IN THE SUPREME COURT OF THE STATE OF DELAWARE

PARAMOUNT COMMUNICATIONS INC. and KDS ACQUISITION CORP.,	)	No. 279,1989
Plaintiffs Below-Appellants,	)	
v.	)	
TIME INCORPORATED, TW 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.,	)	Interlocutory Appeal From The Court Of Chancery Of The State Of Delaware In And For New Castle County C.A. No. 10866
Defendants Below-Appellees.	)	

OPENING BRIEF OF PLAINTIFFS-APPELLANTS PARAMOUNT COMMUNICATIONS INC. AND KDS ACQUISITION CORP.

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NATURE OF THE PROCEEDINGS AND THE ORDER SOUGHT TO BE REVIEWED

This is an interlocutory appeal from the July 14, 1989 opinion and order of the Court of Chancery (Allen, C.) denying motions for a preliminary injunction by plaintiffs below-appellants Paramount Communications Inc. and KDS Acquisition Corp. ("Paramount") and certain shareholders. A 16-97.

On July 14, the Chancery Court certified this interlocutory appeal and enjoined the closing of the tender offer by defendant below-appellee Time Incorporated ("Time") for defendant below-appellee Warner Communications Inc. ("Warner") for ten days, or until July 24, 1989. On July 14, the Supreme Court orally accepted certification of the interlocutory appeal.

SUMMARY OF ARGUMENT

1. The court below erred in rejecting the objective analysis of Unocal in favor of a requirement that plaintiffs must prove subjective bad faith by a company's directors.
2. The court below erred in holding that an all-cash, all-shares negotiable offer can be considered a threat to the shareholders to whom it was made.
3. The court below erred in holding that it is a "reasonable response" to an all-cash, all-shares offer to take actions that will preclude the shareholders from obtaining any control premium in the foreseeable future.

STATEMENT OF FACTS

The June 16 Transaction

On June 16, 1989, the Time board met to consider Paramount's all-cash, all-shares offer to acquire Time for $175 per share. The board was "free to choose" among several options. A 64, 1820. It could have allowed the proposed stock-for-stock merger of Time and Warner to be voted upon by Time shareholders. It could have investigated the merits of the Paramount offer and even entered into negotiations with Paramount. It could have negotiated a new deal with Warner. It could have considered other alternatives.

Instead, the Time board rejected Paramount's fully negotiable $175 offer as "inadequate", based on the financial analyses of their investment bankers -- Wasserstein Perella and Shearson Lehman Hutton. No Time director ever suggested talking to Paramount about its offer. A 46. The Time board stated that it believed that the Paramount bid was a "threat" to the "implementation, through the acquisition of [Warner], of Time's corporate strategies and policies," and was a threat to "the journalistic integrity of Time's publications and the independence of their editorial voice." A 484-486.[1/]

1/ Yet Mr. Munro testified that "The Time Culture" did not play any role in the board's consideration of Paramount's offer. A 1090. No one from Time ever asked Paramount for any guarantees of editorial integrity,
(continued...)

In response to what the Time board said was "the serious threat" posed by the Paramount offer (A 484), the board negotiated a two-step acquisition of Warner ("Revised Merger Agreement") so as "to avoid the risk that the [original] merger would not get an affirmative vote . . . ." A 55.

Under the Revised Merger Agreement:

-- Time's directors are unable to consider any offer for Time, no matter how advantageous. A 56-57.

-- Time will incur "at least $7 billion of new debt and may have $10 billion or more of new debt, and will have reduced ability to support substantial additional borrowing." A 57. To meet its loan obligations, Time may have to sell off substantial assets, including up to 100% of Warner's cable franchises. A 1078, A 1465, 1477, 1832-1833.

-- The merger consideration was changed from stock for all Warner shares to cash for 51% of Warner plus some mix of cash or securities for the remainder. Time exchanged favorable "pooling of interest" accounting treatment for purchase accounting treatment that requires Time to amortize at least $9 billion in "goodwill." (A 57-58).[2/]

-- No Time shareholder choice or vote is permitted, although, (i) Time's board is increased from 15 to 24 seats, (ii) Warner directors are guaranteed 12 seats on the new board, (iii) Steve Ross becomes Co-Chairman and Co-CEO, and (iv) Warner executives take over many senior positions in the newly formed Time-Warner. A 496-497.

1/ (...continued) although Paramount has stood ready to guarantee Time's editorial integrity (A 1313(a)-1313(e)) and has a long and distinguished history in publishing and film-making.

2/ Time's Chairman and CEO J. Richard Munro testified that the goodwill figure was approximately $12 billion. A 1089, 1093.

-- Warner shareholders receive a large control premium of $70 per share -- approximately 56% over the price of Warner shares at the time of the original merger (A 56, 58), more than 50% over the after-tax break-up value of Warner, and "double" the selling price of Warner shares in the months preceding the announcement of the original merger. A 1928, 1934.

The Chancery Court found that:

> the [Time] 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.

A 63-64.

On June 23, Paramount increased its offer to $200 per share. When the board approved the original merger with Warner on March 3, Wasserstein and Shearson estimated Time's value range from $189.88 to $212.25 per share. A 900. On June 16, after management provided new and dramatically increased projections for the next 10 years, Wasserstein and Shearson increased their valuations of Time. A 1645. Although the advisors gave an estimated trading range for Time shares in the future, they did not calculate the present value of those future prices. A 383-84. On June 26, the Time board rejected Paramount's $200 offer as "inadequate" based on the same financial analysis that was presented to them on June 16. A 1302.

<u>It Is Undisputed That Time's Directors Have Consistently Refused To Consider Any Transaction -- At Any Price -- That Would Not Leave Time's Management In Control</u>

The record reveals one consistent theme of Time's management over the last two years. Neither Time's management nor its directors would consider a transaction that did not guarantee that Time's senior management would remain in control, no matter what the economic benefits might otherwise be to Time's shareholders.

> 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. <u>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."</u>"

A 27-28. (emphasis added).

Gerald M. Levin, Time's Vice-Chairman, has been Time's chief strategist for several years. A 1032-1033. On August 11, 1987, Mr. Levin wrote to J. Richard Munro, Time's Chairman and CEO, and N. J. Nicholas, Time's President, about the advantages of "strategic consolidation of Time Inc., Warner Communications and [Turner Broadcasting System]." A 1056. Mr. Levin considered the potential problems:

> Indeed, in my view the principal issue is [Warner Chairman and CEO] Steve [Ross]. Can we work with him, can we communicate comfortably? <u>Will we ultimately be the survivor company and management focus</u>?

A 1058 (emphasis added). If Time did enter into a business combination, Mr. Levin felt the "overriding question would still be: have we secured the company? Is sheer size sufficient protection, or will we still need a large block of stock in friendly hands?" A 1059 (emphasis added).3/

During negotiations in 1988, Time managers focused on the necessity of guaranteeing the succession of Mr. Nicholas as sole CEO of the combined companies. A 34. Mr. Munro felt Mr. Nicholas was his "heir apparent." A 1086(a). There was no discussion about selling Time to Warner, or about obtaining any control premium for Time shareholders.

