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**VIA ELECTRONIC MAIL AND FACSIMILE**

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Department of Attorney General  
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Re: **Service Industry Association – AG No. 2010-0035510-A**

Dear Assistant Attorney General Pascoe:

I am writing in response to your letter of December 27, 2010, to Mr. Gary N. Miller of Oracle Corporation concerning the complaint that was lodged against Oracle by the Service Industry Association (SIA). Oracle appreciates the opportunity to respond to SIA's contentions, which are factually inaccurate in many respects and legally without merit. We are confident that once we correct the facts your office will have no concerns about the legality of Oracle's service policies.

**Background and Context**

Oracle has been one of the world's largest business software providers for many years. As the SIA notes, Oracle acquired Sun Microsystems, which was primarily a computer hardware vendor, in January 2010. For several years prior to the acquisition, Sun was struggling to compete and remain relevant as a provider of computer servers and storage systems. The markets in which Sun servers and storage systems are sold are intensely competitive, and Sun had fallen behind IBM, Hewlett-Packard and its other rivals. Oracle bought Sun with the stated intention of revitalizing Sun's server and storage systems businesses (including their support components), and we think everyone would agree that this was to the great relief of Sun's customers. Customer response to the Oracle-Sun transaction has been overwhelmingly positive.

Upon acquiring Sun, Oracle carefully reviewed all of Sun's business practices and made changes where changes were needed. Oracle believes that Sun's struggles as an independent company were partly attributable to comparatively weak business practices, including a surprising departure from industry best practices concerning intellectual property (IP) licensing and customer support. One manifestation of this was that Sun's support

**ORACLE**

DJ Pascoe, Esq.  
2/17/2011  
Page 2

policies gave away much of the competitive advantage that the developer of the Sun IP ought to have in servicing and supporting Sun products. Over the past year, Oracle has been engaged in a broad effort to improve the service and support for Sun hardware products, and also to realign Sun's IP and customer support policies with industry norms. To a very large degree, that effort simply brings Sun's policies in line with Oracle's pre-existing policies for support that it provides on its many software products. We appreciate that both efforts are frustrating to Independent Service Organizations (ISOs), who fared better when Sun was less competitive and less protective of its IP. Oracle, however, is focused on customers rather than competitors, and on putting the Sun server and storage businesses back on a solid competitive footing. In these markets, the quality of a vendor's service and support and the total cost of owning and operating a server or storage system (which includes support) are every bit as important to one's competitiveness as the quality and performance of the hardware. Oracle is known for superior customer service and support, and it is committed to bringing the support for Sun hardware products and all of Sun's business practices up to its standards.

We also need to state at the outset that it is misleading for SIA to portray these issues as about "hardware maintenance." That term suggests that supporting computer server and storage systems can be compared to auto maintenance where most service involves repairing malfunctioning hardware (the car) with parts and labor. That is incorrect. Server and storage systems physically consist of hardware and several kinds of copyrighted software, all of which are intricately and inextricably linked. The hardware sometimes malfunctions and requires the more traditional kind of "break-fix" service, but on the whole it is quite reliable. The support of server and storage systems like that sold by Oracle therefore is often software-oriented, encompassing issues such as whether the software has been updated, than about broken or malfunctioning hardware. In fact, many customers would say that the primary value in a support agreement is access to software updates, ranging from complete new versions of the operating system (akin to moving from Windows Vista to Windows 7), to minor revisions and bug fixes. Those are neither literally nor by any analogy "hardware maintenance."

We mention this because SIA clearly conflates software-related service with "hardware maintenance" when it sizes the affected market (at over \$5 billion per year), and more importantly when it articulates its complaints. True "hardware maintenance" would only be a fraction of that market. Furthermore, as we explain below, SIA has no arguable legal basis to complain about Oracle's efforts to steward its software assets, most, if not all, of which have IP protection. We believe SIA adopts the term "hardware maintenance" to obscure this important fact.

**SIA's Contentions**

SIA's complaints are vague in a number of ways, but we understand SIA to be claiming all of the following:

**ORACLE**

DJ Pascoe, Esq.  
2/17/2011  
Page 3

1. Oracle forces customers into an "all or nothing" decision either to take service and support completely from Oracle, or not at all. As SIA puts it, "Oracle will not allow a customer to split its service requirements between Oracle and an ISO."
2. Oracle has imposed this "all or nothing" choice on the existing installed base of Sun customers who bought Sun hardware expecting more service flexibility than Oracle now provides. In other words, the policy changes Oracle has made are retroactive.
3. Oracle will not provide back-up "time and materials" service to ISO customers.
4. Oracle charges reinstatement fees where a customer goes off Oracle support and then wants to return to Oracle support.

