IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

PARAMOUNT COMMUNICATIONS INC. and KDS ACQUISITION INC., :

Plaintiffs, :

vs. : Civil Action No. 10866

TIME INCORPORATED, et al., :

Defendants. :

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Courtroom No. 1
Public Building
Wilmington, Delaware
Wednesday, June 7, 1989
10:25 a.m.

- - -

BEFORE: HON. WILLIAM T. ALLEN, Chancellor.

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ARGUMENT ON PLAINTIFFS' MOTION FOR TEMPORARY RESTRAINING ORDER

- - -

CHANCERY COURT REPORTERS
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APPEARANCES:

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-and-
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THE COURT: Good morning, counsel.

MR. STARGATT: Good morning, Your Honor.

MR. RICHARDS: Good morning, Your Honor.

MR. HAMERMESH: Good morning, Your Honor.

THE COURT: I am glad to see everybody could get here on short notice.

Mr. Stargatt, you asked for this time with the Court. Let's not spend too much time on the background. I have to be leaving for some meetings that I must attend in one hour. I have read the affidavits and the short submissions you have given me.

I understand from defendants' point of view the awkwardness of coming in with virtually no notice, and I understand from plaintiffs' point of view why you thought that was necessary. So you don't have to go into that.

MR. STARGATT: Very well, Your Honor. Let me then merely indicate that you have on your desk motions for the admission pro hac vice of Mel Cantor and Mike Chepiga, of Simpson Thacher, and I

will introduce Mr. Cantor to make plaintiffs' presentation.

MR. CANTOR: Good morning, Your Honor.

THE COURT: Good morning, Mr. Cantor.

MR. CANTOR: As Your Honor is aware, we are here this morning seeking a TRO on the so-called lockup stock swap that is in existence between Time and Warner. We have filed a plenary complaint seeking relief on a lot of other issues, but we seek no preliminary relief today on the other aspects of our case. We do seek expedited discovery, the issuance of a commission and things like that, which I will get to and which I would hope would not be controverted.

The reason for the application for immediate relief on the stock swap, Your Honor, is, under its terms a notice may be given, in which case it would be consummated five business days from today, and also, according to its terms, its terms may be amended so that it could be consummated immediately. And the real reason for a hearing today is the concern that we have that without some intervention by the Court, there will be an immediate

and irreparable consummation of the stock swap.

Now, what the swap does, Your Honor, essentially is provide that Time issues to Warner today, or whenever it is implemented, 7.1 million shares of Time stock. Warner issues to Time --

THE COURT: How many shares of Time stock are existing now?

MR. CANTOR: 56 million. It is about 11 percent, Your Honor.

In exchange for that, Warner issues to time 17.3 million shares, which is roughly 9-1/2 percent of the outstanding Warner stock.

THE COURT: Is this the same ratio as the merger agreement called for?

MR. CANTOR: It is not the same ratio. There is an adjustment mechanism which provides that down the road immediately prior to the effectuation of the merger, if that, indeed, happens, an additional 960,000 shares of Time stock would be issued to make the ratio precisely the same, .465 ratio.

Our concern, Your Honor, and the reason we are here, is that the issuance of the shares today provides a substantial deterrent to any

third-party offer for Time and I think was intended to do that, was almost admittedly intended to do that in the proxy statement that was issued, the merger proxy statement that was issued by Time and Warner.

First of all, Your Honor, the issuance of the shares will increase at $175 a share, which is what Paramount is offering, will increase the purchase price by over $1-1/4 billion. Now, that is the cash price that would have to be paid.

Now, it is true that Time would be getting and, if acquired by Paramount, Paramount would be getting Warner stock. But the Warner stock, number one, would not have any premium attached to it and, number two, is really impossible today to determine the value of. So unlike a break-up fee, where it is a dollar a share and you know what you are in for, here the way the defendants have set this transaction up, the Time stock goes out at a premium, and if the price ever goes up, that premium keeps increasing, and the Warner stock comes in and has a value that nobody knows. That's Problem No. 1, Your Honor.

