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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

PARAMOUNT COMMUNICATIONS INC., and KDS ACQUISITION CORP., Plaintiffs, v. TIME INCORPORATED, T.W. SUB INC., JAMES F. BERE, HENRY C. GOODRICH, CLIFFORD J. GRUM, MATINA S. HORNER, DAVID T. KEARNS, GERALD M. LEVIN, J. RICHARD MUNRO, N.J. NICHOLAS, JR., DONALD S. PERKINS, CLIFTON R. WHARTON, MICHAEL D. DINGMAN, EDWARD S. FINKELSTEIN, HENRY LUCE III, JASON D. MCMANUS, JOHN R. OPEL and WARNER COMMUNICATIONS INC., Defendants.	Civil Action No. 10866
IN RE: TIME INCORPORATED SHAREHOLDER LITIGATION	Consolidated Civil Action No. 10670
LITERARY PARTNERS, L.P., CABLEVISION MEDIA PARTNERS, L.P., and A. JERROLD PERENCHIO, Plaintiffs,	

v.) Civil Action No. 10935

TIME INCORPORATED, TW SUB INC., JAMES F. BERE, MICHAEL D. DINGMAN, EDWARD S. FINKELSTEIN, MATINA S. HORNER, DAVID T. KEARNS, GERALD M. LEVIN, HENRY LUCE III, JASON D. MCMANUS, J. RICHARD MUNRO, N.J. NICHOLAS, JR., JOHN R. OPEL, DONALD S. PERKINS and WARNER COMMUNICATIONS INC.,

Defendants.

MEMORANDUM OPINION

Date Submitted: July 11, 1989
Date Decided: July 14, 1989

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ALLEN, Chancellor

Pending are motions in several related lawsuits seeking, principally, a preliminary injunction restraining Time Incorporated from buying stock under a June 16, 1989, offer to purchase 100 million shares of common stock (comprising 51% of the outstanding common stock) of Warner Communications Inc. at $70 per share cash. That offer may close no earlier than July 17, 1989. The only condition to that closing is the submission of tenders of at least 100 million of Warner's outstanding shares. The offer contains no financing condition and in all events the $10.4 billion necessary to finance the purchase and related re-financings has been obtained. See Britt Aff., ¶¶ 2, 3. The motion does not seek to require Time to dismantle its "poison pill" takeover defense or to take other action sought in the complaints.[1]

Plaintiffs in these lawsuits include Paramount Communications Inc. and its KDS Acquisition Corp. subsidiary, which is itself currently extending an offer to purchase up to all

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[1] In their complaints, plaintiffs seek, among other relief, to require the board to excuse a follow-up merger between Time and any Paramount affiliate from certain voting requirements of the Time certificate of incorporation and of Section 203 of the Delaware General Corporation Law; to require the board to redeem the company's preferred stock purchase rights that impede the closing of any offer; and to rescind a certain Share Exchange Agreement between Time and Warner, which is touched upon below.

shares of Time at $200 per share; various holders of modest amounts of Time common stock, who purport to represent Time shareholders as a class; and several very substantial Time shareholders who sue on their own behalf. Defendants are Time Incorporated, all 12 of its current and three recently resigned directors, as well as Warner Communications Inc.

On this motion, the court is required to express an opinion on the question whether the directors of Time, who plainly have been granted the legal power to complete a public tender offer transaction that would be the first stage in accomplishing a thoughtfully planned consolidation of the business of Time with that of Warner Communications, have a supervening fiduciary obligation to desist from doing so in order that it be made more likely that the shareholders of Time will be afforded an opportunity to accept the public tender offer for all shares extended by Paramount's KDS subsidiary. The record in this case indicates — and the information before the Time board on June 16 when it made the critical decision to reject the transaction offered by Paramount indicated as well — that it is very unlikely that the market price of Time stock immediately following consummation of the now planned two-stage Warner transaction will equal the initial $175 price offered by Paramount.

It is the gist of plaintiffs' position in the various lawsuits now before this court that Time's board of directors does have such a supervening fiduciary duty and has failed to understand or, more accurately, has chosen to ignore that fact, in order to force the Warner transaction upon the corporation and its shareholders — a transaction that, plaintiffs assert, the shareholders would not approve, if given the opportunity to vote on the matter. The board of Time is doing this, it is urged, not for any legitimate reason, but because it prefers that transaction which secures and entrenches the power of those in whose hands management of the corporation has been placed.

It is the gist of the position of the directors of Time that they have no fiduciary duty to desist from accomplishing the transaction in question in these circumstances. They contend, quite broadly speaking, that their duty is to exercise their judgment prudently (i.e, deliberately, in an informed manner) in the good faith pursuit of legitimate corporate goals. This, they say, the record shows they have done. Moreover, they assert that the result of that judgment is a proposed transaction of extraordinary benefit and promise to Time and its shareholders. It is quite reasonable, they contend, for the board to prefer it, on behalf of the corporation and its shareholders, to the sale of the company presently for $200 per share cash, which sale is plainly inconsistent with accomplishment of the proposed Warner transaction. In short, the directors say the question whether the Warner transaction in its current form should be pursued or not in the corporation's interest is for them to decide, not the shareholders; that they have addressed it deliberately and in good faith; and that while some shareholders, even a majority of shareholders, may disagree with the wisdom of their choice, that fact provides no reason for this court to force them, under the guise of a fiduciary obligation, to take another, more popular course of action.

These same points are made by Warner, which is also a defendant. In addition, Warner asserts its own rights under the contracts in question. It says there is no evidence that it has acted other than as an arm's-length negotiator; that it has now changed its position (in part by the public announcement of the merger agreement and in part in entering into contracts with others in reliance upon the merger agreement); and entry of any injunctive relief at this point would disregard its rights and cause it irreparable injury.

Before attempting to define the legal issues raised by these motions, it is appropriate to turn to a statement of the facts as they appear at this time. While these actions have been actively litigated for only a matter of weeks, the record developed through discovery and by affidavit is very extensive. The following facts, from my review of that record, appear to be in many respects uncontested (even if the legal consequence of those facts is ardently contested), and in other respects the subject of dispute. Insofar as there is dispute with respect to a relevant fact, I will assume the fact in favor of the moving party if it appears after evaluating all of the evidence in the record that there is a reasonable likelihood that on final hearing that fact will be so established by a preponderance of the evidence.

I.

A. Time Incorporated and the composition of its board of directors

Time Incorporated is a Delaware corporation with its principal offices in New York City. Time's businesses fall into four broad segments: its traditional business of the publication of magazines, most notably Time magazine but also including People, Fortune, Sports Illustrated and numerous others; the publication of books, including The-Book-of-the-Month Club, Little, Brown & Co., Time Life Books and others; the production of pay television programming through its Home Box Office, Inc. and Cinemax subsidiaries; and the ownership and operation of cable television franchises through its American Television and Communication Corporation subsidiary.

For the year ending December 31, 1988, Time had gross revenues of $4.5 billion and reported net income of approximately $289 million.

Time's capital stock consists of 200 million authorized shares of common stock and 25 million shares of preferred stock. As of May 1, 1989, 56,977,150 shares of common stock were issued and outstanding and no preferred stock was issued and outstanding.

Time's board presently-is composed of 12 directors. It includes the following four officers of the company: J. Richard Munro, Time's chairman and CEO since 1980; N.J. Nicholas, Jr., president and chief operating officer of the company since 1986; Gerald M. Levin, vice chairman of the board; and Jason D. McManus, editor-in-chief of Time magazine and a board member since 1988. The following are "outside" or non-officer directors: James F. Bere, chairman of the board and CEO of Borg-Warner Corporation (Time director since 1979); Matina S. Horner, recently president of Radcliffe College (a director since 1975); David T. Kearns, chairman and CEO of Xerox Corporation (1978); Donald S. Perkins, former chairman and CEO of Jewel Companies, Inc. (1979); Michael D. Dingman, chairman and CEO of The Henley Group, Inc. (1978); Edward S. Finkelstein, chairman and CEO of Macy's Inc. (1984); John R. Opel, former chairman and CEO of IBM Corporation (1984); and

Henry R. Luce III, president of The Henry Luce Foundation, Inc. (1967). Mr. Luce is the son of the founder of Time and individually and in a representative capacity controls 4.2% of the outstanding Time stock.

Recently, four long-term directors resigned from Time's board: Arthur Temple, Henry C. Goodrich, Clifton R. Wharton, and Clifford J. Grum. Mr. Temple, personally and as the representative of a foundation, owns or controls the voting of some 1.1% of the stock of Time Incorporated.[2]

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[2] These resignations for the most part appear to reflect (see Goodrich Aff., ¶¶ 23-26; Grum Aff., ¶ 15; Wharton Dep. at 41-42) not dissension and disagreement about the course the board has elected to pursue in this matter, as these directors have supported that course throughout, but a willingness to step down for a variety of reasons, one of which is that the board of the planned Time-Warner Corporation will comprise just 12 incumbent Time directors as well as 12 former Warner directors. In the case of Mr. Temple, this accommodating spirit was augmented by a motive not apparently shared by others: a personal disinclination to be associated with a corporation engaged predominately or even importantly in the entertainment business. See Temple Dep. at p. 39; Temple Ex. 1. While of all of the Time directors Mr. Temple appeared to have the most pervasive reservations about a merger with Warner, for this reason and others, after discussion he voted to approve that course, see Temple Dep. at 10, 31, and continues to support a consolidation of these two enterprises as in the interests of Time and its shareholders. See Temple Dep. at 179.

B. <u>The genesis of the March 3, 1989 Time-Warner merger agreement</u>

1. <u>Strategic planning and management's commitment to maintaining Time as an independent enterprise</u>

Over the years, Time's business appears to have evolved from one completely dominated by its publishing activities to one in which to an increasingly important degree, video supplies the medium in which its products reach consumers. Simultaneously, the firm has tended to reinterpret its mission from one of supplying information to a relatively educated market segment to one in which entertainment of a mass audience plays an important role.[3] Time was, of course, founded as a journalistic enterprise. That meant most importantly that its writers created the material that it offered for sale. Publishing continues to be vitally important to it.[4] As Time has in this decade become importantly dependent upon video media for its income and growth, however, it has recognized a need to create for itself and thus own the video or

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[3]It was just this evolution that disheartened director Temple. <u>See</u> note 2 above.

[4]Time's magazines earn about 20% of the revenues generated in the United States magazine industry and more than a third of the profits. McManus Aff., ¶¶ 14, 21; Munro Dep. at 201; Nicholas Dep. at 148-49.

film products that it delivers through its cable network (HBO) and cable franchises. To fail to develop this capacity would, it was apparently feared, leave the firm at the mercy of others (both as to quality and to price) with respect to the element most critical to success in the video entertainment business. Thus, for some time, management of the corporation has reviewed ways in which the firm might address this need. See, e.g., Bere Aff., ¶ 7.

