



To: Microsoft's Premier Preferred Provider Law Firms

From: Brad Smith

Date: September 17, 2008

Re: Microsoft's Law Firm Diversity Program

I'm writing to provide you with information about the final elections and the details concerning the Law Firm Diversity Program for Microsoft's Premier Preferred Provider (PPP) law firms. This memo also includes and updates our prior information, so that you have everything in one place. As described in detail below, under this program Microsoft is changing its legal fee structure so that each PPP firm is eligible for a two percent quarterly or annual bonus based on whether it achieves concrete diversity results. Given the substantial business value we derive when law firms that work with us strengthen diversity and address the historical imbalance in representation of women and minorities at major law firms, we believe this is an important and appropriate step.

We wanted to give you a summary of the PPP elections. First, we are pleased and honored to announce that all PPP firms have elected to participate in the program. In addition, your elections broke out as follows: nine firms elected the .5 percent firm composition formula, and eight firms elected the formula based on the 2 percent billable hour formula. (The specifics of the two formulas are outlined below.) Also of note, 11 firms chose to seek the bonus based on an annual measurement, while six firms selected the quarterly measurements.

This letter provides information on both the context for this diversity initiative and the substance of our final plan for our fiscal year 2009 (FY09), which started on July 1. You will also find attached a Q & A that covers the detailed mechanics for this program. Again, I'd like to convey our thanks to each of you for continuing to provide candid feedback as we design and implement the program. After further discussions and questions looking to clarify certain points, we have made slight revisions to the program documents we sent on July 14th. This revised memorandum and the accompanying documentation will govern the program.

1. The Context Guiding Our Thinking

I think it's helpful first to frame our plan by providing some background on our thinking. This will give you a better sense of what we're trying to accomplish and why. Overall our plan reflects and is grounded in three core convictions.

Business Necessity. First and foremost, we believe that diversity in our legal teams is a business necessity. We believe that we best serve Microsoft through a highly talented,

committed, diverse, and collegial group of legal specialists, working as part of effective teams. The reality is that we cannot be effective if we cannot understand and appreciate the interests and needs of the incredibly diverse individuals who make up our stakeholder groups, from employees and customers to business partners, regulators, and judges. Microsoft has subsidiaries in over 110 countries. We have employees in Redmond alone from over 130 countries. Our employees, customers, and other stakeholders represent every background in the country and on the planet.

Microsoft needs a legal and corporate affairs team that better reflects the diversity of these groups. Otherwise I believe we'll fall short. We'll fail to appreciate fully how other people are thinking about us and the legal questions at issue. And as we've learned from experience, sometimes even painfully, if we cannot understand how other people are thinking, there's a greater likelihood that we'll fail to address their needs or persuade them of our position. In this sense, diversity is not simply something that would be nice for us to have; it's a prerequisite for our success.

Slow Progress. Second, we believe that despite good intentions, the legal profession has not yet achieved impressive results in expanding diversity that fully reflects equal opportunity for the available pool of qualified talent. This lack of success hinders our ability to call on the full diversity of professionals we need.

We do not believe that the relative lack of progress in the profession results from an absence of good intentions and initiatives by major firms. Virtually every major law firm in the country has leaders who we believe are personally committed to expanding the diversity of their firms. Increasingly one also finds firms pursuing various initiatives of which they are justifiably proud. But collectively these efforts have not yet produced results that are commensurate with the diverse talent graduating from law schools. Only 18 percent of the partners at the nation's large law firms are women. Only 5.4 percent of partners at large firms are minorities. Of course progress takes time. But the pace of progress needs to accelerate.

Working in the information technology industry, we've seen over the years a number of business initiatives in which good intentions and lots of hard work don't necessarily translate into successful business results. To a considerable degree this reflects the nature of a rapidly-changing industry that requires long-term innovation and big bets. We've had the opportunity to learn from these experiences about the recipe for long-term success. Certainly one doesn't give up. But changes in approach are sometimes required.

Part of what we've learned is that goals need to be measurable — not as quotas, but as indicators of the extent and direction of progress that is being made. In the context of legal diversity, for example, we believe that there needs to be a more consistent and stable set of metrics against which results can be compared. New initiatives and

supporting activities need to be launched, but one cannot confuse efforts with outcomes. The short- and long-term success of these activities needs to be assessed by evaluating whether they are achieving the desired results. When it comes to challenging goals, almost all progress is incremental. But progress in producing results needs to be both real and sustained in measurable terms.

We've also found that the best form of learning comes from doing. This is not to underestimate the importance of being thoughtful in advance. But in most circumstances one can learn more quickly by experimenting with new initiatives than simply by debating their merits. This requires a willingness to invest resources and try new things, coupled with disciplined, self-critical evaluation to learn and change based on what is succeeding and what is not. One needs to be bold and take some risks.