THE COURT: Well, why does no one know the value of the Warner stock?

MR. CANTOR: Well, you can look in the newspaper today and see that the close yesterday was 51-3/4. But nobody knows what that value will be on the day that the transaction is consummated. In a break-up fee, in the traditional break-up fee -- and by the way, this is in terms --

THE COURT: The transaction. We are talking about your client not being able to value the Warner stock in Time's hands, and you are saying that your client can't say what that stock will be worth when your client consummates the transaction it proposes down the line --

MR. CANTOR: Correct.

THE COURT: (Continuing) -- at some point.

MR. CANTOR: That's correct. So we don't know --

THE COURT: Is that because you can't see the future?

MR. CANTOR: Yes, that's right, Your Honor. Okay? That's Problem No. 1, Your Honor.

It is very different from the traditional break-up fee, even looking at the dollar component of it for a moment, because you can't

quantify it.

But beyond that, Your Honor, what it does is, it gives an 11 percent share, a blocking share essentially to Warner in the Paramount proposed transaction. And the reason for that, Your Honor, is, if you have had a chance to go through our entire complaint, there is a so-called discriminatory voting provision in the Time charter, and what that provides essentially is that to go ahead with the transaction, you need both 80 percent shareholder approval and a majority of the minority. If Warner is sitting with 11 percent of the stock plus Time management has 6.6 percent of the stock, it will be impossible to get the majority of the minority that is required to do the deal.

THE COURT: "Do the deal" meaning a second-step merger?

MR. CANTOR: To do a second-step merger. That's right, Your Honor.

THE COURT: So you say that your client could only sit there with 84 percent of the stock if everybody else got a chance to and accepted this offer.

MR. CANTOR: Well, let's assume

hypothetically that we get to 80 percent, and there is 20 percent out there, 20 percent remaining. Warner has 11 percent. Right away you don't get a majority of the minority.

THE COURT: Right.

MR. CANTOR: The Time management has another 6-1/2 percent, which, you know, just is icing on the cake, I guess.

The third problem, Your Honor, is that if a bidding war ensues for time, you have got Warner now sitting with 11 percent of the Time stock, giving it a tremendous advantage, and an unfair advantage, I would submit, over any competitive bidder.

Now, what are we asking for exactly? Your Honor, we are asking for a TRO until we can be heard on a preliminary injunction. We would submit to you that there is absolutely no harm to Time and Warner emanating from a TRO. If Your Honor finds at the preliminary injunction phase that you are not prepared to issue a preliminary injunction, they can do, if they really want to do, the lockup stock swap at that time, and they are no worse off. There is no advantage to them other than creating problems for

their own merger, frankly. And other than killing us off, there is absolutely no business advantage to them to trigger that stock swap today.

If you want to look at it --

THE COURT: You say there is disadvantage to that. You may lose the pooling of interests.

MR. CANTOR: Pooling of interests; that's right. And that is a huge problem for them, as I understand it. It creates all kinds of accounting problems for them. They would take a real hit on their earnings. And I would hope someone would stand up and say they don't plan to trigger it today, but hope always springs eternal, I guess.

There is nothing on the other side of the equation, Your Honor. There is no reason why this can't be frozen pending a hearing on a preliminary injunction after discovery, at which time Your Honor will have the opportunity to consider this in a more complete manner.

I do have a few comments on expedited discovery, but maybe I will save those.

THE COURT: All right. Why don't you hold off on those. Who would like to speak for the

defendant?

MR. HAMERMESH: If it please the Court, thank you, Your Honor. We are here on behalf of Time, and the simplest thing I suppose I could do would be to tell the Court that we can all give you assurances that nothing is going to happen. I am not in a position to do that this morning. I am not sure I ever will be.

