each other and work together.

Shultz: I completely agree with that. If one looks at the history of Soviet-American relations, then one sees that in one sphere [our] cooperation was able to survive all the highs and lows of our relations, and to preserve its constructive character. I have in mind the interaction of our navies within the framework of the agreement on preventing accidents on the high seas. Therefore, we would consider it important that meetings be held between our defense ministers and other military representatives, meetings between Marshal Akhromeev and the chairman of the U.S. Joint Chiefs of Staff, Admiral Crowe.

Gorbachev: Good. Let us now discuss how we are going to conduct our meeting. We are in a process of democratization in our country now. And that means that this issue should also be resolved in a democratic fashion taking into account both your and our considerations. Maybe you could tell us what you discussed with E. A. Shevardnadze. And then it will be clear what we should discuss with you today.

Shultz: Good. I would like to summarize briefly the discussions that took place. We have developed a certain process, which allows us to consider all the issues that are of interest to both sides. Within the framework of this process, the work is conducted on the basis of combining meetings in a comparatively narrow circle with the work of the working groups, which discuss more concrete issues. We believe that this is a good process.

Gorbachev: Yes, this organization of [our] work has proven itself.

Shultz: We have assembled a good group to conduct the main negotiations: from the Soviet side it is E. A. Shevardnadze together with A. F. Dobrynin and A. A. Bessmernykh; and from our side, myself, F. Carlucci, and R. Ridgeway. We created working groups, which did some good work on such issues as bilateral relations, human rights and humanitarian issues, arms control. We also created, I would say spontaneously, a group on conventional weapons. Nonetheless, the most productive part of the discussion on regional issues took place within the small group.

We discussed a number of arms control issues. The working group on conventional weapons tried as much as possible to help the discussions, which are now conducted in Vienna, about the mandate for future negotiations on conventional weapons. Another

group held a useful discussion, in our view, on chemical weapons. As far as negotiations on nuclear and space weapons are concerned, we had a separate working group on INF and SRINF, as well as a working group, which discussed strategic weapons and space—the ABM. In addition, these latter issues were discussed in a detailed way at the ministerial level.

We came here with a task and instructions from the President to complete the bulk of our work on the treaty on intermediate and medium-range missiles, i.e. if not to literally dot the last “i”, then to reach a stage where it would be sufficiently clear that this task is solvable. The President also starts from the assumption that the key issue is strategic weapons. We have also noted your statement to the effect that this is the cardinal problem, as well as another statement in which you said that the work on the strategic offensive weapons could be completed before the spring of next year. We agree with this task and we would like to have a sufficient degree of progress to allow us to talk not about the INF but mainly about strategic weapons during your visit to the USA, which we hope will take place, and to establish a foundation for completing our work in this area. This is our goal.

We clarified a number of issues on INF and SRINF. It relates in particular to the so-called problem of Pershing 1A [missiles] in the FRG, as well as to some other issues. We have to say that we resolved most of those issues at the ministerial level. There remain a number of issues, which the working group was working on last evening and night. I must say that I was disappointed with the report of that working group. I think that we should make them do some serious work. We hear too many statements that such-and-such issue should be left for consideration in Geneva, to which I say: no, this issue should be resolved here because the people working in Geneva receive their instructions from Moscow and Washington. Today, the people who can make the appropriate decisions are gathered here, and it is necessary to resolve those issues.

In short, I was hoping to inform you that the main issues on INF and SRINF weapons have been resolved. Unfortunately, I cannot do that. However, I can say that all of these issues seem to be quite resolvable.

As far as the ABM and space are concerned, those discussions between us and within the working group were, I believe, not useless. I think that we were at least able to identify those key issues, on which we will need major political decisions. It also became clear which issues will require a more comprehensive, detailed working through. I believe that now, when we, while maximizing our efforts, are taking the final steps toward the treaty on INF and SRINF, it has become especially clear how complex the issues of verification are in all their detail and specifics. And when we start talking about the treaty on strategic weapons, where even after the cuts there will remain a large quantity of armaments subject to verification, the complexity and difficulty of control will be even greater.

That is why we agreed that it is necessary right now to step up our efforts seriously in this sphere. This is especially relevant to one big problem, which we admit. I have in mind

our differences on ground-based mobile missiles. As I explained, the problem is not that we have objections in principle to mobile missiles. To the contrary, these weapons in principle have some advantages. The problem is that everything on which we agree should be subject to reliable verification. That is why we agreed that this issue will be given priority attention, so that by the time of your visit, which we hope will take place, substantial work will have been conducted that will help you and the President to discuss that issue.