Another large-scale consideration that has played a role in the strategic thinking of Time's management and its outside directors (see, e.g., Perkins Dep., ¶ 6; Horner Aff., ¶¶ 6, 10-11) is the emergence of a deeply interrelated global economy. Recognition of this fact coupled with the objective of creating a stronger, more dominant company led management and the company's outside directors to perceive the expansion of Time into international markets in a more substantial way, as an important long-term goal for the company. See, e.g., Levin Dep. at 36, 99; Finkelstein Dep. at 155; Munro Dep. at 220; Opel Dep. at 65.

Neither the goal of establishing a vertically integrated entertainment organization, nor the goal of becoming a more global enterprise, was a transcendent aim of Time management or its board. More important to both, apparently, has been a desire to maintain an independent Time Incorporated that reflected a continuation of what management and the board regarded as distinctive and important "Time culture." This culture appears in part to be pride in the history of the firm — notably Time Magazine and its role in American life — and in part a managerial philosophy and distinctive structure that is intended to protect journalistic integrity from pressures from the business side of the enterprise. See, e.g., Perkins Aff., ¶¶ 13-17; Temple Dep. at 116; Nicholas Dep. at 149; Dingman Dep. at 16-18; Hill Dep. at 24-25.

I note parenthetically that plaintiffs in this suit dismiss this claim of "culture" as being nothing more than a desire to perpetuate or entrench existing management disguised in a pompous, highfalutin' claim. I understand the argument and recognize the risk of cheap deception that would be entailed in a broad and indiscriminate recognition of "corporate culture" as a valid interest that would justify a board in taking steps to defeat a non-coercive tender offer. Every reconfiguration of assets, every fundamental threat to the status quo, represents a threat to an existing corporate culture. But I am not persuaded that there may not be instances in which the law might recognize as valid a perceived threat to a "corporate culture" that is shown to be palpable (for lack of a better word), distinctive and advantageous. In any event, for now it is enough to note that the management and the outside board members of Time from early in this process did, in any transaction that might satisfy the perceived need to acquire better access to video production and to global markets, seek to maintain a distinctive Time organization, in part at least in order to maintain a distinctive Time corporate culture. There has never been the slightest subjective interest in selling to or submerging Time into another entity.

2. Anti-takeover protections

Management and the outside board of Time have been concerned for some while that the company have in place certain of the protections against uninvited acquisition attempts. In fact, Time seems to have equipped itself with a full armory of defenses including, among other things, a staggered board, restriction on shareholder action by consent or to call a meeting, rather long (50-day) notice of shareholder motions at meetings, and a poison pill preferred stock rights plan, which was recently (1988) amended to reduce its trigger to acquisition of a 15% stake in the company.

3. Exploration of possible opportunities to meet strategic goals

Time's management appears to have been alert to opportunities to meet the goal of providing the corporation with a video production capacity. In the spring of 1987, senior management (i.e., Messrs. Munro, Nicholas and Levin) advised members of the board (e.g., Perkins Aff., ¶ 7; Horner Aff., ¶¶ 5, 6; Grum Aff., ¶ 5) that, upon the initiative of Steven Ross, chief executive officer of Warner (Ross Dep. at 8-9), management was pursuing conversations with Warner in order to explore the mutual advantages of a joint venture involving at least each company's cable television franchises and perhaps HBO and Warner Brothers Studios. The outside directors were encouraging, with the exception of Mr. Temple. Warner was seen as a firm that might provide both an outstanding video or film production capacity and talent, and a substantial and effective international marketing relationship and organization. E.g., Perkins Aff., ¶¶ 7-8; Horner Aff., ¶ 6. Those discussions, however, encountered tax and other impediments and did not lead to a definitive proposal. Warner by that time had become the focus of Time's strategic thinking. See, e.g., Perkins Aff., ¶ 8; Levin Dep. at 50-53.

Prior to a July, 1988 board meeting, Messrs. Munro and Nicholas held a series of meetings with outside directors to discuss long-term strategy for the company. Perkins Aff., ¶ 11; Kearns Aff., ¶ 2; Dingman Dep. at 63; Temple Dep. at 94. Those meetings were occasioned in part by a comprehensive long-term planning document prepared by senior division level managers, and in part by continuing discussions with Mr. Ross of Warner. At these meetings, it was apparently the case that the directors with whom there were discussions endorsed the notion of moving from a joint venture concept with Warner to some more complete form of consolidation between the firms. Id.

At the Time board meeting of July 21, 1988, the board heard reports from management concerning the possibility of a Warner merger. Management reported that it had reviewed other "studios" — including Disney, Paramount (then Gulf & Western), MCA-Universal, Columbia and Twentieth Century Fox, and had concluded that Warner was the most desirable prospect for achieving the corporation's goals. E.g., Kearns Aff., ¶ 3; Goodrich Aff., ¶ 8; Perkins Aff., ¶ 18; Nicholas Dep. at 146-47, 280; Munro Dep. at 41, 147, 217-23; Finkelstein Dep. at 149.

Warner was considered the best "partner" or candidate for Time for several reasons, including the success of its movie studio, Warner Brothers; the fact that its existing cable operations would meld easily with Time's; its important presence in the music business where Time had no presence; and because of its international distribution assets and capability. Kearns Aff., ¶ 3; Perkins Aff., ¶ 19. The financial success it had achieved under the management of its chief executive offer was viewed as impressive. Dingman Dep. at

160; Finkelstein Dep at. 189, 200; Munro Dep. at 41, 217-23; Luce Dep. at 144.

4. Outside directors informally approve the pursuit of a Warner combination but express conditions

No resolution was adopted at the July 1988 board meeting but the record is without contradiction that the board at that meeting approved the negotiations of a merger agreement with Warner if certain conditions could be satisfied. While it was not the unanimous view of the outside directors,[5] it was confirmed by a large majority of the outside directors that if a combination was to be feasible from Time's point of view "corporate governance" issues must be resolved in a way that assured that Time's senior management would ultimately come to control the combined entity. See, e.g., Bere Aff., ¶ 14; Grum Aff., ¶ 8; Perkins Aff., ¶ 12; Goodrich Aff., ¶ 9; Finkelstein Dep. at 165, 200; Levin Dep. at 83, 85-88; Munro Dep. at 63-65. It should not of course be assumed that this position was forced upon Messrs. Munro and Nicholas by the outside directors. The "governance" question was always central to

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[5] Mr. Temple felt unable to encourage a Warner combination in any event (see note 2, supra), but if it was to be pursued, his view was that the economic terms of any transaction would be of paramount importance.

their discussions. But the record does seem uncontradicted that — with the exception of Mr. Temple — the outside directors did regard the succession of Time management to the senior positions in a merged entity as important.

While each of the outside directors' articulation of why it was thought critical to assure the continuation of Time senior management in control of any resulting enterprise is somewhat different, the sworn statement of David T. Kearns is typical:

> From the very beginning, the Time Board was absolutely clear in its desire that Time personnel be the managing group in any possible combination. This was important to the Time Board for two reasons. First of all, there had been discussion over a long period of time about the desirability of Time remaining an independent company in control of its own destiny. Second, Time's magazine franchise, its publishing operations, is an important part of Time's business, and it has long been the Board's view that the magazines should retain their editorial independence. The Board explicitly discussed the importance of preserving editorial independence.

Kearns Aff., ¶ 4. Time had developed a unique (see Perkins Aff., ¶¶ 14-17) structure (in which the senior writer — the editor-in-chief — reports directly to a special committee of the board of directors) in order to protect the "culture" or value of journalistic independence which the corporation had found, historically, to have been economically advantageous. See Perkins Aff., ¶¶ 14-17; Munro Dep. at 31.

It is noteworthy, however, that Time's magazine business contributes about 40% to its gross income and will contribute about 20-25% of the revenue of a merged Time-Warner. Munro Dep. at 151-54. One is entitled to be suspicious, therefore, that some other motivation than protecting the journalistic integrity of Time and People magazines may be at work in the insistence on assuring the integrity of the journalism for financial reasons. Not only did magazines not provide the dominant part of the income of the merged entity, but Time was not proposing to merge with a firm to whom the importance of expressive freedom is presumably unknown. How great a threat to 20% of the combined gross income did Warner represent? Yet maintaining a Time culture — all the outside directors except Temple agree — was the first and central requirement and could only be assured by securing the top job ultimately for Mr. Nicholas.

There may be at work here a force more subtle than a desire to maintain a title or office in order to assure continued salary or prerequisites. Many people commit a huge portion of their lives to a single large-scale business organization. They derive their identity in part from that organization and feel that they contribute to the identity of the firm. The mission of the firm is not seen by those involved with it as wholly economic, nor the continued existence of its distinctive identity as a matter of indifference.

Director Horner, for example, testifies:

> 13. I am very concerned about the need to preserve Time's editorial freedom. I believe that editorial freedom free from political or other kinds of intervention is absolutely essential if members of our society are to be enlightened enough to form wise judgments and fulfill their responsibilities as citizens. I believe that the need to foster a literate and informed citizenry is the *sine qua non* of this nation's and the company's future.
>
> 14. That feeling on my part coincides with the interests of Time stockholders. The editorial integrity I value is also a tremendous source of value to the company and its stockholders. Without it, *Time* magazine and the company's other magazines would lose their loyal readers and advertisers, and Time's revenues and value would suffer. The governance provisions were necessary to ensure Time writers and editorial personnel that editorial independence would continue to be respected at Time. Otherwise the integrity and ultimately the financial viability of the institution would be threatened.

Horner Aff., ¶¶ 13-14.

Thus, while the record suggests that the "Time culture" importantly includes directors' concerns for the larger role of the enterprise in society, there is insufficient basis to suppose at this juncture that such concerns have caused the directors to sacrifice or ignore their duty to seek to maximize in the long run financial returns to the corporation and its stockholders.

In all events, in July, 1988, the governance agenda included a plan for co-CEO's (initially Munro and Ross, then Nicholas and Ross to be followed by a sole CEO, Nicholas). It also provided for a board equally divided between 12 former Time directors and 12 former Warner directors and required a supermajority board vote (2/3) to modify the structure that established the board committee to whom the editor-in-chief would report. Munro Exh. 15 at 19501.

At its July, 1988, meeting, the board was presented with a report from the company's investment bankers with respect to ways and means to effectuate a transaction.

There was sentiment on the Time board to seek to pursue a negotiated cash acquisition of Warner (Nicholas Dep. at 33-34; Levin Dep. at 124-25; Dingman Dep. at 124) because of the more risky advantages that leverage may offer. It was reported, however, that Warner would insist upon a stock for stock deal — a rare form of transaction when firms of equivalent market capitalizations are involved, but one that might offer certain accounting advantages (pooling of interest treatment) and tax advantages. The Time board as a whole, with Mr. Temple an unenthusiastic participant, encouraged senior management to continue with the Warner talks and to negotiate a form of transaction, provided the question of "governance" could be resolved as the board and management of Time required.