Indeed, Mr. Levin believed that Time should be "flexible" and pay a premium to Warner if Mr. Ross would agree to retire by a date certain and allow Mr. Nicholas to succeed him as sole CEO. See, e.g., A 1060-1061.

In early July, Mr. Levin recommended that Munro "meet Ross alone." The first priority was to obtain assurances about Mr. Ross' retirement. A 1060. Number five on Mr. Levin's list of points was the price of any such merger, as reflected in a stock exchange ratio. Mr. Levin wrote: "Should be market-to-market (currently .38) . . . [w]e should be flexible if Ross agrees to no. 1 [the management succession provisions]." A 1061; see also A 1036.4/

3/ Mr. Levin believed that apart from Warner, the "only other entertainment option" was Paramount. A 1059.

4/ "Flexibility" on price could severely dilute the equity interests of Time shareholders. Mr. Levin calculated: "Each one hundredth of a point is 1.6 to 1.8 million (continued...)

On July 21, the Time board heard reports from Time management and advisors on the possibility of a merger with Warner. See A 1044-1055. Management described the status of negotiations with Warner. They discussed five other "studios", including Paramount. A 31. All the companies were described as "Acquisition Candidates." A 1049.

Time management and the board recognized that announcement of a merger would signal that both Time and Warner would be "in play." A 1053, 1092, 1238, 1245, 1442, 1459, 1481. Thus, discussion at the July 21 meeting centered on a number of "structural safety measures" that might prevent a bid for Time. These defensive moves included (i) the exchange by Time and Warner of large blocks of stock or options on the purchase of such blocks, and (ii) a line of credit for the purchase of Time's own stock or Warner's stock. A 1054.

The Time directors insisted that Time's senior management must control the combined entity. A 32. For all the outside directors (except Arthur Temple)5/, "maintaining a Time culture . . . was the first and central requirement

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4/ (...continued) additional shares, so that .4, for example, is 72 million new shares - post Lorimar - whereas .38 is 68.4 million new shares. Their number is around .415 (although they say its .45)." A 1061.

5/ Temple testified that: "I'll have to confess that I wasn't particularly concerned about the order of succession. * * * It seemed to me there was more discussion about that than there was about the content of the financial deal." A 1441.

and could only be assured by securing the top job ultimately for Mr. Nicholas." A 34.

Board members recognized that Time might have to pay a price -- or premium -- for the "rights to set the governance rules." A 788. They were not willing to go forward with any deal, no matter how favorable the price to Time's shareholders, if it did not include such protections for Mr. Nicholas. A 784-785.

On August 4, 1988, Mr. Munro informed Time's directors that management had "successfully negotiated certain corporate governance arrangements." A 1132. He wrote that the "chief protection mechanism is through a supermajority voting requirement with respect to certain types of actions by the new Board." A 1132. Under the plan, Mr. Munro, if he had not yet retired, or Mr. Nicholas would ultimately be the sole CEO of Time-Warner. A 1135. This succession arrangement could not be changed without a supermajority vote or a two-thirds vote of the Time-Warner directors. A 1136. <u>See also</u> A 1257-1258.

Mr. Munro's plan included an "Editorial Committee" of the board, composed of four Time directors and two Warner directors, to which the editors of Time's publications would report. The composition of this committee, as with other governance arrangements, "could only be amended, rescinded or waived by a resolution approved by directors constituting <u>at least two-thirds of the entire Board of Directors of</u>

Time/Warner Inc." A 1138 (emphasis added). The Editorial Committee would be "dominated by Time Inc. directors." A 1132. Mr. Munro stated that the "delegation of authority to the Editorial Committee will continue to preserve the editorial integrity of our magazines." A 1132.

Almost immediately after this letter was sent, discussions with Warner broke off. Mr. Ross would not agree to retire within five years and ensure Nicholas' succession. A 37-38; see also A 1035, 1037, 1063, 1092, 1255-1256, 1453-1454. Mr. Munro and Mr. Nicholas saw this as a "deal breaker." A 1256.

Time's management continued to reject any proposal for a sale of the company without regard for the possible price to be paid to Time shareholders. In the fall of 1988, Mr. Warren Buffett approached Time and inquired about the possibility of merger discussions between Time and Capital Cities/ABC. As soon as it was suggested that Capital Cities might have "one or two more . . . board members than Time Inc. board members," the talks ended: "Dick Munro said, thank you very much, I am not interested in continuing these discussions, Time Inc. is not for sale." A 1291-1292.

Mr. Munro also had sporadic discussions with Martin Davis, Chairman and CEO of Paramount, about a possible combination of Time and Paramount. Mr. Davis recalled that Mr. Munro "seemed to be obsessed with who was going to succeed him, and -- not who, but basically Nick Nicholas."

A 1486-1487. Mr. Davis responded that it was not his or Mr. Munro's prerogative to decide "who was going to succeed whom. A 1487-1491.

Negotiations with Warner Resume

Negotiations resumed with Warner in January, 1989, after Mr. Ross agreed that he would publicly announce that he had agreed to retire within five years and allow Mr. Nicholas to become sole CEO. A 38.

Only after reaching this agreement did Time management begin to negotiate an exchange ratio with Warner. Messrs. Levin and Nicholas negotiated the exchange ratio for Time. Oded Aboodi, a Warner investment advisor, negotiated on behalf of Warner. A 1259-1260. On March 3, the parties agreed on .465 shares of Time stock for each share of Warner stock. This was significantly higher than the market-to-market ratio of .38. A 39.

Nicholas negotiated the final .465 exchange rate in one meeting. He did not have his financial advisor present. A 1262. He did not receive a specific number from his financial advisor, only a "range" of numbers. A 1264-1265; see also A 1025. He made no attempt to trade off any corporate governance issues for a more favorable exchange rate. A 1260-1261.

The .465 ratio was more than Warner expected. Warner's financial advisors advised the Warner board on March

2 that anything over .40 was fair and anything over .45 would be "a hell of a deal". A 1898.

None of Time's outside directors was involved in the negotiations with Warner. None of Time's outside directors knew how the .465 exchange ratio was chosen, other than that Nicholas negotiated it. A 787, 1295, 1447-1448.

The Terms Of The March 3 Agreement

The directors of both companies approved the Merger Agreement on March 3, 1989. *See* A 1726; A 1911-1912. The Merger Agreement was subject to approval by the stockholders of Time and Warner.

It was to be a stock-for-stock transaction, accounted for as a "pooling of interests." At the conclusion of the merger, Time shareholders would own less than 40% of the outstanding shares of the newly constituted company. A 1155, 1204-1205; *see also* A 339, 774, 1325-1327.

At the March 3 meeting, the Board approved new contracts for Munro, Nicholas and Levin. As with the exchange ratio, Nicholas and Levin negotiated long-term employment contracts for Messrs. Munro and Nicholas, Time's senior management, without any involvement by outside directors. Those contracts could not be modified or terminated without a 2/3 vote of the new Time-Warner board. A 496-497, 1217.