Shevardnadze: In principle, I agree with the assessments presented by the Secretary of State.

Gorbachev: I see, you have agreed on everything? What is left for me and the President?

Shevardnadze: I said—in principle.

Shultz: If not for the work accomplished by you, Mr. General Secretary, and the President, in particular in Reykjavik, we would now be so mired in a bog that we would not be able to move a step.

Shevardnadze: Of course, the agreement achieved in Washington on the liquidation of two classes of missiles was made possible only on the basis of Reykjavik. One has to say that even after Washington, the positive tendency has continued, thanks to which we have been able to achieve agreement on a number of issues that seemed very difficult.

Yesterday we were able to agree on a formula regarding warheads for the Pershing-1A. That is a complex and sensitive matter. On that issue, we were able to find a solution that will be acceptable to the USA, the FRG, taking their alliance obligation into account, and to us as well.

The issue of the overall timetable for eliminating intermediate and shorter-range missiles turned out to be rather difficult. Yesterday we agreed in principle that for medium-range missiles it would be a three-year period, and for shorter-range missiles a year and a half, with consideration for technological capabilities in this sphere.

Discussion of a number of issues will be continued. We had a good discussion on the issue of non-circumvention, not allowing transfers of relevant technologies to third countries. I think a mutually acceptable compromise is emerging in this sphere.

There are still quite a few difficult problems in the area of verification and inspections. These problems can be solved on the basis of an objective approach with the understanding that there are a number of sensitive problems and difficult aspects touching upon the interests of the United States and the Soviet Union.

Gorbachev: I think Mr. Shultz put it right when he said that the most important issue now is no longer intermediate and shorter-range missiles, but the prospects for resolving the problem of strategic offensive weapons, and the shifting of negotiations to the plane

of practical decisions. As far as the remaining issues of the INF treaty are concerned, they should be resolved in such a way that both of us have complete confidence and there will be no anxiety regarding treaty implementation.

Shevardnadze: Yes, this is precisely the basis on which we should continue the discussions. At the same time we emphasize that the United States has its own system of missile production and deployment, which differs from our system. We have our own system. And today we stated that in order to work out a realistic agreement, it is necessary to take these differences into account.

Shultz: I agree with that. We do not argue with that.

Shevardnadze: I think that on some fundamental issues it is necessary to make a decision now, today. We have to be clear. In the opposite case, if we leave these issues open, if we transfer them to Geneva, they could persist for a long time.

Gorbachev: Yes, the main issues should be decided here, and leave only technical issues for Geneva. We have the appropriate experience.

Shevardnadze: The second group of issues is disarmament. This, as was correctly noted here, consists of the cardinal problem of radical reductions in strategic offensive weapons and the ABM treaty. In this sphere, results have been more modest. I would say that it is hard to speak of any results whatsoever. Yesterday I openly told the Secretary of State that after Reykjavik the Soviet side made substantial changes, which took into account the interests of the United States, and made significant steps toward the U.S. position. However, precisely after Reykjavik, the U.S. administration added a number of complicating factors to its position, which are causing problems in the negotiations and retarding progress on the main issue.

Gorbachev: If we recall our Reykjavik marathon, then it was precisely the issue of the ABM in space, which became the main obstacle that we were not able to overcome in the end. Obviously, you drew the attention of the Secretary of State to the fact that space remains the biggest obstacle. One also has to note that while we introduced positive elements, elements of flexibility, into our position, the American side continued to stand on its position of reinforced concrete. And it is precisely that position which impedes progress toward an agreement on this issue, which is not only central to Soviet-American relations, but is the most important issue for the entire world. How are we going to move ahead?

Shevardnadze: Yes, it was precisely after Reykjavik that the new elements that are making negotiations more difficult, such as the demand to eliminate all Soviet heavy missiles, appeared in the American position.

Gorbachev: And by the way, we were ready to eliminate them, but in tandem with you, in tandem with the elimination of all nuclear weapons.