C. Negotiation of the Time-Warner March 3, 1989, agreement of merger

Negotiation of a possible transaction seemed to fall to the ground promptly when the parties were unable to agree to a management structure of a combined entity that satisfied Time's expressed need to assure continuation of its "culture" by assuring the ultimate succession of Time executives to the senior executive positions in the new firm. Progress had been made. The concept of a 24 member board equally divided between incumbent directors of the two firms was agreed upon. The policy of editors reporting directly to a special board committee (initially to have comprised two former Time directors and one former Warner director) was to be employed and a parallel structure for the management of Warner's relationship with creative artists was agreed upon.

The rub came in agreeing to a plan for a chief executive officer. Mr. Munro was set to retire in 1990. Mr. Nicholas was to succeed him. The prospect of co-CEO's had been discussed and agreed upon in principle: Munro and Ross until Munro's retirement, then Nicholas and Ross until such time as Ross was to retire. At that time, it was proposed that Nicholas would succeed as sole CEO. Time, however, insisted that Mr. Ross should set a retirement date at the outset, to be agreed upon, and Mr. Ross did not find this appealing. Discussions broke off in August. Nicholas Dep. at 74; Ross Dep. at 24, 40.

Negotiations were reopened in January, 1989. Various informal contacts caused Mr. Ross to reevaluate his position and to agree upon a date when he would step down as co-CEO. The agreement reached was that Ross would retire five years after the merger and that Nicholas would then become the sole CEO of Time-Warner.

Other aspects of the agreement came easily. The parties agreed to a stock for stock deal and turned to an exchange ratio.

Some members of the Time board had taken the view that the ratio should be a simple reflection of the market price of the respective shares, while others recognized that Time's insistence upon being the "acquiring" company (to the extent it makes any sense to try to refer to one of these companies as an acquiror in these circumstances) would require or justify the payment of some small premium. Thus, the Time negotiators (principally Mr. Levin) felt themselves authorized, subject to board approval, to agree to an exchange ratio that did represent a premium for the Warner shareholders.

The exchange ratio was the last item agreed upon. It was agreed at a fixed rate (rather than a formula that would work off future data) of .465 of a Time share for each share of Warner's common stock. Nicholas Dep. at 85-100; Aboodi Dep. at 39-41. The ratio of market value of Warner's stock to Time's was about .38. The deal struck represented about a 12% premium for Warner shareholders. Should this merger have been effectuated, the shareholders of Warner would have owned approximately 62% of the common stock (and the voting power) of Time-Warner. In terms of market capitalization and 1988 net income, Warner was the larger of the two companies.

D. <u>The initial Time-Warner merger agreement</u>

On March 3, 1989, the boards of both companies authorized entering into the merger agreement, which was done also on that day. Both corporations have a majority of outside directors. Both approved the transaction after receiving investment banking and legal advice. There were no dissenting votes. There is nothing in the large record that has been created, of which I am aware, that would support a charge that the March 3 agreement was other than an arm's-length negotiated agreement between two parties seeking individual advantage through mutual action.

As a technical matter, the merger agreement contemplated the merger of Warner into a wholly-owned Time subsidiary (TW

Sub Inc.) with Warner as the surviving corporation. The common stock of Warner would be converted into common stock of Time Incorporated at the agreed upon ratio. The name of Time would then be changed to Time-Warner. In such circumstances, the Delaware General Corporation Law requires for the effectuation of a merger an affirmative vote of a majority of the shareholders of Warner (since its stock is being converted into something else in the merger), but does not require a vote of the shareholders of Time (since its stock will remain unaffected by the merger and the issuance of additional shares did not require amendment of Time's certificate of incorporation). See 8 Del. C. § 251. The merger agreement, however, contemplated a stockholder vote by both corporations since under New York Stock Exchange rules, issuance of the number of Time shares contemplated required such a vote.

E. Steps to protect the merger

1. The Share Exchange Agreement

At the same time that they authorized entering into the merger agreement, each board authorized execution of a Share Exchange Agreement. This agreement gave each party the option to trigger an exchange of shares in which event if triggered, Warner would acquire 7,080,016 shares (11.1%) of Time, and Time would acquire 17,292,747 shares (9.4%) of Warner's outstanding stock. These blocks of stock would have had approximately equal value if calculated on average closing prices of Time and Warner stock for the five business days preceding the announcement of the merger. Aboodi Dep. at 210-11. This agreement is said to have served several purposes including giving each party an investment in the other should the merger fail to be completed for any reason. For present purposes, I assume its principal purpose was to discourage any effort to upset the transaction. See Munro Exh. 19 at A001649, A001676; Temple Dep. at 45-46; Finkelstein Dep. at 92, 141-42.

Parenthetically, I note that earlier in this litigation and promptly upon announcing its initial $175 offer, Paramount sought a restraining order with respect to the Share Exchange Agreement on the theory that it was an impermissible impediment to achieving the best available transaction for the shareholders. The premise of the motion — that the signing of the merger agreement put the corporation in a "Revlon mode" in which there was an obligation to justify transactions that might impede effectuation of an offer to acquire control of the corporation — was contested. Without addressing that question, the application was denied on the basis that, as both parties to the agreement were before the court, effective relief could be fashioned at a later stage if that appeared warranted.

Thereafter, Warner did trigger the Share Exchange Agreement and that exchange has now occurred.

2. Restriction on information and "dry-up" agreements

Everyone involved in this negotiation realized that the transaction contemplated might be perceived as putting Time and Warner "in play." Realizing that the corporation might be deemed "in play," management sought and paid for commitments from various banks that they would not finance an attempt to take over Time. See, e.g., Munro Exh. 19 at A001676-77. In this litigation they are cited by plaintiffs as wrongful attempts by the "target" corporation to interfere with the ability of an offeror to present the shareholders with the best available price. In all events, these "dry up" fees appear to be a dubious, futile innovation at this point when the global economy seems awash in cash available to finance takeovers.

An additional attempt to secure the closing of the merger may be reflected in a provision of the merger agreement that severely limits the ability of Time to enter into any takeover negotiations prior to the closing of the merger. "Time may not solicit or encourage or take any other action to facilitate any inquiries on the making of any proposal which constitutes or may . . . lead to, any takeover proposal." Ross Exh. 10 at 16-17. The only exception to such provision would occur if a hostile tender offer for 25% or more of Time's stock is announced (or 10% of its stock is purchased), at which time Time may, after consultation with Warner, communicate with the offeror (or stockholder). In all events, such an occurrence would not excuse Time's performance under the merger agreement, but would give Warner an out.

F. Paramount announces a $175 cash offer on June 7

The Time board had fixed June 23 as the date for the annual shareholders meeting of the company at which the Time-Warner merger was to be presented for shareholder approval. On June 7, Paramount announced that it was extending an offer to purchase all of the outstanding common stock of Time at $175 per share cash. While the step had been under consideration from mid-March, the announcement was timed to await the distribution of proxy materials for the June 23 meeting so that Time would be publicly committed to a shareholder vote on the merger agreement. Hope Dep. at 202; Pattison Dep. at 93.

Paramount's offer was subject to a number of conditions, the most pertinent of which were the following:

1. termination of the Time-Warner merger agreement (or the agreement being left subject to a vote in which Paramount controlled 51% of the vote);

2. termination or invalidation of the Share Exchange Agreement under circumstances in which there would be no liability to Time;

3. Paramount to be satisfied in its sole discretion that all material approvals, consents and franchise transfers relating to Time's programming and cable television business had been obtained on terms satisfactory to Paramount;

4. removal of a number of Time-created or Time-controlled impediments to closing of the offer (e.g., redemption of a "poison pill" preferred rights purchase plan) or effectuation of a second-stage merger (e.g., supermajority voting requirements of 8 Del. C. § 203 and supermajority voting provisions of Time's certificate of incorporation) and;

5. financing and majority acceptance of the offer.

G. Market reaction to the Paramount offer

The Time-Warner merger had been warmly received. The stock for both companies rose on the market, although perhaps that only reflected that both began to receive attention from arbitrageurs. In any event, Time stock which had been traded in a \$103 5/8 — \$113 3/4 range in February, rose to \$105 — \$122 5/8 in March and April; Warner stock, which had been trading in a range of \$38 7/8 — \$43 3/4 in February, prior to the announcement of the merger agreement, traded in a \$42 7/8 — \$50 1/2 range in March and April.

The prospect of immediate \$175 cash payment, however, excited the market even more. Following the announcement of the Paramount offer, Time stock jumped 44 points in one day to \$170; it hit a high of \$182 3/4 on June 13 whence it relaxed to close at \$146 1/4 on the day of presentation of this motion.

A lot of stock changed hands after the Paramount offer. Average daily trading volume for Time over recent months has been as follows: 139,953 in February; 490,109 in March; 317,660 in April; 524,600 in May; and 1,679,977 in June.

H. Time and Warner react to the demand to terminate their negotiated contract

Time's management immediately responded to Paramount's announcement, aggressively sending to Mr. Davis of Paramount a biting letter attacking his "integrity and motives" and calling the offer "smoke and mirrors." Munro Exh. 21 at 2. Mr. Munro, who never considered exploring what Paramount might be willing to do on a negotiated basis, stated "[w]e had made a deal with Warner that we were planning to conclude and . . . we were not for sale." Munro Dep. at 126. Management also appears to have sought to cause delay in the process that Paramount would engage in to secure necessary governmental approvals for the transfer of cable franchises.

Time's board met on June 8, June 11, June 15 and June 16 to consider the $175 offer. No one suggested talking to Paramount. Nicholas Dep. at 160-61; Opel Dep. at 215-18 ("[t]here was no purpose to meet with Mr. Davis to discuss anything"); Dingman Dep. at 140-41 ("[w]e were under a commitment to do a deal with Warner"). Director Finkelstein reports that as a result of the June 8 board meeting:

> . . . the board members had each individually thought that one, the Paramount deal was so insufficient and that the Warner deal, if it could be put on track, was so much more attractive, that it made no sense to deal with Paramount at all.

Finkelstein Dep. at 131-32. See also id. at 133.

The board resolved on June 16 after further negotiations with Warner to reject the implicit demands of Paramount and to recast the Warner transaction in a form (a cash acquisition of a majority stake in Warner to be followed by a merger for cash or securities, or a combination of both) that would not require shareholder approval, which now, of course, was problematic.

While plaintiffs in these lawsuits interpret these actions as those of directors determined to ignore shareholder rights and interests in the pursuit of a transaction that assures them continued access to the salaries and prerequisites of a powerful corporation, the Time board purports to have been motivated on June 16 chiefly by two considerations: (1) a reasonable belief that the $175 per share offer was inadequate <u>if</u> Time were to be sold, and (2) a reasonable belief that if Time were not to be sold, which was the board's determination, then Warner was a far more appealing partner with whom to have ongoing business consolidation than was Paramount.