We received notice of the Paramount offer last night and got the papers this morning. The company has announced that its board of directors will consider that offer and do what the law requires it to do in response to it. The merger vote, as I think the Court may have seen, is scheduled for June 23, and the matter will be before the stockholders at that point, and they can vote up or down on the merger, as they wish, in light of the circumstances, including the Paramount offer as they perceive it.

To come to the matter that is before the Court this morning, which is the application for a TRO against the effectuation of the share exchange agreement, just a couple points.

First, I understand the applicable standard to be one that principally focuses on

whether or not the accomplishment of that agreement will irreparably injure Paramount in any cognizable way, and I suggest that the answer is, it will not, even if that does occur. The suggestion is that it is a substantial deterrent to Paramount in going forward. Their offer, as I see the announcement in the paper this morning, indicates that their offer is conditioned upon a permanent injunction against implementation or consummation of that share exchange agreement.

I am not sure what a temporary restraining order will do, but putting that aside for the moment, the parties to that agreement are before the Court. They are both Delaware corporations. If there is anything wrong that the Court ultimately finds in the share exchange agreement and if that agreement is accomplished and shares are issued pursuant to it, the parties will be before the Court. The matter can be rescinded upon final hearing. That much is very clear.

The only reason why any relief might be useful to Paramount at this point in time is to give it some comfort of an advisory nature that perhaps would encourage it in going forward to the

stockholders and perhaps may affect the vote of the stockholders at the June 23 meeting.

To go back just a moment, these agreements, the merger agreement with Warner and the share exchange agreement, have been in place since March 3, which is a little over three months ago, and they have been public since then, a long time. It is only now, just a couple weeks before that vote, that Paramount has chosen to surface with what purports to be a bid. The decision they have made was made with full knowledge of the existence of those agreements, and if they choose to go forward, they can go forward. Nothing in that share exchange agreement prevents them from accomplishing or consummating a tender offer if they are otherwise able to do it.

The only thing that would stand in their way is their uncertainty about their legal position. If they are right that the agreement is invalid, and we strenuously disagree that it is, they are free to consummate the offer, obtain final relief and so forth, and the Court can deal with the problem at that point.

I have been before the Court recently -- at least my colleagues have -- in the

Davis-Northwest matter, where we made similar arguments, and the Court concluded that the matter was one not only that could be addressed at final hearing but one in which an order entered by the Court of a preliminary nature, preliminary injunctive nature, would, in fact, have a deleterious impact on the consideration of the stockholders at their meeting.

The stockholders ought to be free to vote on this agreement at the meeting without any implications from the Court, which, frankly, I suspect is what the Paramount people hope for, any implications from the Court that the share exchange agreement or the merger agreement is invalid is not going to be allowed to go forward because of Court intervention.

There is no cognizable deterrent posed by the share exchange agreement offer, not so far as Paramount is concerned. They have been on notice of this for a long time, and they can go forward without it. To the extent that there is any claim that some impact exists by virtue of some supposed differential between the Warner shares that are to be issued and the Time shares that are to be

issued, that is one that can be sorted out after final hearing.

They make another point about this 11 percent blocking position, as they call it. It is -- I don't recall whether Mr. Cantor mentioned this this morning. I don't think he did. I think his papers were forthcoming on the point.

The board of directors of Time, if it determines that this offer is appropriate and ought to go forward, can exempt it, if you will, in short, from application of the charter provision that requires the 80 percent vote for a second-step merger. To discuss here whether or not that is going to occur is utterly premature, and it is one that requires the most rank sort of speculation to assume it is going to impose any obstacle at all to Paramount.

And finally, I think Mr. Cantor has suggested that if a bidding war ensues, if a bidding war ensues, Warner may have some advantage. Well, first of all, I don't know whether a bidding war will ensue or not, but I do know that whatever advantage Mr. Cantor sees in the situation is one that stems necessarily from the share exchange agreement. And

as I said before, if Mr. Cantor wants an advisory opinion, Paramount wants an advisory opinion from the Court as to whether that is valid, fine, then we can be in the business of doing that. But in terms of irreparable harm, there is absolutely none. This Court can undo that agreement if it finds it appropriate to do so after final hearing.