Shevardnadze: Absolutely true. And the American side is presenting demands to resolve this issue on a purely unilateral basis. They are also raising the issue of banning mobile ICBMs, and proposing to count middle-range bombers as strategic weapons when that question was already decided in 1979 when the SALT II treaty was negotiated. Also, the American side does not agree to resolve the issue of limiting the number of sea-based cruise missiles. As you know, in Reykjavik we agreed to resolve this issue separately, outside the framework of the main strategic triad. However, it is clear that if sea-based cruise missiles are not limited, it could open a new channel in the arms race, and create an opportunity to circumvent the treaty.

The American side raised the issue of stepping up discussions of verification. We believe that if the main fundamental issues of the future agreement are resolved, we would be able to find a solution to the issues of verification.

As far as the ABM treaty is concerned, yesterday I presented our position in detail. The essence of it is that if there is any retreat from the mutual understanding achieved in Reykjavik about the need for a 10-year period of non-withdrawal from the ABM Treaty, along with strict compliance with its provisions, it would make it impossible to achieve agreement on strategic offensive weapons. The American side is aware of the fact that we developed and clarified our position on such issues as laboratory research, research conducted at plants, testing grounds, etc. The USA is also aware of our new proposals regarding development of a list of devices that would be banned from space, and our proposals regarding the specific parameters and characteristics of such devices.

It so happened that we did not have time for a sufficiently comprehensive discussion of this group of questions. But yesterday we reminded the American side that in order for the summit to be fruitful and full-scale, it would be very important to coordinate our key positions on these issues.

As far as chemical and conventional weapons are concerned, they were discussed within the working groups. Today we will listen to their reports on those issues. We also discussed such regional issues as the situation in the Persian Gulf in particular. Yesterday, while discussing those themes, we stayed up almost until midnight. The discussion was serious, and at times sharp.

Gorbachev: On this last issue I would like to say the following. It might seem to you that sometimes we present demands against the position of the American side that are too great. But here are two instances of principal importance. First of all, we are not sure that you have calculated everything well, that you really understand where this policy might lead for you, for us, and for the entire world.

Secondly—although in terms of importance it might be the main instance—we believe that our interaction in the Persian Gulf is the freshest example that proves the possibility of constructive cooperation between the USSR and USA in resolving a most acute international problem. It was precisely this cooperation that led to the adoption of well-known documents by the [U.N.] Security Council. We believe, and we have told you that

and stated it publicly, that we still have substantial potential there. And we need to use our coordinated positions on Resolution 598¹ to the fullest extent, [in order] not to allow that situation to escalate to a new level.

However, the United States is apparently offended by the fact that we did not support its demand for sanctions, for a second resolution, and [you] decided to act alone, like “the good old days.” We believe that the cooperation that has developed there is a positive new factor, and is important for our overall relations. However, the United States has preferred to throw away this interaction and to act alone. I will not talk about the reasons for why it happened, but I want to say that your withdrawal from cooperation with us creates disappointment. This political line is wrong. In addition, I repeat, we believe that it could have very serious consequences, which, you, apparently, did not analyze. We are watching America's actions. For our part, we are searching for ways to improve relations with the U.S., ways to lead them to a new stage.

Shevardnadze: Mikhail Sergeevich, I presented our position during yesterday's discussions in that exact same spirit. We believe that it is very important to preserve the unity of the permanent members of the Security Council. The Soviet Union proceeds from the assumption that resolution of the conflict in the Persian Gulf is possible. But for this it is imperative to use the capabilities of the UN Security Council, in particular an organ such as the Military Staff Committee, to the fullest extent.

I would like to summarize. The agreement on INF and SRINF does not look like a distant possibility any longer. Given mutual desires, I believe it is possible to complete all work on this treaty in, let's say, three weeks' time. As far as the key principles of strategic offensive weapons and the ABM are concerned, here some serious work is required. But now, regrettably, we do not have a serious basis for resolving the issue of a 50% reduction in strategic offensive weapons under conditions of preserving the ABM Treaty. I think that our task is to prepare a serious, solid basis for resolving this problem for the summit.

Shultz: Speaking broadly, we have approximately the same impression. Nothing to argue about here. As far as INF are concerned, I think that we should try to resolve the majority of issues on the list prepared by the [working] group today. All that should be left for Geneva would be editing work, dotting the last “i’s”. We would prefer not to leave the resolution of serious issues for Geneva, where participants in the negotiations would have to wait for instructions from Washington and Moscow.

Gorbachev: We would welcome such approach.