1. <u>The Time board's purported conclusion that the $175 offer was inadequate</u>

The Time board concluded at the June 16, 1988, meeting[6] that the Paramount $175 cash offer was inadequate if Time were

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[6] After consideration, the outside directors concluded they had no need for investment banking advice or legal counsel in addition to, or independently of, the advice that they had been receiving from those advisors who had been retained by management for the company. Given the origin and nature of the transaction, I am inclined to agree that there was no special need for an additional source of advice. I also take (Footnote Continued)

to be sold. Equally important, they concluded that given the circumstances — including the prospects that a Warner consolidation promised — it was not in the long-term interests of the corporation or its shareholders to sell the corporation at this time. Bere Aff., ¶ 36.

With respect to the question of the adequacy of the $175 price offered, the board was advised by its investment bankers that if it elected to sell the company, a substantial premium over the current values to be achieved otherwise would be realized. Several techniques to estimate this control market value were employed. See Rossoff Aff., ¶ 30. The board was told that "the price [in such a transaction] would likely be in the mid to high end of the pre-tax segment value range, which is to say that the price would likely be greater than $250 per share." Id.[7] This analysis was premised upon a

(Footnote Continued)
this occasion to note that after Paramount emerged, the investment bankers' retention agreements were amended to remove contingencies to their compensation — giving them a flat fee not contingent upon "who buys who." Wasserstein Dep. at 48.

[7] Plaintiffs urge that the board could not (and this court ought not) give substantial weight to such advice as, plaintiffs say, it is quite inconsistent with the advice that the exchange ratio (.465) in the merger transaction was fair and that the $70 per share offer to Warner was fair, which together imply about $150 per share value for Time. This argument, however, rests upon the assumption that the ratio
(Footnote Continued)

pre-tax valuation of each segment (i.e., did not contemplate a "bust-up" acquiror). The board was also presented with valuation ranges for a strategic acquiror; a leveraged buyout range (on various assumptions) and recapitalization ranges, both of which ranged from levels somewhat above the $175 price to prices higher than the now current offer. See Rossoff Aff., Exh. C.

This June valuation advice is now attacked as transparently unprincipled; a post hoc attempt to rationalize ignoring shareholder interests, which is shown to be a sham by comparison with the same firm's markedly lower reference ranges for Time in connection with the March merger agreement. In that earlier transaction, Time's advisors, in connection with the board's approval of an exchange ratio, established a range of value for Time of between $189.88 to $212.25 per share. Finkelstein Exh. 7 at A001788. Warner was valued, in March, at between $64.39 and $72.87 per share. Finkelstein Exh. 7 at A001728. In a June 15 board presentation, the board was

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(Footnote Continued)
between the value of Time in a control (takeover) market and the value of Time shares in a normal trading market (as to the existence of such distinct markets, see n. 13 infra) would be the same as the ratio between Warner's control market value ($70) and the trading value of Warner shares prior to the original merger agreement. There is no reason why this need be the case. While apparently seen as complimentary, Time and Warner are very different companies.

apparently told that "a strategic buyer" would pay more than $250 — very substantially more than the upper limit of the March range. <u>See</u> Rossoff Aff., <u>supra</u>. The defendants respond that the June analysis considered a change in control market, while the earlier analysis was for a different purpose and that, in addition, more recent projections and changes in the market for entertainment companies justify the difference.

2. <u>What the board was advised with respect to (a) likely short-term stock price following a revised Time-Warner merger, and (b) likely longer-term stock price</u>

It was the view of Wasserstein, Perella that the stock of Time-Warner would trade at around $150 per share. Wasserstein Dep. at 175. They noted as well that the range might also be higher, citing a range of $160 to $175 per share. <u>Id</u>. In the written presentation given to the board on June 16, the trading range given for the year 1990 is $106 — $188, based on both cash flow and earnings per share analysis.[8] Nagy Exh. 3.

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[8] Dillon, Read & Co. Inc. was retained by Paramount's counsel as an independent financial analyst to evaluate Time's financial data. Mr. Phillips of that firm opined that the common stock of the combined Time-Warner entities would trade in a range between $90 and $140 per share. Phillips Aff.,
(Footnote Continued)

In the longer term, Time's advisors have predicted trading ranges of $159 — $247 for 1991, $230 — $332 for 1992 and $208 — $402 for 1993. Nagy Aff., Exh. 3. The latter being a range that a Texan might feel at home on.

3. <u>Purported consideration of non-price terms</u>

In addition to price, the board considered that the $175 offer was itself subject to conditions that would delay its effectuation for, at a minimum, some months or as much as a year, to get the approvals for the transfer of control of local cable television franchises, which approvals Paramount had made a condition to its closing. Finkelstein Exh. 15 at 5-6. In fact, it appears that this point was seen less as a problem than as an opportunity. Time has been active in

(Footnote Continued)
¶ 3. Time's investment banker takes issue with Mr. Phillips' cash flow multiples, stating that they are inappropriately low for a company such as the proposed Time-Warner. Several other outside analysts have produced the following trading estimates:

David J. Londoner of Wertheim Schroder	— $155
Kendrick Nobel of Paine Webber Group	— $173
Jeffrey Russell of Drexel Burnham Lambert	— $145--$160
Richard MacDonald of First Boston	— $120--$150

Rossoff Aff., ¶ 16.

trying to impede Paramount's ability to satisfy this condition.

The board considered that the terms of the offer (Paramount to be satisfied in its sole discretion, etc., see p. 28, supra) gave Paramount great flexibility and that in a sense the offer could be viewed as a "request" to terminate the Warner deal and to grant Paramount a free option on the company for some period necessary to see if the transfer of all material franchises could be arranged. Perkins Aff., ¶ 55. There was some speculation that Paramount — a competitor of the planned Time-Warner entity — sought mainly to disrupt and prevent the formation of an effective competitor, but no evidence of this view is cited.

During these June meetings, the board received a presentation on Paramount. The board concluded that there was a poor fit between the companies. Nicholas Dep. at 191-92; Munro Dep. at 127, 202. A key factor said to make Warner a far better vehicle for satisfying Time's strategic goals than Paramount is "the international distribution power of Warner." Wasserstein Dep. at 161; Bere Aff., ¶ 39; Nicholas Dep. at 146-47; Munro Dep. at 220. Moreover, Paramount, unlike Time and Warner, is not in the record business. Munro Dep. at 219; Levin Dep. at 342.

The board concluded that pursuit of the original conception — a merging of the businesses of Time and Warner — was preferable to a present sale of the enterprise (which Paramount's offer presented as an alternative) or a negotiated consolidation with Paramount, if it were otherwise possible.

Outside director Finkelstein testified as follows as to the board's conclusion:

> In looking at a variety of options that [the investment bankers] presented including what shareholder value would be two, three, four years down the line on the merger, and various other approaches . . . that they presented us with, I came to the conclusion Time is a very valuable company, and it is my own judgment that the acquisition of Warner will magnify that value.
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> * * * *
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> My general conclusion was that Time had decided on a course of action a long time before — to go forward with Warner after discussing the opportunities that might have been presented with going forward with other people, Paramount included. And that general conclusion, which I agree with, was that the Time-Warner fit of businesses was in the best interest of Time, and I did not see anything in terms of the Paramount offer that interferes with that logic, so it was logical to me to attempt to get the businesses together in a form which had been considered previously, which a lot of people in Time, I think, preferred, but which was unacceptable at that time to Mr. Ross. So it seemed to me that it was a logical continuum of the board's feeling about where Time should be going.

Finkelstein Dep. at 127, 128.

4. Recasting the merger transaction

With the determination to decline Paramount's invitation to negotiate the sale of Time and to continue to pursue the Warner transactions, the directors faced the fact that it was problematic whether the Time shareholders would share the board's expressed view that $175 cash now should be rejected in order to afford the company's management some additional years to manage the trading value of Time shares to levels materially higher than the future value of $175 now. The annual meeting had been set for June 23. Time's shares are held largely by institutional investors. While some of these investors could be expected to continue, despite the emergence of a cash option, to support what had been widely supported as a fine transaction,[9] it is reasonable to suppose that most such money managers would be tempted by the cash now. While

[9] For example, one money manager who serves as a senior vice president of a firm that in a fiduciary capacity owns approximately 7% of Time's common stock, 7% of Warner's common stock and just under 5% of Paramount's common stock, and who himself specializes in research in the entertainment and media industries, has submitted the expert opinion (his own, not as a representative of his firm) that for an investor with a long-term investment horizon (undefined by him) "the proposed Time-Warner combination is superior for Time shareholders . . . to the currently outstanding Paramount [$200 per share cash] offer." See Crawford Aff., ¶¶ 1-3.

the record here contains testimony about a possible concern about confusion or deception of shareholders as part of the reason that the board elected to abandon the merger form of transaction and pursue a cash offer, I will decide this motion not on the understanding that the board was reacting to a threat of confusion (arising, for example, from alleged misperception about how quickly a Paramount offer could or would close), but on the understanding that it sought to avoid the risk that the merger would not get an affirmative vote even if there were no confusion.

Thus, the "return" to a cash acquisition format must be seen as a reaction to the effect that emergence of the Paramount offer could be expected to have on the shareholder vote. While in this litigation Time seeks to avoid or obscure that point, the point seems evident and, in fact, has been admitted by Time in its Schedule 14D-9 filing:

> In response to the serious threat posed by the PCI Offer to Time's effectiveness in furthering such strategic objectives and corporate policies, including its ability to consummate the Original Merger, the Board of Directors determined to modify the terms of the Original Merger as described in Item 7 below.

There had been sentiment on Time's part for a cash acquisition originally, even though the stock for stock deal was trumpeted by Time management as outstanding because it did not follow the trend towards greater leverage. The higher leverage that a cash acquisition implied might be expected to boost the value of Time's equity, so long as the debt could be effectively managed. With respect to an appropriate price for Warner in a cash deal, the investment bankers advised that a $70 cash price would be fair from Time's point of view. Warner had been trading at around $45 prior to the announcement of the merger so the price represented about a 56% premium. Because of the increased leverage that would be involved, Shearson-Lehman advised the board that immediately following completion of the tender offer merger transaction, Time's stock could be expected to trade at a price higher than that expected if the original merger transaction were to be completed. See Rossoff Aff., ¶ 12.

The revamped transaction was negotiated at arm's-length. Warner sought a control premium, of course. It sought assurances that certain of the "governance" provisions, principally those dealing with the co-CEO concept and evenly divided board representation that had made the original merger agreement acceptable to its board would remain. It negotiated tight commitments that would assure that if it were to in effect announce it was for sale by accepting the restructured deal, the deal would close unless enjoined. See Greenough Aff., ¶¶ 10-11; Ross Dep. at 179; Nicholas Dep. at 213. Specifically, the agreement provided no condition to Time's obligation to buy Warner stock under the offer if the minimum number of shares were tendered.