The first two contentions are incorrect. They reflect—at the very least—a serious misunderstanding of Oracle's policies. The third and fourth contentions are more accurate, but describe standard practices in these markets. None of the contentions raise serious legal issues.

1. **Oracle does not force customers into an "all or nothing" decision.**

SIA is incorrect when it states that Oracle will not provide any service to a Sun hardware customer if it patronizes an ISO. In fact, one need search no further than Oracle's corporate website to see that Oracle allows customers to choose either comprehensive support for their "system," including all hardware and software, or "operating system" support, which covers support for the Oracle Solaris, Oracle Linux, and Oracle VM operating systems. See <http://www.oracle.com/us/support/premier/index.html>. Full system support costs 12 percent of the net hardware cost per year, while operating system support only costs 8 percent of the net hardware cost per year. Therefore, a customer that wishes to obtain "hardware maintenance" from ISOs would chose operating system support only, save one-third of the cost of full system support, and move on from there. This appears to be fully consistent with SIA's "Hardware Maintenance Bill of Rights,"<sup>1</sup> so we do not understand why SIA has any grounds to complain.

SIA also claims that Oracle requires Sun hardware customers to put all of their Sun hardware under Oracle support. This is true in part, but SIA's point is misleading overall. Oracle is phasing in a new requirement that disallows the practice of putting some but not all

<sup>1</sup> See [http://www.servicenetwork.org/news/bill\\_of\\_rights.php](http://www.servicenetwork.org/news/bill_of_rights.php) ("Choice of a hardware service agreement shall not be a requirement for software support, including operating system, special purpose software, or application support."). Oracle imposes no such requirement.

**ORACLE**

DJ Pascoe, Esq.  
2/17/2011  
Page 4

of a customer's systems under support. This is not an issue about ISOs or competition, but rather about the integrity of Oracle's support pricing, which as noted is a percentage of the net acquisition cost of the hardware that is under support. Once a customer is on support, it has access to an array of resources, many of which are not tethered to particular hardware systems as, for example, a replacement part might be. That means that a customer that supports only a subset of its Sun systems has the ability, if not the right, to access support materials and use them for the benefit of other, unsupported systems. Oracle discovered that it was not uncommon for Sun customers to be paying for support on only some of the Sun servers they were using. In fact, it was well-known in the industry that Sun did a poor job ensuring that customers paid for the support they received. Oracle decided to change support policies to eliminate this "free-riding" opportunity.

That said, Oracle does not require Sun hardware customers to put all of their Sun hardware under Oracle full system support, *i.e.*, the top-level, 12% per year support package that includes hardware support. The requirement is that, if a customer chooses to acquire support, every system (other than older, "end-of-life" systems) must be under some support agreement. That could be operating system support only, full system support on all systems or full system support on some systems and operating system support on others.

It is also important to understand that because what Oracle calls "operating system support" consists almost entirely of intellectual property assets protected by copyright and other IP laws, ISOs cannot lawfully compete for most of that business anyway. For example, no ISO can provide software updates to any customer, at least not lawfully. Similarly, operating system support includes access to software update tools and security resources that are copyrighted and owned by Oracle. There are some kinds of software support that ISOs can provide, like telephone "help line" technical assistance, but that is a minor part of a software support agreement. We find it hard to understand why ISOs should lose any significant amount of business that they are able to pursue lawfully by reason of the requirement that all systems have at least operating system support.

2. **Oracle's policy changes are generally prospective and do not affect the vast majority of the existing opportunity to service Sun hardware systems.**

SIA's letter is also highly misleading in suggesting the changes Oracle is making to Sun's support policies will foreclose ISOs from supporting existing Sun hardware systems. The policy changes are, for the most part, prospective, applying to systems purchased after March 16, 2010, not earlier. The small degree to which they apply to the existing installed base is simply because lines needed to be drawn, and they could not always be drawn in perfectly prospective ways. Therefore, the immediate effects of the changes on ISO business ought to be very small, as nearly all of the business opportunity today and for at least the next few years is to support systems not subject to these policy changes. It is disappointing that SIA did not mention this.