Munro received a ten-year contract, even though he plans to take early retirement as Chairman and Chief

Executive Officer in May 1990. This extends his present contract by seven years. A 1216-1217. Nicholas received a ten-year contract, extending his contract by 7 years. A 1216-1217. Ross also received a ten-year contract and will become Co-Chairman and Co-CEO of Time-Warner for five years, and, most probably, the sole Chairman thereafter. Nicholas and Ross would be compensated as advisors for an additional five years after the end of their ten-year contracts. A 496-497, 1217-1220. In stark contrast to these long-term contracts, Time's Editor-in-Chief, Jason McManus, did not get a long-term contract, nor did any other editorial employee.

The Time board would increase in size from 15 to 24 seats, and twelve of these seats would be filled by Warner directors. A 1211. The March 3 Merger Agreement abandoned the requirement of a two-thirds vote of the board to change the structure or composition of the Editorial Committee, or for other major corporate decisions such as the filling of board vacancies or the sale of assets of the newly constituted company. These voting requirements were the centerpiece of the "protections" Munro had "successfully negotiated" in August 1988. A 1136-37. They were dropped at Mr. Ross' request. A 1905.

In Warner board meetings on March 2 and 3, Felix Rohatyn and other members of Lazard Freres & Co., Warner's financial advisors, told the Warner board that Warner's shareholders would benefit from this transaction. He stated that any exchange ratio "above .45 would be a 'hell of a deal,' but, in the opinion of Lazard, anything above .4 would be 'fair' to the shareholders of [Warner]" (A 1884), Lazard also told the board that at an exchange ratio "of .4 or more, the [Warner] shareholders would own more than 50% of Time Warner following the Merger, and thus 'in no way could it be considered that [Warner] is being sold.'" A 1884.6/

Mr. Rohatyn concluded that exchange ratio of .465 made this "an even more fantastic transaction" for Warner. A 1908.7/

The proposed merger would expand Time into new lines of business in the entertainment world and reduce the importance to Time-Warner of Time's journalistic groups in terms of revenues and operating cash flow. Time's magazine businesses will contribute only about "20-25% of the revenue

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6/ Warner Cable Communications ("Warner Cable"), a wholly-owned subsidiary of Warner, told local governments that because a majority of the equity of the new Time Warner would be owned by Warner shareholders and a minority of the equity owned by Time shareholders, there was no change of control in Warner or Warner Cable as a result of the merger. A 779, 1329-1330; see also A 1423-1431.

7/ The court below misunderstood the implications of the lopsided transaction in favor of Warner. It is not that shareholders must take the risk that their management will be out-negotiated. See A 62-63. Nicholas and Levin were skilled negotiators who carefully protected the contracts of Time's senior management. Their failure to protect the interests of Time's shareholders is telling evidence that shareholder values was not their principal concern during the negotiations.

of a merged Time Warner". A 34, 1094-1097.[8/] People and Sports Illustrated make up the lion's share of these revenues. A 1102.

Structural Defense Measures

"Everyone involved in this negotiation realized that the transaction contemplated might be perceived as putting Time and Warner 'in play.'" A 42; see also A 781-783, 1442-1443; 1445-1446. On March 3, the Time and Warner Boards approved a number of admittedly "defensive" measures, including the Share Exchange Agreement. A 1735, A 1912. The purpose was to make it more difficult, if not impossible, for a third party to attempt to acquire Time.

These defensive measures included a share exchange agreement pursuant to which Warner was to receive 11% of Time's common stock in exchange for 9% of Warner's common stock. The Time board was told on March 3 that the share exchange was "intended to dissuade any potential raider from disrupting our plans by putting one or both of us 'in play.'" A 1186. See also A 1213. ("As a defensive measure, the two companies have agreed to exchange shares.") The Chancellor assumed that the "principal purpose of the arrangement was to discourage any effort to upset the transaction." A 41.

8/ This entitles one to be "suspicious" 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." A 34.

Director Temple testified that no reason was given for the share exchange other than "[t]o make it more difficult for a third party to succeed in a hostile bid." A 1439-1440; see also A 786, 798-799, 801; 1296, 1480.

Time's management agreed to pay banks for "highly confident" letters, (A 1214) and required the banks to sign agreements promising not to finance any bid for Time. A 1214; A 414-425. Time ultimately paid over $5 million in dry-up fees for such assurances. A 389-425. These fees did not take the place of the fees that Time would have to pay for commitment letters if Time ever wanted the money. A 1267-1268.

The Agreement contained a "no shop" clause. Time could not:

> solicit or encourage (including by way of furnishing information), or take any other action to facilitate, any inquiries or the making of any proposal which constitutes, or may reasonably be expected to lead to, any takeover proposal, or agree to or endorse any takeover proposal.

A 1357 (emphasis added); see also A 1272. The only "fiduciary out" in the Merger Agreement was to this no-shop provision. If a party buys over 10% of Time's shares (pre-existing ownership does not count) or makes a tender offer for over 25% of Time's shares, Time was free to talk, after consulting with Warner. But no matter how friendly an offeror might have felt, it was not possible to approach Time without beginning an unsolicited tender offer. A 1040-1041.

Even after a tender offer, and even with Warner's approval, Time could not terminate the Merger Agreement in favor of another offer. A 1358. "In all events, such an occurrence would not excuse Time's performance under the merger agreement, but would give Warner an out." A 43.[9/]

These "structural safety" devices were in addition to the substantial takeover defenses Time already had in place on to March 3, 1989: "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. . . ." A 29.

A special committee of three outside directors (Finkelstein, Kearns, Opel) was created on March 3 to deal with all matters relating to the Merger. They were given plenary power to act in all such matters, but they never met and they never hired independent counsel or financial advisors. A 791-793; A 1311-1312.

Beginning on March 4, Time and Warner repeatedly proclaimed the non-leveraged stock transaction and "pooling of interest" merger as a major benefit to their shareholders and the American economy. They said so to the House of Representatives of the United States, the Senate and the President of the United States. A 1103-1130.

9/ Because the original Merger was subject to a shareholder vote, the ability of Time's directors to change their recommendation and tell shareholders to vote against the Merger was the functional equivalent of the ability to cancel the Merger.

For example, Levin testified before the Senate Subcommittee on Antitrust, Monopolies & Business Rights that:

> On March 4, Time Inc. and Warner Communications announced that the companies planned to merge. . . We are particularly pleased that these goals will be accomplished without the often-devastating impact of a highly leveraged buy-out. The merger will not create enormous debt. The companies' assets will not be broken up and sold for short-term profits. No employees will lose their jobs. This grand old-style merger will have no negative impact on our employees or the communities in which we operate.

A 447-448.

By the end of March, the Securities and Exchange Commission told Time and Warner that the exchange of shares under the Share Exchange Agreement would deprive the parties of "pooling of interests" treatment. As a result, the parties modified the transaction so that the share exchange could be triggered only if a hostile bid was made for either company. Moreover, the Merger Agreement was modified to provide that if "pooling of interests" treatment was lost, that would be grounds for either party to terminate the Merger. A 112, A 166-167.

By June 6, 1989, the investment community had reviewed the proposed Time-Warner transaction for three months. The proxy statement, with a full description of all the perceived benefits of the merger, had been available since May 23. With all this information available to the market, and with intense speculation about a possible bid for

Time, Time's shares were trading on the New York Stock Exchange ("NYSE") at $126 per share. A 1553.