And as in the Northwest situation and the Newell situation, bidders can go forward with their decision, the stockholders can go forward with their decision, all in light of their own perceptions of whether or not that agreement is valid and without the interposition of a judgment or pronouncement from the Court on the point. It is just a classic case of seeking an advisory opinion at this point on little or no notice, and there is no reason to grant the kind of relief we are seeking here.

I understand that there may be some other matters presented, but that's the position of Time at least on the TRO application.

THE COURT: All right. Thank you, Mr. Hamermesh.

MR. HAMERMESH: Thank you, Your Honor.

MR. RICHARDS: Good morning, Your Honor.

THE COURT: Good morning.

MR. RICHARDS: While I think in light of Your Honor's introductory comment probably no apologia is necessary, I should say that because of the time that I received these papers this morning and where I found myself, that I haven't been able to read a single word of them. So that if I miss something, I think the Court should look at this matter as if it was really almost ex-parte, because I just haven't been able to. And I should observe that the plaintiffs have obviously been laying their plans for some considerable time, and they could have given us notice, even notice last night, of what they were doing, and I would be better prepared.

I think we are all familiar with the standards on a temporary restraining order. And as I understand them, as differentiated from the standards for a preliminary injunction, the primary focus is on the standard of irreparable harm, but there is some attention as well to the probability of success. And I won't review those, because I know Your Honor is familiar with them.

I would agree with my colleague on behalf of Time that the plaintiffs have shown no irreparable harm whatsoever for the reasons that he advanced; that is, both companies are before the Court, and in addition, the share exchange agreement provides that the stock is subject to restriction and restraints on alienation in either parties' hands. So should the exchange agreement be exercised and should it close, the Court would either be able to fashion a remedy in damages if it turned out to be wrongful or, of course, could undo it.

So I think there has been no showing that something is to occur which would irreparably harm, I think, these plaintiffs. They I don't think have even tried to make that showing. Instead, they have said, well, there wouldn't be much harm to us if we were restrained from going forward with the exchange agreement, because if they didn't get a preliminary injunction, we could always go forward then. I think that's turning the standard completely upside down, as I understand it. And, of course, there is the harm of having an arm's-length, legitimate contractual relationship bargained for as part of the dealings between the parties set aside

right off the bat.

The plaintiffs didn't spend any time on the probability of success, as I heard their presentation, and I don't know what is in their papers, as I have said. I think there is a very significant question here as to their standing to make these claims. I am informed that it is not alleged that they were a shareholder at the time that this contractual commitment was entered into. And I am really not familiar with the basis on which a stranger to these two corporations should come forward and say that a contractual relationship between them was improper even if that were so. So I think there are significant standing questions with respect to their application this morning.

But secondly, they haven't suggested in any way why this isn't a perfectly legitimate contract. We know, in fact, that it is a contract that was negotiated at arm's length between two independent boards of directors, both of whom I think the Court will ultimately find are entitled to the business judgment rule in entering into what people have hailed as one of the first legitimate major mergers to occur in some time.

I say legitimate in the sense that this is a merger that the parties planned between themselves. This is not the usual case in which we sometimes come before the Court where a transaction is planned in response to some hostile takeover.

They haven't suggested in any way why that arrangement should be set aside. And, indeed, I think it can be looked at. It is an executory form, to be sure, but I think it can be looked at as the parties as we know had initially explored a joint venture and over a period of time had sought various joint ventures, and then as they got to know each other and have confidence in each other, it eventually evolved into if we are going to joint-venture these various operations, why don't we explore a merger. And so they explored that and ended up in the merger agreement.