**ORACLE**

DJ Pascoe, Esq.

2/17/2011

Page 5

The prospective nature of the policy changes is also important legally. The courts that have addressed these kinds of issues in antitrust litigation have consistently held that prospective changes in service policies cannot be attacked under a monopolization or "abuse of dominance" theory when, as here, the primary systems markets are competitive. The rationale is straightforward: if policy changes are prospective only, customers can choose not to buy more hardware (such as Oracle servers and storage systems) if they do not like the vendor's new support policies, creating a "market check" on the vendor's behavior that defeats any claim of monopoly power. The SIA seems to understand this, as it tries to argue that Oracle is taking away rights that customers expected when they purchased Sun systems. But the premise of that argument is wrong. These are not retroactive policy changes.

### **3. Oracle's "time and materials" policies are fair and lawful.**

Oracle has decided not to offer "time and materials" support on Sun servers and storage systems. We appreciate this has an effect on ISOs, but with all due respect it is rather perverse for ISOs to complain about it. Oracle is simply defining its own service offerings—as any firm is entitled to do. There is no legal principle that requires Oracle or any other firm to offer service in some disaggregated form. It is completely normal and common for software and systems support to be offered in bundles of services rather than *a la carte*. The only reason that ISOs are concerned about this is because some ISOs like to tell their customers, particularly those who are worried about going off manufacturer support to get ISO service, that if anything goes wrong the customer can go back to the manufacturer to get the problem fixed on a time and materials basis. The ISOs, in other words, use the manufacturer's time and material offering against it, as a hedge against the risk of poor ISO service. Needless to say, that is not why manufacturers offer time and materials service in the first place. Oracle's role in the marketplace is not to be the ISOs' safety net. To be clear, Oracle has a broader rationale for this policy change than preventing this behavior, but in all events there is no legal basis to force Oracle to offer time and materials service.

### **4. Oracle's reinstatement policies are fair and lawful.**

Oracle—like the majority of companies that offer support for their own hardware or software products—charges a reinstatement fee when a customer that has not purchased support at all or for some period of time wishes to return a system to Oracle support. This is nothing new—Oracle had this policy long before it acquired Sun—and it was not inspired by ISO competition against Sun. This very common policy exists because support agreements of this type are in the nature of insurance contracts by which the customer pays premiums that reflect a portion of the expected cost of providing service over the life of the equipment. Customers sometimes want to forego a support agreement during periods when they think they will not need service, and then acquire support when they are more likely to need it. Service providers reasonably see that as a way to avoid paying one's fair share of the costs of providing support. They also reasonably worry that the customer wants to return to service

**ORACLE**

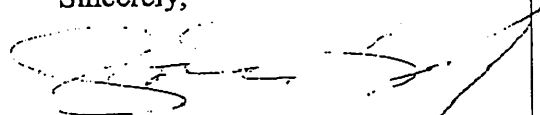
DJ Pascoe, Esq.  
2/17/2011  
Page 6

because it knows something about the performance of the product that suggests it will need a lot of service in the coming months or years. Furthermore, allowing customers to go on and off service creates "revenue recognition" issues under accounting standards that require consistency in support pricing. For all of these reasons, service providers often charge a reinstatement fee before they put unsupported hardware or software back on support. In part this is to deter the gamesmanship in the first place, in part it is to be compensated for the risk that the unsupported products will require more service going forward, and in part it is to deal with the accounting issues. It is normal, customary, and in no way illegal.

ISOs have never liked reinstatement fees because they would prefer to tell their customers that they can return to the manufacturer's service without penalty if they are dissatisfied with ISO service. In that respect, SIA's complaint is another manifestation of their members' desire to position Oracle service as a cost-free hedge against the perceived risks of patronizing an ISO. We understand their position, but it is not a serious legal argument that should be occupying the Department of Attorney General's time.

We hope and trust this has satisfactorily answered your questions. Please do not hesitate to contact me should you require further information. I can be reached at 650-506-5500. You can also contact my colleague, Jeff Ross, at [jeff.ross@oracle.com](mailto:jeff.ross@oracle.com) or 781-744-0449. Thank you in advance for the courtesy and cooperation.

Sincerely,



Dorian Daley, SVP, General Counsel  
and Secretary

DD:lcs

cc: Deborah Miller, Vice President, Associate General Counsel, Litigation