Paramount's First Offer and Time's Reaction

On June 7, Paramount announced an all-cash, all-shares offer for $175 per share. The offer was fully negotiable on all points, including price. A 1228-1229. It represented a $49 (or 38.9%) premium over the closing price of Time shares on June 6 and a $66 (or 60.4%) premium over the market price of Time shares immediately preceding the announcement of the March 3 Merger Agreement. On June 8 Time stock gained $44 per share to close at $170. In the week that followed, Time stock rose to over $182 per share. A 45.

On June 8, the day after the Paramount offer began, Munro sent a letter to Davis. Munro Dep. at 155-56. He attacked Davis' "integrity and motives" and he attacked Paramount's offer as "smoke and mirrors." A 1231.

Munro did not show the June 8 letter to the outside directors before he sent it. However, after seeing it on June 8, no outside director objected to its being sent. A 1278-1279.

From June 6 until today, no Time director or advisor has suggested that Time talk to Paramount about the terms and conditions of Paramount's offer. From June 6 until today no Time director has suggested negotiating with Paramount to see if any conditions could be removed or the price increased.

Munro testified:

> Q. Did you ever consider picking up the phone, calling Mr. Davis, who I think you described before as a friend, and seeing whether you could find out whether the offer was for real or illusory as you put it?
>
> A. No, I didn't. We had made a deal with Warner that we were planning to conclude and we -- as we said before, we were not for sale. We had an agreement and we were going to pursue that agreement.

A 1091.

Nicholas testified similarly:

> Q. Did anyone at the [June 8] board meeting suggest that someone from Time should talk to someone from Paramount about the terms of the offer?
>
> A. No. Not to my recollection.
>
> Q. Did anyone suggest that it might be worthwhile to at least find out what terms Paramount would be willing to negotiate?
>
> A. You have to understand the situation. Time Inc. was proceeding to its -- with its acquisition of Warner, and Time Inc. was not for sale, and this last minute tender, two to three weeks before the Time Inc. shareholders were to vote, was clearly an intrusion on a strategy Time Inc. directors had considered over a couple of years. They had decided the company wasn't for sale. A hostile bid was offered by [Paramount], and the board decided to go ahead with its original transaction.

A 1275-1276. <u>See also</u> A 1042, 1043, 1282-1283, 1285 A 1306-1309. (Opel: "There was no purpose to meet with Mr. Davis to discuss anything.")<u>10/</u>; A 775-776 (Dingman: "we were

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<u>10/</u> When asked if he was the least bit interested at the June 8 meeting if Paramount would increase its offer, Opel testified: "I don't recall specifically being interested in that at all." A 1304-1305.

under a commitment to do a deal with Warner"); A 1580 (Perkins: ". . . I simply see no need to meet with Paramount and do not believe there is anything to negotiate about"); A 1609 (Bere: "We did not feel it necessary to negotiate the Paramount bids because they were determined to be inadequate"); A 1620 (Kearns: ". . . we saw no purpose in meeting").

Time's board met on June 8. By the end of that meeting, a week before any formal presentations were made to the board about Paramount's bid, Time's directors had decided to reject Paramount's alternative and pursue a deal with Warner. E.g., A 794 (Finkelstein: "I had decided that they should continue on with pursuing the -- to see if they could pursue the Warner offer . . . . I had concluded if they could negotiate it, that it would lead to a much higher shareholder value.") Outside director Finkelstein further testified that after the June 8 meeting, "it made no sense to deal with Paramount at all." A 795-795. See also id. A 796 ("the board had no interest in the Paramount offer") and A 797 ("I think it was not within anybody's imagination to consider why they would want to talk to Paramount.")

Time's Board Takes Advantage Of The Cable "Opportunity" to Try And Delay Any Payments to Time's Shareholders For As Long As Possible

Immediately following the June 8 board meeting, Time's management and advisors began efforts to block Paramount's offer. They viewed Paramount's condition for cable regulatory approvals "less as a problem than as an opportunity. Time has been active in trying to impede Paramount's ability to satisfy this condition." A 51-52.11/

Since June 8, Time and ATC have contacted at least 48 local government officials in some 42 geographic locations and asked them to "consider the commencement of litigation and a letter to the Federal Communications Commission . . ." A 718. "ATC representatives contacted the offices of most state attorneys general to suggest that they write to the Federal Communications Commission to oppose Paramount's application to allow the transfer of Time, Inc. common stock to a trustee . . ." A 719.

These "suggestions" included form letters, addressed to Chairman Dennis R. Patrick of the FCC, asking the FCC to deny or, "at the very least," defer action on Paramount's application. A 731. Legal memoranda, draft complaints and other ready-made court papers were often enclosed. Local counsel for Time and ATC joined the brief-writing teams of municipalities who accepted their invitation to sue. See, e.g., A 733-756.

"In five instances, ATC's franchisors discussed with ATC whether ATC would indemnify the franchisors for any counterclaim that might be asserted as a result of any

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11/ The Chancery Court did not address whether the tactics of Time and its majority-owned subsidiary American Television and Communications Corporation ("ATC") were proper.

litigation commenced against Paramount by the franchisors. . . ." A 720. Stevens & Lee, counsel for BerksCable -- a division of ATC -- stated in a June 19 memorandum to the City Solicitor of Reading, Pennsylvania:

> BerksCable requests that the City bring an action to enjoin Paramount's hostile tender offer of Time. Because the City is the franchising authority under federal and local law, the City has standing to bring such an action, whereas BerksCable may not. BerksCable will bear all costs and fees associated with this action.

(A 757-761) (emphasis added)[12/]

Time Formally Rejects Paramount's First Offer

The majority of these contacts and solicitations were begun before the June 15 meeting at which the Paramount offer was "considered." A 1577, 1593-1599, 1609, A 716-717, A 1512.

On June 15 and 16, the Time directors formally considered Paramount's bid. Not surprisingly, they rejected it. They said it was "inadequate", relying on their financial advisors' valuation analyses. Those analyses included significantly increased values for Time over what

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12/ *See also* draft agreement between Public Cable Partnership in Portland, Time, and ATC, in which the latter two agree to "pay the reasonable compensation of any attorney familiar with communications law selected by City to provide it with independent technical expertise, or who is determined by City to be necessary to prosecute an action or proceeding in a particular forum." A 766, 769-770.

had been presented on March 3.[13/] No director considered approaching Paramount to see if the offer could be increased. No director considered offering Paramount the confidential inside information that had been provided to Warner, to see if that would encourage Paramount to increase its bid.

The outside directors did not hire independent counsel or independent financial advisors. A 1312. All of their information came from the financial advisors who had put the entire Warner transaction together and had been advising management for years. Until the day of the June 16 meeting, the financial advisors had a multi-million dollar incentive to see that the Warner merger went through. On June 16 the Time board approved amended agreements dated June 15 removing this condition and giving the advisors their full fees outright. This was the last item of business on June 16, and was approved after they had delivered their opinions on the inadequacy of Paramount's offer. A 1868-1870.