Effectuation of the reformatted transaction would accomplish the basic purposes of the initial merger transaction, from Time's point of view. It would afford the company a video production capacity of recognized talent, it would extend the company into global markets in a substantial way, and it would continue the Time identity and the Time "corporate culture" (i.e., in this instance, it would assure that Mr. Nicholas ultimately will serve as the CEO of the enterprise). The revised transaction will be significantly different in some respects, however. Now, at the conclusion of the transaction, Time's balance sheet will have at least $7 billion of new debt and may have $10 billion or more of new debt,[10] and will have reduced ability to support substantial additional borrowing.[11] Secondly, under the revised merger

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[10] Consideration in the second-stage merger, it now seems, will be half equity. See Waters Aff., ¶ 3.

[11] Compare Waters Aff., ¶ 5 (company "tapped out") with Seegal Aff., ¶¶ 2, 3 (not so). In all events, the balance sheet of an ongoing enterprise is never in a final condition. If the merged entity is the success that its proponents believe it will be, Time-Warner could replace this debt with equity through a new offering and move towards the balance sheet originally envisioned — without, however, the income statement advantages of pooling of interest accounting treatment.

reported earnings of the new entity are expected to be essentially eliminated by the necessity to amortize approximately $9 billion of goodwill as a result of the purchase method of accounting for the revised merger. Thirdly, the revised deal pays a large control premium to Warner shareholders whereas the earlier transaction paid them a premium of approximately 12%.

At meetings on June 15 and 16, Warner's board approved the restructured proposal. That same day, Warner caused the exchange of shares contemplated by the Share Exchange Agreement to be triggered.

I. <u>Paramount's $200 offer and Time's rejection of it on June 26</u>

On June 23, Paramount, not having been able to induce Time to engage in negotiations, unilaterally increased the cash price of its offer to $200. That subject was addressed at a June 26 meeting of the Time board. The factors that had earlier led to the decision not to pursue a sale transaction with Paramount apparently continued to dominate the board's thinking. The increase in price did not overcome the factors earlier relied upon: the continued possibility of delay, the presence of possible Paramount outs in the cable franchise approval process and the comparison of the new price with the ranges of sale values earlier discussed. In addition, Time had, as of June 16, entered into an agreement that the board felt was legally binding to complete the Warner transaction. Abandonment of that transaction was a condition of the $200 offer and the Time board had not negotiated a contract right to abandon its offer in the event that Paramount or another potential acquiror might condition an all cash, all shares offer on such abandonment. The record is uncontradicted at this stage that Warner would not have agreed to such a provision. It is equally plain that Time did not seek it.[12]

J. <u>Executive management's compensation</u>

Before turning from this summary chronology of events, I recur to dilate briefly on a point earlier touched upon: the compensation of the senior officers of Time and Warner under the merger agreement and under the revised form of transaction. This matter is relevant to plaintiffs' theory that it

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[12]Time airily (Answering Brief, p. 114) dismisses Paramount's complaint that the board ought to have tried — its duty in these circumstances required it to try — to maintain flexibility. "What offeror has included a fiduciary out?" Time's counsel asks. It is, of course, the case that circumstances have rarely if ever arisen in which an offeror need concern itself with likely changes in circumstances affecting its shareholders prior to the proposed closing of its offer. But that general condition provides no answer to the specifics here, which may be answered more substantively by reference to Warner's negotiation position.

is the selfish interests of dominating insiders that are the real motivation behind the Time-Warner consolidation, not an honest pursuit of corporate and shareholder interests.

One of the subjects for consideration raised by some outside directors of Time when the notion of a Warner merger was first discussed was whether the compensation of Mr. Ross under his then current arrangements with Warner was so rich, in comparison to the compensation of Time's senior officers, as to render problematic a scheme in which he and they were to share executive power — unless the Time senior officers' compensation was changed materially. Would not such a change, however, affect morale throughout the organization; would it threaten injury to the perceived Time culture? It was acknowledged that entertainment industry executives are exceptionally well paid. While Mr. Ross' cash salary and bonus was high ($4.5 million in 1987), his long-term stock related consideration promises to be munificent. The 1988 proxy statement of Warner states that he might earn as much as $200 million over the next ten years. (One should note, however, that the performance of Warner under Ross' management has been outstanding. Mr. Ross testified that an investor who purchased stock in his initial public offering would now have an investment that has appreciated 100 times. Ross Dep. at 87).

The level of Mr. Ross' compensation was a topic for consideration. Temple Dep. at 17-18, 134; Temple Exh. 8; Luce Dep. at 32, 63; Finkelstein Dep. at 59, 95; Nicholas Dep. at 197-98. In the end, the Time board viewed the assumption of this obligation as an inextricable part of the proposed deal. Dingman Dep. at 160; Finkelstein Dep. at 59-60; Temple Dep. at 14. Moreover, no director ever appears to have questioned that Mr. Ross is largely responsible for Warner's great success or that his compensation was not justified, in markets relevant to such things, by his performance.

In all events, it is stated in this record that, broadly speaking, Mr. Ross' compensation arrangement will not on balance be substantially altered or improved by effectuation of the revised merger agreement between Time and Warner. Ross Dep. at 83.

The "Time culture" problem was diffused when the outside directors understood that Munro and Nicholas would not seek as a result of the merger to have the basis upon which they are compensated substantially changed. Ross Dep. at 29-30. Finkelstein Dep. at 168-69. They would, however, receive new contracts at substantial increases. (Mr. Munro, for example, enjoyed an increase of $7 million over ten years). Munro Dep. at 234. It is the case that as part of the planning for a transition period involving the co-CEO structure, Mr. Munro

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II.

The legal test for the issuance of a preliminary injunction has essentially three parts. First, those seeking the relief must establish a reasonable likelihood of success on the merits of their claims. Second, it must be established that failure to grant the relief sought will result in injury to plaintiffs that will not be remediable by later injunctive relief or compensable by an award of damages. Lastly, the court must evaluate the chance that the defendants (or other persons) will be injured by the granting of the improvident relief sought and whether any injury of that kind could itself be remedied later. Thus, the court must weigh and balance all of the equities. See, e.g., Ivanhoe Partners v. Newmont Mining, Del. Supr., 535 A.2d 1334 (1987); Shields v. Shields, Del. Ch., 498 A.2d 161 (1985).

Before turning to an analysis of the merits of plaintiffs' complaint, I pause to make one observation that should be apparent. It is not part of the function of the court to evaluate whether the Time-Warner deal is a good deal for Time shareholders or a poor one. The Time shareholders complain, feeling that under the revised merger Warner shareholders get all of the premium and they get little — except a promise that Mr. Nicholas will someday guide their company, and knowledge that they may be foreclosed from a comparable premium from Paramount. Plaintiffs find this to be cold comfort. Determination of the legal issues, however, does not require this court to try to evaluate, in light of the evidence, whether Mr. Ross and his negotiator, Mr. Aboodi, out-negotiated Time's Mr. Levin and Mr. Nicholas in this transaction.

III.

On June 16, the board of directors of Time, upon what would appear competent advice, resolved that it would commit the corporation to the revised Warner transaction. It then implemented its decision in a way intended to assure that no future event would upset achievement of the goal embraced. I am convinced that in doing so, the board understood that it was foreclosing for the present, as a practical matter, the option for Time shareholders to realize $175 cash for their shares — indeed it understood that $175 could be realized from Mr. Davis and perhaps substantially more from him or others — and, more significantly, the board understood that immediately following the effectuation of a Warner merger, the stock market price of Time stock was likely to be materially lower than the $175 then "on the table," perhaps $150, but more likely, within the wide range of $106 — $188 (see p. 32, supra).

The board explains its choice — for despite the long negotiations and the agreements with Warner, it was free to let the Warner transaction go to the shareholders, and thus on June 16 it was free to choose — by reference to the view that the long-term value of a Time-Warner combination would be superior not only to the premium $175 presently available to the shareholders, but to any current sale price in the ranges it had been told could be achieved. See, e.g., Finkelstein Dep., supra at 182-84. This is the heart of the matter: the board chose less current value in the hope (assuming that good faith existed, and the record contains no evidence to support a supposition that it does not) that greater value would make that implicit sacrifice beneficial in the future.

That decision raises many subsidiary, but two overarching questions: First, does it make any sense, given what we understand or think we understand about markets, to posit the existence of a distinction between managing for current value maximization and managing for longer-term value creation — a distinction which implies, unless I am wrong, that current stock market values fail to reflect "accurately" achievable future value? The second overarching question raised by the decision of June 16 is this: who, under the evolving law of fiduciary obligations is, or should be, the agency for making such a choice in circumstances of the sort presented here — the board or the shareholders? The legal analysis that follows addresses this second overarching question in terms of two related sets of doctrines.

A.

The legal analysis that follows treats the distinction that the Time board implicitly drew between current share value maximization and long-term share value maximization. For some, this is a false distinction. "The lawyers may talk about a premium for control. But to a true believer of efficient markets, there cannot be a premium for control."[13]

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[13]The statement is Professor Martin Shubik's, the Seymour H. Knox Professor of Mathematical Institutional Economics at Yale. Professor Shubik apparently is not a true believer in efficient markets. He goes on to suggest:

> If, in contradistinction to the adherents of the single, efficient market, we suggest that there are several more or less imperfect markets involving the market for a few shares, the market for control, the market for going-business assets, and the market for assets in liquidation, then we have a structure for interpreting what is going on in terms of

(Footnote Continued)

Therefore, before turning to the legal analysis that does employ that distinction, I pause to address in some brief way the notion that the distinction between any long-term and short-term stock value, at least where there is a large, active, informed market for the shares of the company, is an error; that the nature of such markets is precisely to discount to a current value the future financial prospects of the firm; and that markets with their numberless participants seeking information and making judgments do this correctly (at least in the limited sense that no one without inside information can regularly do it better).[14]

This view may be correct. It may be that in a well-developed stock market, there is no discount for long-term profit maximizing behavior except that reflected in the discount for the time value of money. It may be the case that when the market valued the stock of Time at about $125 per share following the announcement of the merger, an observer

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(Footnote Continued)
arbitrage among these different markets.

Shubik, "Corporate Control, Efficient Markets, and the Public Good," Knights, Raiders & Targets: The Impact of the Hostile Takeover, (Coffee, Lowenstein and Rose-Ackerman eds. 1988).