Shultz: As far as strategic weapons are concerned, this is a very important sphere where we want to achieve some progress. E. A. Shevardnadze told me that you personally have devoted a lot of time and attention to these issues, and that you probably would have some thoughts, which you will present today personally. We would like to hear them.

¹ A key Security Council resolution calling for an end to the Iran-Iraq War.

Several words about the Persian Gulf. As you noted, one very good opportunity has emerged—the cooperation between us within the framework of U.N. diplomatic efforts. We want this cooperation to produce results. We believe that it could help resolve this military conflict, which is poisoning the entire international situation. We think that there could be nothing better to strengthen the prestige of the U.N. than to achieve success in resolving a difficult problem. A success of that kind would be miraculous medicine for the United Nations. Success would show people that if we undertake something, we are capable of achieving our goals.

I would like to assure you that we do not strive to act alone. We want the process to function, to work within the U.N. framework. As far as our ships in the Gulf are concerned, there are now more ships from European states and from the Gulf states there. American ships constitute only a third, or maybe a fourth, of the overall number of ships there. Why do we and others find ourselves there? Because Iran and the war in this region represent a threat—a threat to our friends in the Gulf and to the flow of oil, the main source of energy for the countries of the West. We have to provide support for our friends in the Gulf. We have to ensure the safety of supplies of such an important source of energy. Because now and in the future this region will remain one of the main suppliers of oil for the entire world.

I told your Minister that our forces deployed in the Gulf would be reduced if the acuteness of the problem is reduced. They are deployed there precisely in connection with this problem, not to create a permanent presence there. [...]

[...] We cannot discount that. At the same time we are not looking for confrontation. However, we cannot allow the Iranians to have a blank check.

Yesterday we discussed this issue in detail. We discussed it from the perspective of the situation in the Security Council. In the immediate future the U.N. General Secretary will present a new version of a package solution on implementing the Security Council Resolution for consideration by all sides. Iraq will accept this proposal. We discussed the issue of what we would do if by the end of the month it becomes clear that Iran is continuing to play games. How should we act in the Security Council in that case? We believe that we should take this to the end. We cannot allow Iran to make a laughing stock out of the U.N. Security Council. The Council has defined its position and it is necessary that it take this to the end.

Gorbachev: I don't want to get into detailed discussion of this issue right now. But it is a serious, important issue. This problem could bury many things, including, unfortunately, things in our relationship. I only want to say: we hope that you will weigh all this, that you will not be overpowered by certain forces and emotions. This is very serious business. It might lead to very serious consequences. Let us continue the line that we have worked out together. Its potential has not yet been exhausted.

Shultz: I can agree with that. Indeed, we need to work within the U.N. framework because something really important has happened at the U.N.

Gorbachev: I would like to return to what we were discussing earlier. Indeed, we can see that it is not just that the tempo of our progress that is accelerating. There is also a certain amount of progress on the concrete issues under consideration. I would say that if one takes a look at the progress from Geneva through Reykjavik to today, we have succeeded in clarifying many issues.

[....]

In their search for solutions the sides undertook concrete steps to meet each other halfway. I must say sincerely: in our view, we undertook more of those steps. And in you we still detect a tendency to squeeze as much as possible out of us. What can one do, somebody has to do more, take this additional step, and we decided to do it. But this movement that started gave birth to great expectations among our peoples, and in the entire world. Therefore the anticipation that the next stage of our relations should produce concrete results is completely natural. They have been waiting for them for a long time now. If that does not happen, it would be a big loss both for the American administration and for us. You cannot discount that.

It is from this perspective that I react to reports about the work conducted by you and E. A. Shevardnadze. I have the impression that in the immediate future we could finalize our work on the agreements on INF and SRINF. I agree that the principal issues should be resolved here, in Moscow, while leaving our delegations in Geneva only technical, editing issues.

I would even say: if we complete our work like this, that would be very important in and of itself. It would be a very important event in the eyes of the peoples of the world. But then people will rightfully ask: if we understand the importance of that agreement and if we conclude that agreement in the immediate future, why would we then continue any kind of activity in the sphere of production, testing and deployment of mid-range missiles? Therefore, the right thing to do would be to announce a joint moratorium on such activities. It could be introduced beginning November 1. I repeat, if we have an agreement in principle that we will sign the treaty, then a joint moratorium on deployment and any activities in the sphere of INF would be an important step that would strengthen this political decision. It would show that the agreement would start working *de facto* even before we actually sign it. I think that this important step would determine the degree of our accord on this issue.