The directors said that Paramount's bid was "highly conditional", ironically pointing to the condition for necessary cable regulatory approvals. Time's management, of course, was doing everything in its power to delay those appeals. And they said that Paramount's offer posed a threat to The Time Culture, and specifically to the preservation of

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13/ On June 26, Time's directors rejected Paramount's revised offer of $200 per share based on these same revised analyses, even though Paramount's new offer fell within the range of values presented on March 3. A 900.

editorial integrity, even though no Time director suggested approaching Paramount to ask for protections of editorial integrity. Paramount stood ready to offer such protections. A 1313(a) - 1313(e).

The Time directors then proceeded to the primary focus of the meeting: a new deal with Warner. This transaction had been negotiated with Warner during the week from June 8 to June 15. At Warner's insistence there were no outs. There is no evidence that anyone at Time objected to this, or that anyone at Time tried to negotiate a transaction that would have given Time's directors some flexibility to deal with changing situations. A 56.

As with negotiations over the old agreement with Warner, none of the outside directors was involved in the negotiations over the new transaction. And, as with the original merger agreement, Time's management negotiated all of the terms of the transaction. The outside directors were then told by management and its chosen advisors that the deal they had negotiated was favorable to the shareholders. A 1862-1864.

On June 16 Time's board was free to reject the new proposal. It was under no legal obligation to proceed with the new proposal. And Time's board knew on June 16 that this agreement would foreclose Paramount and any other bidder for the company from offering $175 or more for Time's shares, and that the market price after the merger was likely to be materially below $175. A 63-64. The board nevertheless approved the transaction.

The Time board agreed as part of the new transaction that they would not redeem the poison pill adversely to Warner. Thus, not only was Time unable to get out of the transaction, it was required to leave in place one of its most powerful defenses to stop any and all bidders other than Warner.

Paramount Raises Its Bid to
$200 And Time Rejects It

On June 23 Paramount increased its offer to $200. Time's directors rejected this offer as inadequate. They did not seek to talk to Paramount about increasing the offer price.

Long-Range Shareholder Values

Time's directors rejected offers of $175 and then $200 in cash. They stated at depositions, in affidavits, and in board minutes that they did so because they believed the Warner transaction was in the "long-term" interests of Time's shareholders. That translates into the simple proposition that they believed Time would make a great deal of money in the future, based upon Time's projections.

A dollar five years from now is not the same as a dollar today. Time's management repeatedly used the time value of money to discount Paramount's offer.

But Time's directors chose not to recognize this basic economic fact in rejecting Paramount's $200 per share offer. They relied upon an evaluation by Wasserstein and Shearson that Time stock would trade at very high values in the future. A 50-51. Those values were not discounted back to present value. A 383-384.

In fact, even accepting Time's projections of income as true[14/] and using those cash flows to derive share values in 1990 or 1991 or 1992, and then discounting those values with a very conservative discount rate, leads to a present value of Time's "long-term strategy" that is considerably less than $200. A 376.

Thus, even if the increased cash flows anticipated by Time's management from their "long-range" strategy are realized, the present value will be less than $200. The court below recognized this basic economic principle, but failed to follow through on its obvious implication. A 20, 63-64.

The Reason For Time's Rejection of $200 Per Share: It Was Inconceivable That Time Could Ever Be Sold To Paramount

The record is clear why Time's management could ignore this fact. All three members of Time's senior management thought that it was "inconceivable" that Paramount could acquire Time, at any price. A 1038. Nicholas testified that it was "inconceivable" that Paramount could be

14/ Time claims there will be "synergies" between the two companies. However, Munro testified that there is no long-term plan for the combined companies, and people are only "beginning to explore those possibilities." A 1100-1101.

permitted to acquire Time, that the cultures "could never mesh successfully." A 1269-1270, 1271. Munro agreed that it was "inconceivable" that Paramount could buy Time. In fact, he felt that it was improper for anyone to make a takeover bid for an "American institution" like Time. A 1080-1082, 1081-1083. Levin agreed. A 1038.

ARGUMENT

Standard And Scope Of Review

The decision below was based entirely upon a paper record. The standard and scope of review on this appeal requires this Court to review the entire record and reach its own conclusions about the facts if the findings of the court below are in error and justice so requires. Mills Acquisition Co. v. Macmillan, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,401 at 92,595 Moore, J. (Del. Supr. May 3, 1989); Ivanhoe Partners v. Newmont Mining Corp., Del. Supr., 535 A.2d 1334 (1987); Fiduciary Trust Co. v. Fiduciary Trust Co., 445 A.2d 927 (1982). The findings of the trial court will be accepted if they are supported by the record and are the product of an "orderly and logical deductive process." Newmont, 535 A.2d at 1341; Macmillan, ¶94,401 at 92,595; Levitt v. Bouvier, Del. Supr., 287 A.2d 671 (1972).

Introduction To The Argument

The lower court's decision rests upon extreme deference to Time's "long-term" plan to merge with Warner. In doing so, the court ignored the board's failure even to inquire into the Paramount offer, and the major differences between the March 3 and June 16 transactions. In deferring to this "long-term" strategy, the court failed to recognize that Time's long-term strategy yields share price projections that, even if credible, produce a present value significantly <u>less</u> than Paramount's $200 per share. Thus, Time is telling its shareholders that a "long-term" strategy that yields less -- on any objective analysis -- than is currently available must be accepted.

The lower court agreed. The court held that as long as the directors can plausibly say that they are pursuing a long-term strategy, it does not matter that the strategy is less beneficial to the shareholders than an available offer for the company, and it does not matter that the long-term strategy has the "first and central requirement" of entrenching management.

To uphold this result, the lower court had to effectively reject the most innovative and effective element of <u>Unocal</u>: the application of <u>objective</u> standards to judging directors' actions in change of control situations. <u>Unocal</u> recognized that an inquiry into the subjective intent of directors is often fruitless. Even the best intentioned director, after years of sitting on a board and supporting management, will view decisions about control as "us" against "them". When directors tell shareholders it is in their interests for management to remain in control, the shareholders -- and the courts -- are entitled to be skeptical.

Recognizing this basic fact of human nature, Unocal requires an objective analysis of the board's actions to see if they comport with the goal of protecting shareholder value. The lower court replaced this objective analysis with a focus on the board's subjective motivation. If allowed to stand, the decision will leave directors free to reject any offers if they can point to some long-term strategy, free to unleash any defensive mechanism -- no matter how preclusive -- in support of "long-term strategy".

The practical effect of the decision can be seen in the conduct that the lower court approved in this case. Outside directors whose sole goal was to preserve management, and who had no independent role in the negotiations of transactions that effected major changes in the rights and values of the shareholders.

The Board's Primary Interest -- Preserve Management

The lower court found that Time's board believed that protection of Time's management was more important than any of the other benefits of the Warner combination. See A 27, 31, 33. For all of its purported advantages, the Time board abandoned the Warner proposal in 1988 simply because Mr. Nicholas was not assured of succession (A 37-38) -- presumably they would have rejected the Warner merger again if Mr. Ross had not agreed that Mr. Nicholas would be given the top job in five years.

No Independent Advisors

At no time did the board or the outside directors have independent professional advice. The legal advisors and financial advisors were selected by Nicholas, Munro and Levin -- the managers the board believed it was essential to retain.