We've also learned that economics really do matter. If one can define clear and measurable goals and pay for performance, there is a higher likelihood of producing real results. This is one reason the equity compensation of senior leaders inside our company has been based in part on improving the satisfaction ratings of our customers. When it comes to advancing diversity, however, our profession is not yet embracing the "pay for performance" approach that successfully guides so much activity in our economy.

Finally, one needs accountability that works. The ultimate form of accountability in business is of course the risk that one will lose one's job, or in this case, lose a client. But in many circumstances, this may not represent the right result, especially if the individuals (or law firm) involved are good and strong and have the potential to do better. This is not to take the risk of firing out of the equation. Rather, we believe that this can be coupled with a more measured approach that includes important but more incremental risks and rewards.

We're in This Together. Third, we believe that legal departments and law firms need to advance diversity by working in closer partnership. We've been giving this aspect of the dynamic particular thought, and we very much appreciate the suggestions that you provided to us. As we continue to work together over the years to come, we hope that you'll provide even more.

On the one hand, corporate legal departments are of course the client when it comes to working with large law firms. We believe it's appropriate and necessary for us to be clear about what we want and why. But we also need to do more together. Ultimately we both depend on the same pipeline of new talent from law schools. We both depend on the development of new associates, even if we do so in different ways. We work on specific matters not just as individuals in separate institutions but collectively as part of a common team. To a huge degree we have common needs. We believe there's an opportunity for us to be more successful if we address them together.

We also believe that we should not ask those who work for us to commit to something unless we're prepared to make a similar commitment ourselves. When it comes to data about diversity, corporate legal departments can do more to commit to the type of

transparency they're asking of law firms. We're prepared to share with you information about ourselves in the same way that we're asking you to share information with us. Similarly, if we're going to incorporate diversity into the way we pay for performance for law firms, we need to be prepared to take the same type of step for the compensation of senior management inside our department. We are.

During the last decade the nation's law firms and large corporate legal departments have grown considerably in size. As a profession we've taken important strides to promote diversity with initiatives such as the Call to Action. The recent April meeting of law firm leaders and legal department leaders in Phoenix has created an important opportunity to build on the Call to Action and take it farther, and we are committed to supporting that effort. A number of other individuals, companies, and associations are spearheading important diversity steps, and we have both learned and benefited from their trail-blazing efforts. More than anything, we believe we have an opportunity to achieve more effective results if we can find new ways to work together. This is an important part of what we hope to accomplish with you.

2. **Microsoft's Law Firm Diversity Program**

Our Law Firm Diversity Program has three pieces: (1) new diversity incentives for our PPP law firms; (2) a new and similar commitment by our department, including to partner together with PPP firms to increase diversity in both our organizations and the legal industry as a whole; and (3) a process to assess our progress a year from now to learn from our experience and decide on improvements for the future. We expect to maintain the program in its current form, or something close to this form, for a period of three to five years, after which we will evaluate what progress has been made in addressing the concerns motivating the program.

Law Firm Diversity Program. As you know, in early May I sent a letter to all of the law firms working with Microsoft to explain that we would not pay rate increases in excess of four percent for the new fiscal year that began on July 1. We are also creating a diversity incentive bonus for our PPP firms. Under this plan, our PPP firms are eligible for a rate increase on legal fees of up to three percent, but they can earn an additional two percent bonus by achieving concrete diversity results.

We have created two alternative formulas to measure diversity progress, and each PPP firm can choose which formula it wishes to use. Based on the election you have already made, your firm will need to stick with the same formula for the entire fiscal year.

- The first formula will pay the two percent bonus if the firm achieves in the U.S. a two percentage point increase in the hours worked by diverse attorneys as a percentage of total attorney hours worked on Microsoft matters, compared to the same time period in the preceding year.

- The second formula will pay the two percent bonus if the firm achieves a .5 percentage point increase in total diverse attorneys as a percentage of the firm's total attorneys in the U.S., compared to the same time period in the preceding year.

In other words, the first formula focuses on diverse representation in hours worked for Microsoft, while the second focuses on diverse representation in the firm's U.S. offices, taken as a whole.

In both cases the definition of diverse attorneys includes women and minorities, including attorneys who are Black/African American, Latino/Hispanic, Asian, Native Hawaiian/Other Pacific Islander, American Indian/Alaska Native, or of mixed race. This includes diverse attorneys who are partners, associates, of counsel, and in any other permanent attorney category, but excludes "contract" attorneys. In addition, we strongly encourage firms to include Openly Gay, Lesbian or BiSexual attorneys in their definition of diverse attorneys. We recognize, however, that it may not be legally permissible in some states to require disclosure of or track this latter group. We therefore will honor whatever approach your firm decides to take with respect to this particular aspect, and we will look to you to let us know if you include Openly Gay, Lesbian or BiSexual attorneys in your firm's definition. We also will consider including additional aspects of diversity in this definition as we gain experience with this initiative.