Now I move to the central issue—the issue of strategic offensive weapons and space. You recalled my words in this connection. I confirm those words. We believe that resolution of the issues of strategic offensive weapons and space would indeed be extremely important for the security of the USA and the USSR because it is precisely these matters that define the strategic situation. Therefore, finding mutually acceptable solutions to nuclear and space questions becomes especially important and pressing.

In Reykjavik we had a serious exchange of opinions on those issues. After Reykjavik we tried to do something to reaffirm our readiness to reach resolutions on the complex of those problems. What is the essence of the mutual understanding reached in Reykjavik? The essence is the 50% reductions in offensive strategic weapons and the 10-year non-withdrawal from the ABM Treaty. And what is happening in Geneva? Essentially, bargaining is taking place there. Therefore we have been thinking a lot about what else we could do to move ahead with a resolution to this problem in Geneva. Many issues are being discussed there, a lot is being said. However, if you put it all aside, there are two genuinely big issues. The first is ensuring strict compliance with the ABM Treaty, and the second is the optimal correlation between the elements [that constitute] strategic forces, the strategic triad.

As far as the first issue is concerned, we proposed to the United States not to use the right of withdrawal from the ABM Treaty for ten years. We also proposed a second version, which is also connected with the idea of non-withdrawal from the ABM Treaty. Trying to meet the U.S. halfway, we proposed to discuss which devices could be deployed in space, and which could not. We are waiting for your reaction.

As far as the second issue is concerned—the issue of optimal correlation between the different elements [comprising] strategic forces, we considered this matter carefully once more. We are proposing a new formula, on the basis of which we could determine the limits on concentrations of warheads for each element of the triad. Besides, each side would have an opportunity to compensate for the lower number of delivery vehicles on one kind by increasing the number of delivery vehicles of a different kind within the overall limit.

Therefore, we propose [the following]: the United States agrees to legally undertake an obligation not to use its right of withdrawal from the ABM Treaty for ten years under strict compliance with all of its provisions. The Soviet Union agrees to establish limits on concentrations of warheads on different kinds of U.S. and Soviet strategic armaments. Within the [overall] limit of 6,000 warheads, we propose to have not more than 3,000-3,300 warheads on ICBMs, no more than 1,800-2,000 warheads on SLBMs, and not more than 800-900 warheads on air-launched cruise missiles.

We believe that this kind of movement toward each other's positions would lead us in the nearest term to work out key positions on these issues. This would prepare the ground for the next step—the move toward concluding the agreement. In that case, as I understand it, when I arrive in the U.S., we would create the agenda, which we discussed during your visit in April of this year. First of all, we would sign the treaty on the elimination of INF and SRINF. Secondly, we would agree on the key provisions regarding strategic offensive weapons based on the new compromise proposals. And finally, we would incorporate the agreement about initiating negotiations on the problem of nuclear testing that was reached between you and E. A. Shevardnadze. I think that would be a solid agenda.

We see that not everybody in the United States is in favor of such agreements. There are those who wish to undermine this process. They use all kinds of arguments for this purpose, in particular the issue of the Krasnoyarsk radar station. I have to say that we also have complaints about American radar stations. We could remove these complaints on a reciprocal basis. Now I would like to inform you about our unilateral step. The Soviet Union announces a 12-month moratorium on all work on the Krasnoyarsk radar station. We are expecting a similar step from the U.S. in regard to the American radar station in Scotland.

I think that we can take on the issues of strategic offensive weapons and space as they are connected in a substantive, fundamental way.

Shultz: Thank you. I would like to respond to the proposals you have outlined. Of course, every time you introduce proposals on important issues, we study and analyze them carefully. Now I can provide you some considerations based on our analysis.

First of all, I welcome what you said on the INF, and your words about your readiness to give additional stimulus to this work. We are also instructing our representatives so that the main issues will already be resolved in Moscow.

As far as the ABM and related issues are concerned, among other things we have been trying to clarify what your proposals consisted of. We believe that there is a certain amount of progress here. I would like to have total clarity as to whether I understand the proposals that you presented. This does not presuppose that the President agrees with them. As you know, for him this is a very delicate, sensitive issue. I would like to have an opportunity to present the factual substance of your position to him as precisely as possible. Thus, as I understand it, you are proposing that we define a ten-year period of non-withdrawal from the ABM Treaty with strong compliance with the Treaty in the form in which it was developed.