[14] *See, e.g.*, Gordon & Kornhauser, "Efficient Markets, Costly Information and Securities Research." 60 N.Y.U. L. Rev. 761 (1985).

blessed with perfect foresight would have concurred in that value now of the future stream of all returns foreseen into eternity. Perhaps wise social policy and sound business decisions ought to be premised upon the assumptions that underlie that view. But just as the Constitution does not enshrine Mr. Herbert Spencer's social statics, neither does the common law of directors' duties elevate the theory of a single, efficient capital market to the dignity of a sacred text.

Directors may operate on the theory that the stock market valuation is "wrong" in some sense, without breaching faith with shareholders. No one, after all, has access to more information concerning the corporation's present and future condition. It is far from irrational and certainly not suspect for directors to believe that a likely immediate market valuation of the Time-Warner merger will undervalue the stock. The record in this case refers to instances in which directors did function on a theory that they understood better than the public market for the firm's shares what the value of their firm was, and were shown by events to be correct:

> The Walt Disney Company case is an example of an entertainment company that rejected a $72.50 hostile offer in June 1984 and is now trading at the equivalent of $380 per 1984 share. Another example of an entertainment company that achieved better results by remaining independent and growing than by cashing in when it was

> undervalued in the market is Warner itself. In early 1984, Warner was the subject of unsolicited interest on the part of Rupert Murdoch. At that time Warner was selling for $10 to $12 a share, adjusted for a subsequent two-for-one split. Today, of course — five and a half years later — Warner is the subject of a $70 per share merger agreement with Time and was selling at $45 (or about four times its early 1984 price) before its merger with Time was announced.

Crawford Aff., ¶ 4.

On the level of legal doctrine, it is clear that under Delaware law, directors are under no obligation to act so as to maximize the immediate value of the corporation or its shares, except in the special case in which the corporation is in a "Revlon mode." Mills Acquisition Co. v. Macmillan, Inc., Del. Supr., Nos. 415 & 416 (May 3, 1989); Ivanhoe Partners v. Newmont Mining, Del. Supr., 535 A.2d 1334 (1987); Revlon v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986). See generally TW Services, Inc. v. SWT Acquisition Corp., Del. Ch., C.A. No. 10427 (March 2, 1989). Thus, Delaware law does recognize that directors, when acting deliberately, in an informed way, and in the good faith pursuit of corporate interests, may follow a course designed to achieve long-term value even at the cost of immediate value maximization.[15]

The legally critical question this case presents then involves when must a board shift from its ordinary long-term profit maximizing mode to the radically altered state recognized by the Revlon case in which its duty, broadly stated, is to exercise its power in the good faith pursuit of immediate maximization of share value. Surely, when as in Revlon itself and other cases construing its command, most notably Macmillan,[16] the board decides to enter a change in control transaction, it has elected to enter the Revlon zone. But it now appears resolved that a subjective disinclination to sell the company will not prevent that duty from arising where an extraordinary transaction including, at a minimum, a change in corporate control is involved:

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[15] It is this recognition that, in part, permits a corporation to make reasonable charitable contributions; to grant scholarships or take other action that will not have a direct or immediate positive impact upon the financial performance of the firm.

[16] See also In Re J.P. Stevens & Co., Inc. Shareholders Litigation, Del.Ch., 542 A.2d 770 (1988); In Re RJR Nabisco, Inc. Shareholders Litigation, Del. Ch., Cons. C.A. No. 10389 (January 31, 1989); In Re Fort Howard Corp. Shareholders Litigation, Del. Ch., Cons. C.A. No. 9991 (August 8, 1988); In Re Holly Farms Corporation Shareholders Litigation, Del. Ch., C.A. No. 10350 (December 30, 1988), slip op. at 12.

> [Revlon's requirements pertain] whether the "sale" takes the form of an active auction, a management buyout, or a "restructuring" such as that which the Court of Chancery enjoined in Macmillan I.

Mills Acquisition Co. v. Macmillan, Inc., slip op. at 56.

Thus, more specifically, the first overarching question presented by these facts reduces legally to the inquiry whether the board was, on June 16, involuntarily in that special state — what one can call, as a shorthand, the "Revlon mode" — in which it was required to maximize immediate share value. This question is treated at pp. 54-63 below. If the board was itself under no duty to choose to maximize current value, then the second overarching question must be addressed in terms of the legal questions presented.

B.

The second overarching question is where legally (an easy question) and equitably (more subtle problem) the locus of decision-making power does or should reside in circumstances of this kind. The argument of plaintiffs is that the directors' duty of loyalty to shareholders requires them at such a time to afford to the shareholders the power and opportunity to designate whether the company should now be sold. This position is supported with two distinct legal arguments. First, certain of the plaintiffs argue that the commitment of the original Warner transaction to a shareholder vote gave rise to a fiduciary obligation to permit the shareholders to decide the matter. The reformatting of the deal in order to avoid the risks of shareholder non-approval is thus seen as a breach of a duty of loyalty. Principally involved in this analysis are cases dealing with the exercise of the franchise. E.g. Schnell v. Chris-Craft Industries, Del. Supr., 285 A.2d 437 (1971); Frantz Manufacturing Company v. EAC Industries, Del. Supr., 501 A.2d 401 (1985); Condec Corporation v. Lunkenheimer Company, Del. Ch., 230 A.2d 769 (1967); Aprahamian v. HBO & Co., Del. Ch., 531 A.2d 1204 (1987); Blasius Industries, Inc. v. Atlas Corp., Del. Ch., C.A. No. 9720 (July 25, 1988). This argument is treated at pp. 64-68 below.

The second and more difficult doctrinal setting for the question of whose choice is it, is presented by Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985) and a string of Chancery opinions construing its test to require, in certain circumstances, the taking of action — typically the redemption of a so-called poison pill — to permit shareholders to choose between two functionally equivalent alternative transactions. Grand Metropolitan PLC v. The Pillsbury Company, Del. Ch., C.A. No. 10319 (December 16, 1988); City Capital Associates Limited v. Interco, Inc., Del. Ch., 551 A.2d 787 (1988); Robert M. Bass Group, Inc. v. Edward P. Evans, Del.

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Ch., 552 A.2d 1227 (1988); AC Acquisition Corp. v. Anderson, Clayton & Co., Del. Ch., 519 A.2d 103 (1986). This question is discussed at p. 68-70 below.

IV.

Were the Time Directors Under an Obligation To Seek, in Good Faith, Only to Maximize Current Share Value on June 16?: Plaintiffs' Revlon Argument

A.

Plaintiffs' first argument,[17] restated most simply, is that the original merger agreement constituted an implicit decision by the board of Time to transfer control of the company to Warner, or more correctly its shareholders, and when the board decided to consider doing that, its duties changed from long-term management of the corporation for the benefit of the company's shareholders to the narrow and specific goal of present maximization of share value. That is, it entered a "Revlon mode." See Revlon v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173, 182 (1986). The class action plaintiffs assert that any change in corporate control triggers this special duty. The individual

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[17] This argument is advanced principally by the shareholder plaintiffs.

shareholder plaintiffs urge a different theory as triggering the special Revlon duty. They contend that the original merger, if effectuated, would have precluded the Time shareholders from ever (that is, in the foreseeable future) realizing a control premium transaction, and thus, in its impact upon Time shareholders, the merger contemplated by the March 3 agreement would have implicitly represented the same loss of a control premium as would a change in control transaction with no premium. Thus, these plaintiffs assert that even if the stock for stock merger did not represent a change in control, the same duty to maximize current value should attach to it as to a "sale."

Plaintiffs, having purportedly shown that the board really was in a Revlon mode, then go on to argue that the board violated its Revlon duty by not seeking a current value maximizing transaction and by entering into a number of agreements that were intended to preclude or impede the emergence of current value maximizing alternatives. These agreements include the "dry up" fee payments, the Share Exchange Agreement and the restrictions on supplying information to or entering into discussions with anyone seeking to acquire control of Time.

Defendants respond first that the board did not consider that it was appropriate in March or thereafter to "sell" the company; the purpose of the original merger was quite the opposite in that it sought to preserve and improve the company's long-term performance. Second, defendants say that if something other than their subjective intention is relevant, it simply is not the case that the stock for stock merger they authorized represented a change in control. It is irrelevant in their view that some 62% of the equity of Time would be owned by former Warner shareholders after the merger, that Mr. Ross would serve as co-CEO or that half of the members of the enlarged board would be former Warner directors. There was no control block of Time shares before the agreement and there would be none after it, they point out. Before the merger agreement was signed, control of the corporation existed in a fluid aggregation of unaffiliated shareholders representing a voting majority — in other words, in the market. After the effectuation of the merger it contemplated, control would have remained in the market, so to speak.

As to the individual plaintiffs' theory, defendants say it is flawed in law and in fact. Legally, they contend that a transaction that is otherwise proper cannot be deemed to trigger the radical "Revlon mode" obligations simply because it has the effect of making an attempted hostile takeover of the corporation less likely. All manner of transactions might have that effect and our cases, it is said, have explicitly rejected the motion that a would-be acquiror can compel a target to maintain itself in status quo while its offer proceeds. See, e.g., USI, Inc. v. Walbro Corp., Del. Ch., C.A. No. 9323 (October 6, 1987); City Capital Associates Limited v. Interco Inc., Del. Ch., 551 A.2d 787 (1988) at 800-01.

Factually, defendants claim that this record does not establish a reasonable probability that the initial merger, if it had been consummated, would have precluded a future change in control transaction. The merged Time-Warner company would be large, it is true (a "private market" value approaching $30 billion, it is said), but recent history has shown that huge transactions can be done. While such a transaction would be rare, if a leveraged acquisition of both participants was feasible before the merger, one cannot say that a stock for stock consolidation of such firms would necessarily preclude an acquisition of it thereafter, or so defendants contend.

In Mills Acquisition Co. v. Macmillan, Inc., Del. Supr., Nos. 415 & 416 (May 3, 1989), the Supreme Court, while noting that there was no need for it to address in detail the question when Revlon duties arose, did note that:

> Clearly not every offer or transaction affecting the corporate structure invokes the Revlon duties. A refusal to entertain offers may comport with a valid exercise of business judgment. See Bershad; Ivanhoe at 1341-42; Pogostin, 480 A.2d at

Macmillan I opinion in this court, that a corporate transaction that does represent a change in corporate control does place the board in a situation in which it is charged with the single duty to maximize current share value. I cannot conclude, however, that the initial merger agreement contemplates a change in control of Time. I am entirely persuaded of the soundness of the view that it is irrelevant for purposes of making such determination that 62% of Time-Warner stock would have been held by former Warner shareholders.