No Independent Negotiators

The March 3 and June 16 Warner transactions were negotiated by Nicholas and Levin. No outside director, either individually or as part of a special committee, was involved in these negotiations. No outside director exercised any control over how much "flexibility" these management directors would show on financial matters if their succession could be guaranteed.

If this conduct is sufficient to meet the strict standards of Unocal, then any board can meet that standard. The lower court has effectively overruled Unocal and permitted Delaware directors to entrench management at will, as long as they first say the magic words: "long-term strategy."

I. THE CHANCERY COURT IMPROPERLY DETERMINED THAT THE TIME TENDER OFFER FOR WARNER MEETS THE STANDARDS SET FORTH BY THIS COURT IN UNOCAL

In Unocal Corp. v. Mesa Petroleum co., Del. Supr., 493 A.2d 946 (1985), this Court established a new standard of review for defensive measures. Underlying that new standard was this Court's recognition that, in formulating a response to an unsolicited offer, there is "an omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders." Id. at 954.

This specter of self-interest cautions against a subjective analysis of a board's motives. See City Capital Assocs. v. Interco, Inc., Del. Ch. 551 A.2d 787, appeal dismissed, Del. Supr., 556 A.2d 1070 (1988) ("human nature may incline even one acting in subjective good faith to rationalize as right that which is merely personally beneficial") (emphasis in original). Thus, rather than testing motivations, this Court wisely adopted a two-prong objective test. First, does the unsolicited offer pose a threat to the corporation and its shareholders? Second, is the board's response to the offer reasonable in relation to the threat? Id. at 955-956; see Mills Acquisition Co., v. Macmillan, Inc., Del. Supr., slip op. at 64 [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,401 at 92,602. Both prongs of this test must be satisfied "before the protections of the business judgment rule may be conferred." Unocal at 954; Macmillan, at 92,601-602.

The Chancellor once described Unocal as "the most innovative and promising case in our recent corporation law." Interco, 551 A.2d at 796. In this decision, however, he rejected the objectivity of the Unocal standard and its concern for protecting shareholder interests.15/ Instead, he adopted a subjective standard of review that effectively adopted as the law of Delaware a nine year old decision of the United Stated Court of Appeals for the Second Circuit, Crouse-Hinds Co. v. Internorth, Inc., 634 F.2d 690 (2d Cir., 1980).

A. The Chancery Court Improperly Determined That Paramount's Offer Poses a Threat to Corporate Policy and Time Shareholders

The Chancery Court held that a long-term strategic plan is a protectable interest under Unocal. A 88-93. He reached this conclusion by examining the subjective intent of the Time directors in adopting their long-range plan to merge with Warner, rather than by examining the objective effect of the proposed merger. He concluded that the "primary motivation" of the directors was not to maintain corporate control, but to pursue "bona fide business considerations." A 91-92.

15/ The court below determined that the Time tender offer for Warner was a reaction to the Paramount offer and that Time's actions must be analyzed under Unocal. A 88.

Then, without addressing whether the Paramount offer even posed a threat to any legitimate long-range plan, the Court moved on to consider whether measures "taken to protect transactions contemplated by such [a] plan are reasonable in all of the circumstances." A 93.

Preoccupied with subjective intent, the court below thus failed to objectively examine the substantive effect of an all-cash-for-all-shares offer on shareholder interests. As this Court and the Chancery Court have recognized, the only legitimate interest that can be threatened by such an offer is shareholder value, whether short term or long term. For the purposes of a Unocal threat analysis, "long term plans" is an abstraction. It has meaning only to the extent that it refers to long term shareholder value and the present worth of those future benefits.

Paramount's offer poses no threat to shareholder value and Time's failure to give any serious consideration to the offer before launching its preclusive response was clearly unreasonable.

1. **Time's "Long-Term Strategic Plan" Is A Protectable Interest Only If It Translates Into Increased Shareholder Values**

In applying Unocal and analyzing the effect of unsolicited offers, the lower courts have consistently recognized that the only threat posed by a non-coercive all-cash-for-all-shares tender offer is to "shareholder interests" and not to "corporate policies." Interco, 551 A.2d

787, 797; see also Grand Metropolitan PLC v. The Pillsbury Company, Del. Ch., [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94104, Duffy, J. (ret.) (December 16, 1988) ("only 'threat posed' here is to shareholder value"); Robert M. Bass Group, Inc. v. Evans, Del. Ch., 552 A.2d 1227 (1988) (all-cash-for-all-shares-offer is a threat "only in the minimal sense that [the price] is less than the highest price that the defendants' financial advisors believe might be obtained if the entire company were put up for sale"). Focusing on the objective effect of the offer, the courts in these cases have refused to recognize any threat to long-term corporate interests that are independent of shareholder value.

The decision below is a complete departure from these precedents. The court stated that these cases were not relevant, focusing on the nature of the response rather than the effect of the offer, suggesting that the response in these earlier cases was a "functional equivalent" to the offer. The court then concluded that Time's response was only the effectuation of a preexisting plan, and not the "functional equivalent" of Paramount's offer. A 90-91.

This completely misapprehends Unocal. That decisions neither expressly nor implicitly imposes a "functional equivalent" test. Under Unocal, the relevant inquiry is (i) the nature of the threat, (ii) the nature of the interest allegedly harmed by the threat, and (iii) the objective effect of the response to that threat. For example, invoking a poison pill is hardly the "functional equivalent" of an all-cash offer, yet the decision to use a poison pill is certainly judged under the Unocal analysis.

Indeed, the Court below recognized that the "validity of a 'defensive' measure is addressed under a Unocal analysis, not under the narrower MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc. Del Ch., 501 A.2d 1239 (1985), aff'd, Del. Supr., 506 A.2d 173 (1986) case." A 81. But the effect of the court's "functional equivalent" requirement is to collapse the distinction between Unocal and Revlon. Under the lower court's narrow Unocal analysis, an all-cash-for-all-shares offer could be rejected out of hand by a board unless the board chose to "assure continued control by compelling a transaction that itself would . . . [involve] the sale of substantial assets, an enormous increase in debt and a large cash distribution to shareholders." A 90.16/ In short, unless a board puts the company up for sale, Unocal does not apply. The result is to make Revlon the exclusive universe of Unocal duties, rather than a small subset.

16/ In fact, this transaction does involve "the sale of substantial assets," "an enormous increase in debt," and "a large distribution to shareholders," albeit Warner shareholders.

2. The Paramount Offer Does Not Pose Any Threat To Shareholder Interests

The court below failed to consider what threat -- if any -- could be posed by an all-cash all-shares offer. Having determined that motive was the key to whether an interest is protectable under Unocal, and that long-term plans are protectable if entered into in good faith, the court did not ask if there was any economic threat to shareholder interests from Paramount's offer. The Chancellor reached this conclusion, in part, by misapplying Shamrock Holdings, Inc. v. Polaroid Corp., Del. Ch., [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,340 (Mar. 17, 1989). Indeed, the Chancellor stated that Polaroid was the most apt parallel to this case. Slip Op. at 74. In Polaroid Vice Chancellor Berger found that an inadequate all-cash, all-shares non-coercive tender offer does not, as a general matter, constitute a threat under Unocal. Id., at 92,223. The Vice Chancellor upheld the establishment of an Employee Stock Ownership Plan under Unocal, not because it was pursuant to a pre-existing plan, but because the "unusual circumstances of [the] case appear to justify some level of defensive response." Id. (emphasis added). The "unusual circumstances" were that target's imminent receipt of a damages award for patent infringement that could be up to $5.7 billion, or over $44 per share. No circumstances justify the defensive response in this case.