Gorbachev: As it was before 1983. Then we did not have any differences. And besides, that was not just our point of view. That is the point of view of the U.S. Congress. And the Congress is, I am convinced, a very serious, very important body, which receives reports, including reports from departments in which Mr. Carlucci has worked, from the National Security Council, in which Mr. Matlock worked then, and other detailed information. At that time we shared the same position.

Shultz: I would like to clarify—do you have in mind compliance with the Treaty in the form in which it was presented, for example, in the report of our Defense Department from March 1985? I mention this report because it was mentioned by your representatives at the negotiations.

Gorbachev: In the form as this Treaty was understood and adhered to by both sides before 1983.

Shultz: I would not want to enter into any secondary arguments right now, because different opinions exist about what was adhered to and how, and what they had in mind. In our country, some people believe, for example, that the Soviet Union insists on an even more narrow interpretation of the Treaty than the narrow interpretation itself. I named one document for a reference, which your representatives cited, in order to understand your point of view better.

Gorbachev: I repeat: we are talking not only about that, but also about the fact that before 1983 the Treaty was interpreted and effectively enforced by both sides in the same way. If now this creates some difficulties for you, I told the President in Reykjavik that I am ready to help him out of the situation that was created as a result of the launching of the SDI program. Our proposal—to agree on what can and cannot be deployed in space under conditions of non-withdrawal from the ABM Treaty—allows [you] to conduct research within the SDI framework. In particular, the second version proposed by us presupposes defining concrete parameters for devices that are allowed to be deployed in space. With that, naturally, it is understood that there should be no weapons in space. But as far as the orders you have already placed with companies and research organizations, they can be carried out within the limits of these agreed-upon parameters. This proposal represents a compromise.

Besides that, we are moving in the direction of your requests regarding limits. For example, when I say that there would be a limit of 3,000-3,300 ICBM warheads within the total limit of 6,000 warheads, this represents 50%. This is what I promised the President. As you can see, we are true to our word.

Shultz: I would like to clarify certain aspects. You should not interpret the fact that I am clarifying certain issues related to space and ABM as indicating that I was accepting your positions. I am not able to do that. I can only report on them to the President. Do I understand correctly that within the ten-year period of non-withdrawal from the ABM Treaty, activities which correspond to the Treaty in its traditional interpretation would be allowed, along with activities in space within the limits of the ceilings proposed by you? At the same time, such activities could not include deployments prohibited by the ABM Treaty.

Gorbachev: As well as weapons tests in space. As far as permitted activities are concerned, we could discuss and define that together.

Shultz: I think that enough has been said on this issue within the bounds of what can be said at the present stage. I repeat, I was only asking clarifying questions, which do not signify agreement with your proposals on behalf of the President. I believe that we should conduct our conversation directly and openly.

Now another side of the question—how to implement the 50% reductions of strategic armaments in practice? We believe that significant progress has been achieved on this issue. I would like to present an alternative proposal for your consideration. Realizing that the idea of sub-limits, at least of certain kinds of sub-limits has repeatedly caused

problems, in particular during our discussions in April during my visit, we undertook an analysis of the situation. Now we have a joint draft text of the treaty, at this point with many brackets. We agreed on a total limit on warheads—6,000. We agreed that the number of delivery vehicles and bombers will be 1,600. We agreed on the limit of warheads on heavy missiles—1,540. We agreed on the rule of counting the bombers. We have an agreement that the throwweight would be reduced by 50%, and now we would like to achieve a legal affirmation of that in the text of the treaty, as well as a confirmation that after such a reduction in throwweight there would be no future increases. In principle, I think we have an agreement on this; however, we would like to confirm that in the formulations of the Treaty. One of the limitations, which we have proposed, and which was reflected today in your response, is the limitation on the number of warheads on ICBMs—3,300. In Washington you proposed a sub-limit of 3,600 units, but that was proposed as a maximum level for any of the elements of the triad.