Even if a firm selects the second formula relating to firm composition as a whole, we strongly encourage you to increase diverse attorney representation on Microsoft matters, given the importance of this to our business.

Regardless of which formula your firm chooses, we will, of course, continue to welcome participation of non-diverse attorneys in legal work done for Microsoft; and we expect that your initiatives to increase diversity will be implemented in a manner that is consistent with all applicable anti-discrimination laws.

As a number of you have requested, the final program allows firms to opt for bonus eligibility on either a quarterly or annual basis. In either case your results must be reported within 45 days of the close of the relevant time period. If you select the annual bonus, we would also like to implement a mid-year check point so we can consult together on how things are going, especially if you are using the formula based on diverse representation of attorneys working on Microsoft matters. All firms must use the attached reporting template when submitting their form.

We will preserve the confidentiality of each firm's information and will not disclose publicly or to any other firm either the numeric data or the news of whether any individual firm has earned the bonus. We would like, however, to be in a position to share publicly at the end of our fiscal year the aggregated information about what percentage of all of our premier firms earned the bonus. By way of context, there currently are 17 law firms that are PPP firms for Microsoft.

I'd also like to share additional information about the rationale for some of the foregoing elements of this plan. First, we were persuaded by your feedback that it makes the most sense to cap the base rate increase at three percent while providing the ability to earn a bonus of an additional two percent. In effect, this creates a risk/reward factor for each firm. If a firm fails to make progress on diversity, it will have a lower rate increase than firms that are not in the PPP category. But if a firm does earn the bonus, it will obviously earn a bigger increase than these other firms. This seems equitable to us.

Second, we were persuaded by your feedback that it makes sense to adopt a formula based on year-over-year progress rather than on out-performing a national average. Although you were not unanimous on this point, an overwhelming majority suggested that this gives everyone a comparable incentive and opportunity to earn the bonus. We were also persuaded that different firms might have sound bases to choose one formula over another, and hence we'd like to incorporate this flexibility for you.

We do appreciate, as a number of you suggested, that there may come a time when a firm's absolute progress in strengthening diversity will be so great that it should receive a bonus regardless of whether it makes additional progress compared to the prior year. We agree with you, and we look forward to that day. This suggestion also fits with our expectation that the Law Firm Diversity Program is an approach that will be reexamined over time. Having surveyed the current situation, we do not believe that any of our PPP firms are yet in a position in which we are comfortable providing for this bonus without additional progress. We will, however, continue to consider whether there is a particular milestone that should be established for such circumstances. If so, this will be incorporated into future versions or modifications of the program.

We recognize that there are certain unknowns inherent in launching something like this. Almost certainly we will make changes over time. In part these changes will reflect experience and new learning. (This in part is why we are requesting that you report results under both formulas even though your bonus will be based only on one.) In part it also may reflect changes in the diversity situation for our profession over time. For this reason, the ability to have an ongoing assessment and dialogue with you will be critical.

Diversity Commitment by Our Department. We are coupling the Law Firm Diversity Program with a substantially broadened diversity initiative for LCA that includes a number of concrete steps. Some of these are directly related to your work, so let me start with these.

First, we welcome the opportunity to work together on programs to help attract and retain a broad, talented, and diverse group of attorneys at your firm. The following steps to support attorney recruiting and development at your firms have emerged already, and we are hoping that you may have additional ideas:

- On August 6th we hosted for our Seattle premier firms a "Summer Associate at Microsoft Day." As you know, we used this day to introduce interested summer associates to the cutting edge technologies and legal issues that Microsoft faces and

that our premier firms, in particular, help us address. Attendance was great, and initial feedback suggests that with some minor modifications, we will continue to hold this program for our Seattle firms.