If the appropriate inquiry is whether a change in control is contemplated, the answer must be sought in the specific circumstances surrounding the transaction. Surely under some circumstances a stock for stock merger could reflect a transfer of corporate control. That would, for example, plainly be the case here if Warner were a private company. But where, as here, the shares of both constituent corporations are widely held, corporate control can be expected to remain unaffected by a stock for stock merger. This in my judgment was the situation with respect to the original merger agreement. When the specifics of that situation are reviewed, it is seen that, aside from legal technicalities and aside from arrangements thought to enhance the prospect for the ultimate succession of Mr. Nicholas, neither corporation could be said to be

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The existence of a block of stock in the hands of a single shareholder or a group with loyalty to each other does have real consequences to the financial value of "minority" stock. The law offers some protection to such shares through the imposition of a fiduciary duty upon controlling shareholders. But here, effectuation of the merger would not have subjected Time shareholders to the risks and consequences of holders of minority shares. This is a reflection of the fact that no control passed to anyone in the transaction contemplated. The shareholders of Time would have "suffered" dilution, of course, but they would suffer the same type of dilution upon the public distribution of new stock.

B.

More subtle is Literary Partners' argument that the preclusion of a future change in control transaction ought to be deemed to trigger Revlon duties, to which I now turn.

The argument, as I understand it, is that the original Time-Warner merger, even if it represented no change in control, precluded a future control premium or private market transaction and that as a consequence of that fact, the directors' fiduciary duties required them to capture a control premium now — to sell the company. This brief restatement lacks much of the subtly of the individual plaintiffs' moderate and skillful advocacy, but is, I think, essentially the argument.

It is plain that the original transaction did not legally preclude or impede a later sale or change in control transaction. It does seem reasonable to assume, however, that effectuation of the merger would, as a practical consequence, reduce the likelihood of such a transaction substantially. Our cases, however, have stated the obvious: a would-be acquiror (or the target company's shareholders) has no right to stay the exercise of director power under Section 141 pending the resolution of an attempt to acquire control. So long as the board acts in good faith and deliberately, its acts during such period will be undisturbed unless they are found to be defensive, in which event they must be shown to be reasonable in relation to a threat posed by the offer under Unocal. Thus, for example, in USI v. Walbro, supra, it was said at pp. 8-9:

> . . . [I]t is well established that a tender offeror has no right to freeze the business he seeks to acquire while his offer goes forward. Not only has a board the responsibility to continue to manage the enterprise generally, but a board, if it acts in good faith and with due care, may also take steps to defeat a tender offer that it finds to be unfair to some shareholders. In taking such action, a board necessarily acts under the suspicion that it seeks to protect its personal

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> interests. Thus, those actions must pass later judicial review as being reasonable in relation to a threat to corporate or shareholder welfare. But action designed to defeat a tender offer that the board finds to be at an unfair price — particularly an offer that is for less than all of the stock and has no announced second step at all — is not _ipso facto_ invalid simply because it is effective and thus does deprive some shareholders of an option they might have taken. With these generalities in mind, it seems a stretch to seek to enjoin as yet unproposed transactions that may have the effect of making the Company a less desirable or less practically achievable target to a particular tender offeror.

In _Interco_, among the propositions addressed was the question whether the sale of a division should be enjoined pending completion of the contest for control that was going forward. A number of circumstances indicated that the transaction could be expected to have only modest impact upon the prospects of the pending offer. That fact compelled the conclusion that the asset sale there involved was reasonable under _Unocal_. The general formulation, however, has some bearing on the present argument:

> The question of reasonableness in this setting seems rather easy. Of course, a board acts reasonably in relation to an offer, albeit a noncoercive offer, it believes to be inadequate when it seeks to realize the full, market value of an important asset.

* * * *

> I do understand that this step [the sale of a substantial division] complicates [the bidder's] life and indeed might imperil CCA's ability to complete its transaction. CCA, however, has no right to demand that its chosen target remain in status quo while its offer is formulated, gradually increased and, perhaps, accepted.

Interco, 551 A.2d at 801.

The individual plaintiffs' argument is an argument for extension of the Revlon case beyond sales or other change in control transactions. I have earlier expressed the view that Revlon was not a radical departure from existing Delaware, or other, law (i.e., it has "always" been the case that when a trustee or other fiduciary sells an asset for cash, his duty is to seek the single goal of getting the best available price), as well as the view that to be in a Revlon mode is for a director to be in a radically altered state. The suggested rule, however, would constitute an expansion of Revlon beyond the traditional principle alluded to above which underlies that case. Plaintiffs can cite no authority compelling or commanding this expansion, which would dramatically restrict the functioning of the board whenever an offer was made. Under our law, the validity of "defensive" measures is addressed under a Unocal analysis, not under the narrower Revlon case.

V.

Did the Combination of Circumstances Existing on June 16 Impose Upon the Time Board a Fiduciary Obligation to Afford to Shareholders a Choice With Respect to Whether the Corporation Should be "Sold" or Managed for the Long-Term?

This is the second overarching question referred to above. Two legal theories are advanced by plaintiffs in support of their position that the board was under a duty to provide, or at least not practically preclude, a choice to accept the Paramount offer or another, higher offer for sale of the entire company now. The first, simpler, theory relates to the franchise; the second to the analysis of "defensive" corporate acts envisioned by the important Unocal case. Unocal Corp. v. Mesa Petroleum Co., Del. Supr., 493 A.2d 946 (1985).

A. The recasting of the transaction in a form that avoided a shareholder vote when the vote seemed destined to go against management

The principle is well established in Delaware law that manipulation of the corporate machinery for the accomplishment of inequitable purposes will not be countenanced. E.g. Schnell v. Chris-Craft Industries, Del. Supr., 285 A.2d 437 (1971); Frantz Manufacturing Company v. EAC Industries, Del. Supr., 501 A.2d 401 (1985); Canada Southern Oils, Ltd. v. Manabi Exploration Co., Inc., Del. Ch., 96 A.2d 810 (1953); Aprahamian v. HBO & Co., Del. Ch., 531 A.2d 1204 (1987);

Blasius Industries, Inc. v. Atlas Corp., Del. Ch., C.A. No. 9720 (July 25, 1988).

Primary reliance is placed upon the recent decision in Blasius v. Atlas. There, a board acted in apparent good faith to prevent an already commenced consent solicitation from having the effect that it was intended to have by the consenting shareholders. Specifically, the board used its legal power to fill vacancies on the board so that the holders of a (presumed) majority of shares could not appoint the number of directors, through the consent "vote," necessary to confer effective control upon the consent-designated directors.

It was there held that such action, even if taken in the good faith belief that it was necessary to protect the corporate enterprise from likely harm from the untenable business plan espoused by the shareholders initiating the consent, involved the basic allocation of power between shareholders and directors; and that action, designed and effectuated to thwart the election of directors by consent, was not the sort of question that was entitled to the presumption of validity of the business judgment rule (see slip op. at 21-24), but required the board to demonstrate a compelling justification for such action. See Blasius at 25-31; Aprahamian, 531 A.2d at 1206-07; Phillips v. Insituform of North America, Inc., Del. Ch., C.A. No. 9173 (August 27, 1987) at 23-24. But see

American Rent-A-Car, Inc. v. Cross, Del. Ch., C.A. No. 7583 (May 9, 1984). In Blasius, defendants were found to have offered no compelling justification for their action that in effect disenfranchised shareholders in the process of exercising the consent power.

Plaintiffs' reliance upon Blasius is misplaced here. There are critical distinctions between the facts of that case and this one. There, the shareholders were in the process of exercising statutorily conferred rights to elect directors through the consent process. See 8 Del. C. § 228. In contrast, Delaware law created no right in these circumstances to vote upon the original Warner merger.[18] Indeed, a merger transaction requires board determination approving an agreement of merger. See 8 Del. C. § 251(b). I am aware of no principle, statute or rule of corporation law that would hold that once a board approves an agreement of merger, it loses power to reconsider that action prior to a shareholder vote. Equally fundamentally, Delaware law creates no power in shareholders to authorize a merger without the prior affirmative action of the board of directors. Thus, a board

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[18] Recall that it was only NYSE rules that prompted the proposed submission of that transaction to the Time annual meeting.

resolution rescinding approval of an agreement of merger and removing the matter from the agenda of an annual meeting is altogether different from a resolution designed to interfere with the statutory shareholder power to act through consent.

This case is closer to (indeed *a fortiori* of) *American Rent-A-Car, Inc.*, *supra*, in which this court declined to enjoin action authorized by a bylaw which was amended by the board at a time when it seemed quite likely to fail of stockholder approval.[19] *See also* *Lowenschuss v. The Option Clearing Corporation*, Del. Ch., C.A. No. 7972 (March 26, 1985) (failure to achieve shareholder approval of recapitalization of Phillips Petroleum Company did not provide basis to enjoin board authorized self-tender and buyback of shares that had similar financial effect).

I therefore conclude that plaintiffs have not shown that the June 16 decision to recast the transaction entailed any intrusion upon the effective exercise of a right possessed by the shareholders, either under our statutes or under the corporation's charter. The June 16 decision can therefore not

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> 627; Aronson, 473 A.2d at 812-16. Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer; its legality, feasibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the stockholders; the company's long-term strategic plans; and any special factors bearing on stockholder and public interests. Unocal, 493 A.2d 954-56. See also Smith, 488 A.2d 872-78. In Ivanhoe we recognized that a change in corporate structure under the special facts and circumstances of that case did not invoke Revlon. 535 A.2d at 1345.

Mills Acquisition Co. v. Macmillan, Inc., supra, at p. 55, n. 35.

Elsewhere in Macmillan our Supreme Court did indicate that a board may find itself in a Revlon mode without reaching an express resolve to "sell" the company:

> At a minimum, Revlon requires that there be the most scrupulous adherence to ordinary principles of fairness in the sense that stockholder interests are enhanced, rather than diminished, in the conduct of an auction for the sale of corporate control. This is so whether the "sale" takes the form of an active auction, a management buyout, or a "restructuring" such as that which the Court of Chancery enjoined in Macmillan I. Revlon, 506 A.2d at 181-82.

Id. at p. 56 (emphasis added).

Thus, I do not find it dispositive of anything that the Time board did not expressly resolve to sell the company. I take from Macmillan, however, and its citation of the earlier be seen as implicating the policy of protection of the corporate franchise, which our law has studiously sought to protect.

B. The claim that the Warner tender offer is a disproportionate response to a non-coercive Paramount offer that threatens no cognizable injury to Time or its shareholders

1. Does Unocal apply?

Powerful circumstances in this case include the fact that the original Time-Warner merger agreement was, or appears at this stage to have been, chiefly motivated by strategic business concerns; that it was an arm's-length transaction; and, that while its likely effect on reducing vulnerability to unsolicited takeovers may not have been an altogether collateral fact, such effect does not appear to be predominating.[20] Time urges that judicial review of the propriety of the Warner tender offer should involve the same business judgment form of

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[20]This fact distinguishes in a material way the case of AC Acquisition Corp. v. Anderson, Clayton & Co., Del. Ch., 519 A.2d 103 (1986) which originated from a threat to the existing control arrangement. Other material distinctions are that the two transactions there involved were competing versions of a "bust up" plan for the corporation as it had existed and the board could not determine that either was inadequate.

review as would have been utilized in a challenge to the authorization of the original merger agreement. It cites the case of Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980) as its authority for this position, and contends that the inclusion of that authority in a string of citations in the Unocal opinion supports the notion that the rearrangement of a preexisting transaction in reaction to a hostile takeover qualifies for "unenhanced" (by Unocal) business judgment review. Even the quickest review of Unocal demonstrates that in citing that case in the place that it did, our Supreme Court was not intending to implicitly, indeed silently, create an exception to the innovative and important rule that it there announced.