We believe that the most serious difference between the elements of the triad is the difference between ballistic missiles and warheads that are delivered by air and jet-propelled systems. Of course, land-based missiles are more precise than SLBMs. However, the main distinction is between ballistic missiles and non-ballistic means. Therefore, we would like an agreement to have as a minimum a certain number of warheads on the air-based part of the triad. For this purpose, we proposed a limit of 4,800 for ICBM warheads. In the interests of moving forward, we would be ready to remove our proposal about establishing separate sub-limits for ICBM and SLBM warheads in return for your accepting the proposal on a summary sub-limit of 4,800 units for ICBM and SLBM warheads. Within this ceiling, each side would be free to determine the constituent parts.

As I said before, when we start talking about mobile missiles, it becomes very important to be confident that the limits stipulated by the treaty could be verified. We are ready to engage in work on this issue in Geneva. Frankly speaking, we do not see a satisfactory answer to the problem of verification of mobile missiles. But maybe you can show us how that can be done. Maybe we will be able to work on this issue before your visit to the U.S. At the same time, I have to admit, I do not see how to solve this problem. However, we are ready to work on it.

So here is the structure that we propose. Yes, and there remains the sub-limit of 1,650 units that we proposed. However, as you can see, in general we are making the problem of sub-limits easier, on the condition that there would be a general limit on warheads on ballistic missiles.

Gorbachev: I think that if we find an approach that would allow us to begin movement on all the complex of issues of strategic offensive weapons and space in their interconnectedness, then we should be able to resolve the issue of mobile missiles. By the way, you too are planning to build mobile missiles. You are already building railway-based MX missiles. Therefore it is a problem both for you and for us.

Shultz: Yes, indeed, we are working on this. However, I would like to assure you that we would prefer to introduce a ban on mobile missiles; we are ready to abandon this program.

Gorbachev: But mobile strategic missiles already exist. Besides, as I said in Reykjavik, they have a very short flight time. And what do you do with such a mobile system as a submarine? They come very close to our territory. Besides, while it is known where ICBMs start their flight, it is unknown with SLBMs.

Shultz: Both missiles have a short flight time. Beside that, once ballistic missiles are launched, it is impossible to recall them. In short, ballistic missiles represent the greatest threat, and that is why we consider it necessary to establish a limit on ballistic missile warheads in view of their differences with air-based means.

Gorbachev: You have your own concerns, and we have ours regarding your strategic armaments. I think that these issues should be discussed at the negotiations.

Shultz: I agree.

Gorbachev: I want to reiterate again what I have said many times before. We do not want the United States, after the reductions, to find itself in a situation that would be unfavorable for you, that would weaken your security, weaken your confidence in your security. That would be bad for us as well. Because if one of the sides finds itself in such a situation, it would try to find a way out of it, to seek the possibility of compensation. Experience shows that both of us have found [such] answers. But it is clear that this would not correspond to our interests.

Shultz: You expressed that idea in Geneva. I believe that it is a strong, important idea. I agree with it. You also emphasized the differences in the structure of our strategic forces then, the fact that neither of the sides could force the other to imitate an alien structure. Precisely for this reason, having analyzed the situation, we decided to propose a joint limit on the number of warheads on ballistic missiles, within which the sides would have freedom—at least at the present stage—to determine the combination of warheads. We cannot achieve everything at once. But it seems that it is possible to move considerably ahead on this basis.

Gorbachev: I think now we have a basis on which to work on the key elements of strategic offensive weapons. This could become the central element of the Washington summit because as far as the agreement on INF and SRINF is concerned, all that remains is to sign it. Signing key positions [on strategic weapons] could become the most important outcome of the summit. We could give our delegations concrete instructions on the basis of these key positions to work out a draft text of the treaty, which the President and myself could sign during the President's visit to Moscow.

Recently some of your representatives, Mr. Kampelman, for example, said that we need to start seriously developing a treaty on strategic offensive weapons. They said if we

could do that, then it would be easier to resolve the space issues. I want to say at the outset, this is an unrealistic position, an unrealistic approach. Let's not waste time on such approaches. Issues of strategic offensive weapons and space need to be resolved together because they are interconnected. On this basis, we are ready to move forward, taking into account as much as possible each other's security interests.

Shultz: I think that in terms of numbers and parameters, we have said all that we can for now. I think that we sense a certain flexibility, a readiness for collective work. I have the impression that it is unlikely that our representatives in Geneva will be able to produce much in this sense. These are questions for you and for the President. However, our delegations could create a good foundation for a fruitful meeting between you and the President. I have several thoughts about this.