- We're considering expanding Microsoft's own summer legal intern program, which is for students who have completed their first year of law school, to recruit additional candidates from additional Historically Black/Latino law schools beyond the ones we've recruited from to date. As is the case for our existing program, we would work with these candidates and all of our other summer interns for the first summer here in Redmond. This summer we offered all our premier firms the opportunity to interview our interns on the Microsoft campus on August 4th. Initial indications are that we will continue to offer this option in future years.
- We were an original sponsor of the MCCA Lloyd M. Johnson Scholarship program, funding three students a year for the last three years and recently agreeing to continue that funding level for the next three years. A number of our first year summer interns in LCA have come to us through the MCCA program. We have stayed in touch with those students (who are very impressive) and would welcome the opportunity to have any law firm meet them to consider further opportunities.
- Several years ago we founded and have since continued to lead and create sponsorships for the Microsoft Women and Minority Law Student IP Summit. This Summit is a meeting of law students, law firms, and interested in-house counsel designed to encourage women and minority law students to seek careers that focus on technology/IP related issues. We will host our fifth event October 6 in Chicago. A number of our premier firms have participated with us, and we appreciate that. Winston and Strawn has already offered to support the Summit as a Premier Sponsor. If any firm is interested in participating in Chicago or learning more, please contact Joe Lee at joelee@microsoft.com.
- Last year the Seattle office of Davis Wright Tremaine approached us about cross-organizational mentoring opportunities. We are pleased to be working with them on a program in which LCA attorneys will mentor some of their diverse associates. The program is designed to foster a stronger professional community for DWT associates, and we are excited to be asked by DWT to partner with them in this way. If other firms have an interest or a similar idea, we would be happy to explore it.
- During FY 09, we will organize an Advocacy Academy focused on diverse counsel at our PPP law firms, similar to the Advocacy Academies our Litigation Practice Group has conducted in the past. Our focus in FY 09 will be on providing diverse senior associates and junior partners the opportunity to work with a blue ribbon group of trial lawyers and former judges, along with jury, communications, and other consultants. As with our prior sessions, the participants will have the opportunity to hone their trial skills. Among other benefits, this will help us get to know and work with diverse lawyers who we can then call upon for leading roles in future cases.

We hope that you will provide us with ideas for additional, creative steps that we might take together. We have increased our diversity project budget from \$250,000 last year to \$750,000 for the current fiscal year to ensure that we can take more initiatives.

Second, we recognize the importance of aligning activities and interests in expanding diversity at our premier firms. For this purpose, in addition to deciding that two percent of your firm's fees from Microsoft will be based on diversity progress, we have decided that five percent of the annual bonus paid to our most senior departmental leaders similarly will be based on law firm diversity progress.

Specifically, as some of you have mentioned in providing us feedback, you cannot always make progress by yourself to increase the representation of diverse attorneys working on our matters. Microsoft's legal teams need to be supportive of this effort, given their frequent involvement in signing off on law firm staffing decisions for particular Microsoft matters.

To help encourage this mutual effort, we are adopting for FY09 a new bonus formula for the members of the LCA Management Team (me and my 12 direct reports), plus the head of our diversity efforts. This formula will pay next August the final five percent of each individual's annual bonus only if there has been strong progress over the course of the fiscal year among those premier firms that are relying upon the diversity formula based on achieving a two percentage point improvement in diverse representation on our matters.

Let me describe how we will measure our own success: Next August we'll look back at the fiscal year. We'll add up the total number of PPP firms that selected this diversity formula and calculate how frequently these firms collectively earned their quarterly or annual bonus. If and only if all of these firms collectively earned this bonus at least 75 percent of the time, then our senior people will receive this final five percent of their annual bonus. This ensures that we're all working on the same basis and share a common interest in helping each other succeed.

To further encourage success we will assign a senior leader within LCA who will work with each participating firm to ensure good communication and provide a single point of contact to help support both the firm's and Microsoft's goals with this program. We expect that regular meetings and other opportunities to work across organizations will result from this approach.

Finally, I would note that our work with PPP firms is an important piece of our broader diversity work in FY09. In addition to the work with law firms, we're focused on three other measurable goals for ourselves for the fiscal year – increasing the percentage of legal fees we spend on women and minority business enterprise (WMBE) firms by .5 percentage points; increasing diverse representation of women worldwide at more senior levels within LCA by 1 percentage point; and increasing diverse representation of minorities in the U.S. at all levels by .5 percentage points. We will pursue a wide variety of activities to help achieve these goals. Just as we're asking you to share information on

your progress, we're prepared to share with you information about our progress and what we're learning in terms of various activities and the results they're producing. We would welcome the opportunity to discuss and share best practices with you, in the hope that we can learn from each other.

Assessing Ongoing Progress and Adapting for the Future. As I've mentioned, we'll have a formal process that will include input from you next spring to evaluate the first year of this new effort. We propose to share with you the collective data about how the law firms have done overall, while not disclosing any information about any individual firm either publicly or to any other firm. We will solicit feedback from you and from our own lawyers on the experience. We'd then propose to sit down with you either before or at next year's LCA Summit to talk about how this effort can be changed and strengthened for the future.

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In closing, I'd like to thank you once again for working with us to develop this new initiative. I especially appreciate all the candid and direct feedback that so many of you have provided. We're excited about the opportunity to continue to improve our Law Firm Diversity Program. Moving forward, we hope that together we will develop and pursue new and creative ways to advance diversity for us all.

Sincerely,



Bradford L. Smith
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Microsoft Corporation