The court's focus on subjective motive thus missed a basic point. A shareholder owns a piece of property -- shares -- that he hopes will appreciate in value. Any "long-term" plans for the corporation can only be translated into benefit for the shareholder if those plans result in greater economic value for the shares.

The Court below acknowledged the board's "duty to seek to maximize in the long run financial returns to the corporation and its stockholders." A 35-56. The Chancellor stated that "this is the heart of the matter: the board chose less current value in the hope . . . that greater value would make that implicit sacrifice beneficial in the future." A 64. The opinion -- and the record -- is silent about what the directors did to assure themselves that this "sacrifice" would be beneficial.

In fact, the record shows that the Paramount offer poses no threat to the long-term economic interests of Time shareholders. Charles Phillips of Dillon Reed analyzed the current value of Time's stock <u>assuming the truth of Time's projections</u>. He stated that the market would put a present value on Time's "long-term" plans that was significantly less than $200 per share. A 376.

Thus, even assuming that Time's directors are correct about enhanced values to shareholders from the future combination, those values are worth <u>less</u> today than

Paramount's offer. Time's "long-term" strategy is economically inferior to Paramount's offer.

Time's other response is that the Paramount offer is inadequate. That simply means that if Time were to hold an auction, someone might pay more. But Time has steadfastly refused to even speak to Paramount to negotiate a higher price. The adequacy or inadequacy of Paramount's offer was irrelevant to Time's board. They were obsessed with the Warner merger, and would do anything to see that it was completed.

Even if Paramount's initial offer could be perceived as "inadequate", the board had a duty to consider all available alternatives before launching the preclusive restructuring. Robert M. Bass Group, Inc. v. Evans, Del. Ch., 552 A.2d 1227, 1241 (1988) ("Clearly the Macmillan board was well equipped to respond to any threat posed by the Bass Group. Even if, arguendo, the Bass offers were hostile, coercive and/or unfair, the board scarcely need to fear any threat to corporate policy and effectiveness.")

The Time management and board had available a formidable array of defenses (A 29), and could have: (1) negotiated a more attractive offer; (2) shielded the company while the board pursued alternative transactions; or (3) ensured itself time to convince shareholders, if possible, not to tender but to seek "long-term value" under present management. There was no reason to launch a preclusive tender offer for Warner other than to ensure management succession.

B. The Chancery Court Erred in Determining That Time's Offer for Warner Was A Reasonable Response to Paramount's Offer

On March 3, 1989, Time and Warner announced their original "merger of equals." Between March 3 and June 6, Time's senior management loudly proclaimed that this unique combination of two symbiotic companies would create a powerful new conglomerate capable of ensuring American participation and even dominance in the international media market. Essential to Time's strategic vision was a non-leveraged merger that would not be hampered by "crippling levels of debt" or the necessity to sell off prize assets, and could pursue opportunities on a global scale.

The second element of the proposed "merger of equals" was preservation of shareholder choice and Board flexibility. Thus, in the Joint Proxy Statement filed on May 23, 1989, Time shareholders were formally invited to approve the proposed merger at an annual meeting scheduled for June 23, 1989. Equally important, the terms of the agreement permitted the Time board to negotiate with another party if a bid were launched for Time and provided a "fiduciary out" (albeit a highly constricted one) permitting the board to approve an alternative transaction.

Within nine days after Paramount's June 7 offer, both tenets of this purported "long-term business strategy" evaporated. Having determined that the old merger was "impractical to consummate" because Time shareholders would reject it in favor of Paramount's offer, Time announced that there would be no shareholder vote and postponed the annual meeting one week, keeping the original record date.[17/]

Time also assumed the "crippling" burden of debt it had railed against only weeks earlier -- $14 billion worth -- in order to finance its purchase of Warner. The highly-leveraged new entity will lack the capacity to finance the ambitious expansion contemplated by the first merger. Moreover, in order to pay off debt, Time will most probably be forced to sell those very assets -- such as Warner Cable -- that it had earlier proclaimed as the heart of its synergistic merger.

17/ Time's manipulation of statutory powers effectively deprived shareholders of their right to vote on the election of successor directors and violated the directors' duties to the shareholders. See, e.g., Schnell v. Chris-Craft Industries, Del. Supr., 285 A.2d 437 (1971) (enjoining board from rescheduling annual meeting in order to provide dissident group with less time to stage a proxy contest); Aprahamian v. HBO & Co., Del. Ch., 531 A.2d 1204 (1987) (restraining board from postponing annual meeting upon discovery that dissident group possessed proxies representing a majority of corporation's outstanding shares).

It is not a sufficient answer to say that Delaware law did not require a vote of Time shareholders on the original merger. A 84-85. As this Court held in Schnell, "inequitable action does not become permissible simply because it is legally possible." 285 A.2d at 439. Moreover, this manipulation of the vote will put 12 new directors on the Time board without a shareholder vote.

In addition to stripping the shareholders of any choice or vote and revising the merger terms, the Time tender offer precludes the board from considering any alternative transactions. The only material conditions to the Time tender offer are a tender of the requisite number of shares and the absence of a permanent injunction that prevents Time from proceeding with its scheme. Time cannot even redeem its own poison pill.

Only one paragraph of the lower court's opinion deals with whether Time's offer for Warner was a reasonable response to Paramount's offer. That analysis accords far too much deference to the board's motivation, and far too little deference to Unocal and the shareholders' interests. A 94.

The court below placed great weight on a finding that "the [board's goal] -- realization of the company's major strategic plan -- is reasonably seen as of unquestionably great importance to the board." A 94 (emphasis added). Under Unocal, however, reasonableness is not determined by reference to the board's views, which are inherently suspect. Unocal requires that reasonableness be measured by an objective comparison of the threat and the response.

Time's response was utterly out of proportion. Paramount's offer provides a substantial premium over market value and over the present value of Time's "long-term" strategy. Time blocked that alternative although it provides more value to its shareholders than Time's strategic plan. That is not reasonable.

This precise issue was resolved in Grand Metropolitan PLC v. The Pillsbury Co., [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,104 at 91,188, Duffy, 6J., (ret.) (Del. Ch., Dec. 16, 1988). The Pillsbury, the target company responded to a tender offer by approving an alternative restructuring that included various spin-offs and asset sales. Central to the target's defense was its assertion that since the minimum present value of this restructuring was $68 per share, it was clearly superior to the $63 tender offer.

The Pillsbury court framed the "bottom line" as a choice between a tangible offer for current value and the company's ambitious predictions for future value. ¶ 94,104 at 91,194. Noting that "expectancies over a four or five year period out into the nineties are subject to economic and competitive conditions which are beyond [the company's] control," the court found that a shareholder could well decide that the current tender offer was preferable to a "future hypothetical value." Id. In ruling that the company was required to allow shareholder choice on the competing alternatives, the court concluded that the only "threat posed" was the significant loss to all Pillsbury shareholders if the tender offer were rebuffed and the company stock returned to its prior levels. Id. See also

Gilson, A Structural Approach to Corporation: The Case Against Defensive Tactics in Tender Offers, 33 Stan. L. Rev. 819, 856-59 (1981).