First of all, we could say to our delegations in Geneva that they should tackle the problems of verification energetically and as their priority, especially the verification of mobile missiles. Now we see how difficult the problems of verification are. We should not leave them for February or March. We should focus on them seriously now.

As far as concrete positions are concerned, I think that our delegations in Geneva should not so much bargain about numbers as place an emphasis on clarifying each side's principal approaches. We should talk about why you consider certain provisions important, and why we consider other provisions important. I think that that would help you and the President find resolution to those problems during your meeting.

Finally, I would propose that in addition to continuing our work on removing the brackets in the joint text, which is useful, we should focus on the goal of having your meeting with the President result in joint instructions for our delegations in Geneva regarding parameters for the future treaty. I think that would be a good result of the meeting, which would complement the work that will already have been done on coordination of the treaty.

Gorbachev: From the very start I see weak spots in your proposals. First of all, you did not even mention the problem of space. But if we leave this issue outside the boat, then moving ahead on strategic offensive weapons will not make any sense. We have to consider them as interrelated. Why does the American delegation in Geneva avoid discussing the space issues, especially discussing the latest Soviet proposals?

Overall, I have an impression that with your three considerations, it is as if you are throwing away the idea of developing key positions on strategic offensive weapons and space. Instead, you propose to limit ourselves to some foggy formulas, talk about the need to clarify positions, etc. Of course, resolution of the verification problem, clarification of positions, removal of brackets—all this is necessary. However, our goal should be the preparation of key positions, which we could consider and sign, so that by the time of the President's visit to Moscow, we would have an agreement on the entire set of these issues.

Your approach strikes me as undefined and foggy. In essence, it rejects everything that we said for the purpose of clarifying [our positions] and signaling flexibility on concrete problems.

I would like to repeat: we propose that our delegations in Geneva concentrate on developing key positions for their adoption during the visit. Then it would make sense. Otherwise, everything is moving beyond the term of the present administration. And that would be too bad. Because we wanted to resolve [these issues] precisely with the present administration. And this is possible. A lot has been already done. And we, as we see it, are capable of concluding a good treaty with the current administration. Precisely a good treaty: neither one of us needs a bad one.

Shultz: I would not object to defining coordinated positions. I do not want to offer you anything foggy, not at all. I want to look ahead. Some things are already agreed upon, mainly as a result of the agreements achieved by you and the President in Reykjavik. The question is—what should be done in order to prepare these key positions, these instructions for our negotiators. With all respect for our representatives in Geneva, the main, key positions should be adopted by you and the President. Our representatives in Geneva do not have political mandate for that. But they can prepare the grounds, and we can work to prepare the grounds for your decisions. That is why I emphasize the need for more precision, for working on the issues of verification, especially regarding the mobile missiles.

Gorbachev: Let's still prepare a draft of key positions before we, as you propose, start discussing the issues, so to say, in a scattered way.

Shultz: Of course, the more we could move ahead before the summit, the better. The main decision will have to be taken by you and the President. We, as well as you, want the achieved breakthrough to be written in the treaty, to receive a practical implementation. It would be very good for you and for us, and would be a present to the entire world.

Gorbachev: Yes, Reykjavik already has a place in history. But a second Reykjavik will not happen. We should not meet with the President and engage in improvisation. I think it is very good that we stood for Reykjavik. There were many people who wanted to bury it. But if everything is limited to a second Reykjavik, it might lead to big political losses both for you and for us. And to the contrary, if we find right political decisions, it would bring both of us great political benefits. You need to decide what you want.

I have an impression that you still cannot decide what it is you want. Maybe it is Ambassador Matlock who informs you in such a manner that you still cannot figure it out? Do you want the Soviet Union to develop successfully, or you don't want that? [Do you want] the Soviet Union to develop in the direction of greater democracy or in the opposite [direction]? [Do you want] us to have stagnation or to move forward?

Shultz: It is your business. It is all up to you to decide, but I can give you my opinion: what is happening in your country is very interesting, and I follow all these changes very closely.

[Source: Archive of the Gorbachev Foundation, Moscow,
Published in *Mirovaya Ekonomika i Mezhdunarodnye Otnosheniya*, nos. 10, pp. 69-81
and 11, pp. 73-84, 1993
Translated by Svetlana Savranskaya for the National Security Archive]