Moreover, a rather lengthy list of cases from this court has construed Unocal to mean that its form of review applies, at the least, to all actions taken after a hostile takeover attempt has emerged that are found to be defensive in character.[21] See, e.g., AC Acquisition Corp. v. Anderson, Clayton &

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[21]When I say at the least, I refer to fact that the Unocal form of analysis will also be utilized when a preemptive defensive measure is deployed, where the principal purpose of the action (and not simply a collateral, practical effect) is defensive in a change of control sense. E.g., Moran v. Household International, Inc., Del. Supr., 500 A.2d 1346 (1985).

Co., Del. Ch., 519 A.2d 103, Allen, C. (1986); Robert M. Bass Group, Inc. v. Edward P. Evans, Del. Ch., 552 A.2d 1227 (1988); The Henlev Group, Inc. v. Santa Fe Southern Pacific Corp., Del. Ch., C.A. No. 9569, Jacobs, V.C. (March 11, 1988); Doskocil Companies Inc. v. Griggy, Del. Ch., C.A. Nos. 10095, 10106, 10107, 10108, 10116, Berger, V.C. (August 18, 1988), slip op. at 18-19. Thus, while the preexistence of a potential transaction may have pertinence in evaluating whether implementing it or a modified version of it after the board is under attack is a reasonable step in the circumstances, that fact has not been thought in this court to authorize dispensing with the Unocal form of analysis. The risks that Unocal was shaped to protect against are equally present in such instances.

Factually it is plain, indeed Time's Schedule 14D-9 filing admits, that the reformatting of the stock for stock merger into a leveraged purchase transaction was in reaction to the emergence of the Paramount offer and its likely effect on the proposed Warner transaction. See pp. 36-37, supra.

2. Does the Paramount all cash, all shares offer represent a threat to an interest the board has an obligation or a right to protect by defensive action?

Unocal involved a partial offer for cash; consideration in the second-step merger was to be highly subordinated securities. Equally significant, the facts there justified "a reasonable inference" that the "principal objective [of the offeror was] to be bought off." Thus, the case presented dramatically and plainly a threat to both the shareholders and the corporation.

In two cases decided during the last year, this court has held under similar circumstances that an all cash, all shares offer falling within a range of value that a shareholder might reasonably prefer, to be followed by a prompt second-step merger for cash, could not, so long as it involved no deception, be construed as a sufficient threat to shareholder interests to justify as reasonable board action that would permanently foreclose shareholder choice to accept that offer. See Grand Metropolitan PLC v. The Pillsbury Company, Del. Ch., C.A. No. 10319, Duffy, J. (December 16, 1988); City Capital Associates v. Interco Incorporated, Del. Ch., 551 A.2d 787 (1988). Cf. Shamrock Holdings, Inc. v. Polaroid Corp., Del. Ch., C.A. Nos. 10075, 10079, 10582 and 10585, Berger, V.C. (March 17, 1989), slip op. at 29-32. Those cases held that in the circumstances presented, "whatever danger there is relates to shareholders and that concerns price only." Pillsbury, supra, slip op. at 17-18, or that "in the special case of a tender offer for all shares, the threat posed, if any, is not importantly to corporate policies . . . but rather . . . is securities. Equally significant, the facts there justified "a reasonable inference" that the "principal objective [of the offeror was] to be bought off." Thus, the case presented dramatically and plainly a threat to both the shareholders and the corporation.

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Plaintiffs argue from these cases that since the Paramount offer is also for all shares and for cash, with a promised second-step merger offering the same consideration, the only interests the board may legitimately seek to protect are the interests of shareholders in having the option to accept the best available price in a sale of their stock. Plaintiffs admit that this interest would justify defensive action at this stage. The board may leave its stock rights plan in place to provide it time to conduct an auction or to arrange any other alternative that might be thought preferable to the shareholders. But, they say, this stockholder interest cannot justify defensive action (the revised merger) that is totally unrelated to a threat to shareholders.

In my opinion, the authorities relied upon do not establish that Time has no legally cognizable interest that the Paramount offer endangers. In each of those cases, the board sought to assure continued control by compelling a transaction that itself would have involved the sale of substantial assets, an enormous increase in debt and a large cash distribution to shareholders. In other words, in those cases, management was presenting and seeking to "cram down" a transaction that was the functional equivalent of the very leveraged "bust up" transaction that management was claiming presented a threat to the corporation.

Here, in sharp contrast, the revised transaction, even though "reactive" in important respects, has its origin and central purpose in bona fide strategic business planning, and not in questions of corporate control. Compare AC Acquisition Corp., supra (recapitalization had its genesis in a threat to corporate control posed by the imminent termination of trusts that had exercised effective control for years); Robert M. Bass Group v. Evans, supra (recapitalization under consideration prior to acquisition proposal would have shifted control to management group of a substantial portion of corporation's assets). To be sure, Time's management and its board had, at all times, one eye on the takeover market, considered that market in all they did, and took steps to afford themselves the conventional defenses. But I do not regard that fact as darkly as do plaintiffs. It is inevitable today for businessmen to be mindful of this factor. At this stage, I do not regard the record as establishing, as was done in AC Acquisitions, Bass, Interco or Pillsbury, that there is a reasonable likelihood that such concern provided the primary motivation for the corporate transaction. Nor is this transaction an alternative to the sale Paramount proposes (i.e., the functional equivalent) in the way the enjoined transactions in the cited cases can be said to be equivalents of sales.

The more apt parallel than the cited cases is provided by the recent decision in Shamrock Holdings, Inc. v. Polaroid Corp., Del. Ch., C.A. Nos. 10075 and 10079, Berger, V.C. (January 6, 1989). There, this court found "entirely fair" a transaction (the establishment of an Employee Stock Ownership Plan) that had a significant anti-takeover effect, largely because it was a transaction that had been planned prior to the emergence of the acquisition attempt, plainly could be thought to serve long-term profit maximizing goals, and did not appear motivated primarily as a device to affect or secure control.

Similarly here, I conclude that the achievement of the long-term strategic plan of the Time-Warner consolidation is plainly a most important corporate policy; while the transaction effectuating that policy is reactive in important respects (and thus must withstand a Unocal analysis), the policy itself has, in a most concrete way, its origin in non-defensive, bona fide business considerations. In this respect, the Second Circuit's opinion in Crouse-Hinds is instructive if not directly applicable. Moreover, the Paramount offer and the Warner merger are not, conceptually, alternative transactions;

they are alternatives at the moment only because Paramount has conditioned its offer as it has.

In my opinion, where the board has not elected explicitly or implicitly to assume the special burdens recognized by Revlon, but continues to manage the corporation for long-term profit pursuant to a preexisting business plan that itself is not primarily a control device or scheme, the corporation has a legally cognizable interest in achieving that plan. Whether steps taken to protect transactions contemplated by such plan are reasonable in all of the circumstances is another matter, to which I now turn.

3. Is the Warner tender offer a reasonable step in the circumstances?

This step requires an evaluation of the importance of the corporate objective threatened; alternative methods for protecting that objective; impacts of the "defensive" action and other relevant factors. In this effort it is prudent to keep in mind that the innovative and constructive rule of Unocal must be cautiously applied lest the important benefits of the business judgment rule (including designation of authority to make business and financial decisions to agencies, i.e., boards of directors, with substantive expertise) be eroded or lost by slow degrees. See Interco, 551 A.2d at 796.

In this instance, the objective — realization of the company's major strategic plan — is reasonably seen as of unquestionably great importance by the board. Moreover, the reactive step taken was effective but not overly broad. The board did only what was necessary to carry forward a preexisting transaction in an altered form. That "defensive" step does not legally preclude the successful prosecution of a hostile tender offer. And while effectuation of the Warner merger may practically impact the likelihood of a successful takeover of the merged company, it is not established in this record that that is foreclosed as a practical matter. Recent experience suggests it may be otherwise. <u>In Re RJR Nabisco, Inc. Shareholders Litigation</u>, Del. Ch., C.A. No. 10389 (January 31, 1989).

I therefore conclude that the revised merger agreement and the Warner tender offer do represent actions that are reasonable in relation to the specific threat posed to the Warner merger by the Paramount offer.

* * * *

Reasonable persons can and do disagree as to whether it is the better course from the shareholders' point of view collectively to cash out their stake in the company now at this (or a higher) premium cash price. However, there is no persuasive evidence that the board of Time has a corrupt or venal motivation in electing to continue with its long-term plan even in the face of the cost that that course will no doubt entail for the company's shareholders in the short run. In doing so, it is exercising perfectly conventional powers to cause the corporation to buy assets for use in its business. Because of the timing involved, the board has no need here to rely upon a self-created power designed to assure a veto on all changes in control.[22]

The value of a shareholder's investment, over time, rises or falls chiefly because of the skill, judgment and perhaps luck — for it is present in all human affairs — of the management and directors of the enterprise. When they exercise sound or brilliant judgment, shareholders are likely to profit; when they fail to do so, share values likely will fail to appreciate. In either event, the financial vitality of the corporation and the value of the company's shares is in the hands of the directors and managers of the firm. The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact,

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[22]Thus, in my view, a decision not to redeem a poison pill, which by definition is a control mechanism and not a device with independent business purposes, may present distinctive considerations than those presented in this case.

directors, not shareholders, are charged with the duty to manage the firm. See Smith v. Van Gorkom, Del. Supr., 488 A.2d 858 (1985); Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc., 532 A.2d 1324 (1987).

In the decision they have reached here, the Time board may be proven in time to have been brilliantly prescient or dismayingly wrong. In this decision, as in other decisions affecting the financial value of their investment, the shareholders will bear the effects for good or ill. That many, presumably most, shareholders would prefer the board to do otherwise than it has done does not, in the circumstances of a challenge to this type of transaction, in my opinion, afford a basis to interfere with the effectuation of the board's business judgment.

* * * *

Having therefore concluded that plaintiffs have not shown a reasonable probability that they possess a right in these circumstances to require the board to abandon or delay the long-planned Warner transaction so that the stockholders might enhance their prospects of a control premium or private market transaction now, I need not discuss the issue raised by Warner concerning its rights as an intensely interested third party. The application shall be denied.

IT IS SO ORDERED.

William T. Allen

Chancellor

Date: July 14, 1989