Courts have consistently enjoined directors who have tried -- in the name of long-term values -- to preclude shareholder choice of current value-maximizing offers. See AC Acquisition Corp. v. Anderson, Clayton & Co., Del. Ch., 519 A.2d 103 (1986) ("[A] defensive step that includes a coercive self-tender timed to effectively preclude a rational shareholder from accepting the any-and-all offer cannot, in my opinion, be deemed to be reasonable in relation to any minimal threat posed to stockholders by such offer."); Robert M. Bass Group, Inc. v. Evans, Del. Ch., 552 A.2d 1227, 1243-44 (1988) (fiduciaries "were not free to 'cram down' [their] transaction in order to 'protect' their shareholders from a non-coercive, economically superior one. Under Unocal the directors were obligated to give the shareholders a choice. The restructuring, because it deprives them of that choice, is manifestly unreasonable.")

The same principle was propounded in Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D. Wis.), aff'd, No. 898-1581 (7th Cir. May 24, 1989) (per curiam). The federal district court, applying Unocal, concluded that a company could not permanently preclude shareholder choice solely on the basis of its own perception of the inadequacy of the offer. Thus, the court determined that the proportionality test required that:

> If no other threat is posed to the corporation and shareholders, a board must at some point allow shareholders to choose between the offer and some alternative. Whether the alternative is to remain independent and reap the future benefits with the company, as the board proposes here, or a financial restructuring as proposed in Pillsbury, or an auction of the company as was done in Revlon, the shareholders must at some point be allowed to choose. To do otherwise is to disenfranchise the shareholders.

Id. at 1015. See also Southdown, Inc. v. Moore McCormack Resources, Inc., 686 F. Supp. 595 (S.D. Tex. 1988) (target company enjoined from pursuing restructuring plan without vote of shareholders); Elias v. Wilson Foods Corp., Del. Ch., C.A. Nos. 10107, 10108, 10109 and 10110, Berger, V.C. (Aug. 4, 1988) (preferred stock plan enjoined as a "substantial impediment to any potential acquiror" where there was no mechanism to cancel the redemption option if the board was presented with a more attractive acquisition offer) (slip op. at 3-4).

The particular vice of Time's actions is that it is "cramming down" a financially inferior choice on the shareholders. Time is depriving them of at least $200 per share today in favor of speculative future values, ($106 to $188 in 1990) (A 1477) that are worth less on a present value basis than Paramount's offer. Paramount's analysis suggests that using Time's own projections, the range will be from $90 to $140 for the foreseeable future. A 376.

To the extent that Time is asserting a "right and duty" to unilaterally determine how the long-term interests of its shareholders will best be served, that claim has already been rejected. Interco, 551 A.2d at 799. Under any analysis of Unocal, the preclusive response is unreasonable. It should have been enjoined.

C. The Chancery Court Improperly Ignored The Time Board's Failure To Satisfy Its Duty of Investigation

Directors considering unsolicited offers bear the burden of establishing that they have conducted a "reasonable investigation" of the offer and any threat posed by the offer. Unocal, 493 A.2d at 955 (citing Cheff v. Mathes, Del. Supr., 199 A.2d 548 (1964); see also Robert M. Bass Group v. Evans, Del. Ch., 552 A.2d 1227, 1241 (1988) (Unocal requires that a decision to resist a takeover "rest upon reasonable investigation"). The directors must establish that they had a reasonable basis for believing that the transaction was in the shareholders' best interests. See Interco, 551 A.2d at 795-96. The record is void of any sign that the board investigated the Paramount offer.

The Time board made absolutely no effort to explore the value of the transaction proposed by Paramount. Paramount's offer expressly indicated Paramount's eagerness to begin a dialogue, and Paramount repeatedly wrote to Time offering to negotiate. Not one Time director ever suggested approaching Paramount. Instead, the Time board agreed to enter a concededly defensive "hell or high water" merger agreement with Warner that prevented Time from considering alternative transactions. Wrapped snugly in their "not-for-sale" cocoon, the Time board failed to satisfy their duty of reasonable investigation.

Unocal does not have a "not-for-sale" exception. The board's duty to make an inquiry arose as soon as Paramount made its offer; the board's belief that Time was not for sale does not in any way condition that duty. To the contrary, Time's intention to engage in an extraordinary transaction that would fundamentally alter the corporate and economic structure heightened the board's duty of inquiry. Interco, 551 A.2d at 802-03 ("When the transaction is so fundamental as the restructuring here (or a sale or merger of the Company), the obligation to be informed would seem to require that reliable information about the value of alternative transactions be explored").

The court below, concerned with subjective motive rather than objective fact, ignored the directors' failure to conduct a reasonable investigation. Under a proper Unocal analysis, the board's actions cannot be condoned.

II. PARAMOUNT AND TIME'S SHAREHOLDERS WILL SUFFER IRREPARABLE HARM IF TIME'S TENDER OFFER IS NOT ENJOINED

"It is very unlikely that the market price of Time stock immediately following consummation of the new planned two-staged transaction will equal the initial $175 price offered by Paramount." A 20. Indeed, the record below demonstrates that the completion of the Time-Warner merger pursuant to the amended merger agreement will preclude Paramount from pursuing its offer for Time and will deprive Time shareholders of an opportunity to receive anything approaching $200 per share.

Time will incur at least $8.35 billion in additional senior debt. A 1505. When added to another $2 billion of subordinated debt that Time plans to issue, this will exhaust the borrowing capacity of the new entity. A 1508. As a consequence, an acquisition of Time-Warner by a financial or leveraged buy-out purchaser will be virtually impossible. A 1508. Any third-party acquiror would have to rely solely on its own borrowing capacity to finance a Time-Warner bid. A 1508-1509. There are few, if any, institutions that could make such a purchase. A 1509.

Even if someone were able to make an offer, borrowing off of the bidder's balance sheet, it would be at a price considerably lower than $200 per share. A 1509-1511. This fact is uncontroverted by the record. The court below disposed of the preclusive effect of Time's tender offer in three sentences. The court concluded that the "defensive" step employed by Time does not legally or practically foreclose "the successful prosecution of a hostile tender offer." A 94. The only support cited is the decision in <u>In re RJR Nabisco, Inc. Shareholders Litigation</u>, Del. Ch., C.A.

No. 10389, Allen, C. (January 31, 1989). That ignores the fundamental difference between RJR and this action. RJR was not an all-cash offer, and it was a friendly transaction. Nothing close to a $30 billion all-cash hostile offer has ever been made. There is not a shred of evidence that such an offer would be possible for a merged Time-Warner.

CONCLUSION

For the reasons set forth above and in the pleadings and proceedings below, Paramount respectfully submits that the Order of the Court of Chancery should be reversed and its amended Motion for a Preliminary Injunction granted.

Dated: July 17, 1989

Respectfully submitted,

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