And there was a concomitant commitment, a respect of one company for the other and of the management and its operations, and there was a decision made that in any event, because one can't foresee what is going to happen, each wanted to make an investment in the other. And it is just as if, in fact, Warner had bought 11 percent of Time and

Time had bought 9-1/2 percent of Warner, and that had occurred back on March 3, and here this plaintiff comes forward and he wants to make an offer and he would like to undo that.

That is to say, this is a perfectly legitimate liability, if you will, contractual obligation, of the company that they want to take over, Time, and other than the fact that they don't like it and wish it wasn't there, and they say it is going to cause them some difficulties, they suggested no basis as to why it is wrongful.

THE COURT: Well, their papers -- and I understand you haven't had a chance to see them -- sketch out essentially a theory predicated upon the Revlon case that this transaction, in fact, represents a change of control of Time from its shareholders to Warner, or actually Warner's shareholders is the theory, and that the so-called Revlon duties are implicated by the transaction in that the contract that they attack is a lockup transaction, just as lockups that are done in a bidding contest, and it is that kind of theory.

But we don't have to get into it in great detail. As you say, it is not something that I

am going to evaluate this morning.

MR. RICHARDS: Well, I think that's a somewhat -- I don't know whether Your Honor -- I didn't know that. I don't know whether Your Honor's comment invites some response on that argument. I think it is an entirely fanciful argument. I mean, they are trying to say --

THE COURT: The answer to your question is no.

MR. RICHARDS: Okay. Good. Let me see if I have something else to add.

I think that I do not have anything else to add. And in summary I think, to repeat the points that I have made briefly, I don't believe they have demonstrated any irreparable harm under the circumstances here, where the stock is not going to get out into the marketplace if the exchange agreement is consummated and where the parties are both before the Court. And I think that is the first test.

And secondly, I think they have made no showing of any probability of success. And while a lesser showing under the cases is required, and maybe it is described as a substantial claim or some

reasonable possibility of probability of success, something like that, I think they have to suggest something that commends itself to the Court other than simply a fanciful reconstruction of events in a way that hasn't occurred here, where you have a perfectly legitimate business transaction entered into months ago that the plaintiffs now find to be inconvenient.

THE COURT: Thank you, Mr. Richards.

MR. RICHARDS: Thank you.

THE COURT: Mr. Cantor.

MR. CANTOR: Let me suggest something, Your Honor. This was originally signed up on the same day as the merger agreement. When the SEC said that won't fly because of pooling of interests which can cost the merged entity's shareholders hundreds of millions of dollars, if not billions of dollars, in charges to earnings, they went ahead and amended it and said, okay, we won't do it unless, of course, somebody makes a bid. Now, if that's not defensive under Unocal, in addition to the Revlon argument, then I don't know what is.

Now, with respect to Mr. Hamermesh and the irreparable injury, Your Honor, rescission is

wonderful, but in the meanwhile the bidding process is going to be chilled. Warner is going to have an 11 percent vote that is going to block the back end. And to stand up and say don't worry, the Time board may approve that, the Time board which is up here arguing today to do a deal that is going to kill pooling of interests may approve the back end for us, is an --

THE COURT: If you own 80 percent of the stock, he says, if your --

MR. CANTOR: That's right. If we own 80 percent of the stock, they will say no problem. Without Your Honor telling them to say so they are just going to say no problem. Well, it is interesting, and maybe they might say that, but I don't know what they are doing here this morning arguing to go ahead with a transaction that is going to shoot their stock to smithereens.

They are free to vote the stock, Your Honor, on the back end. They are free to use it in a competitive bidding contest. They are free to do all those things. And the thought that somewhere down the road Your Honor may say, "This was improper. You have to give the stock back," will have a devastating

effect on this bid or on any other bidder who might come in, and that is precisely after the SEC ruled why they amended the share agreement and had it provide that it would trigger only upon the commencement of an offer. That's the specific raison d'etre for this agreement, Your Honor.

I will answer any questions Your Honor has.

THE COURT: No, I don't have any questions. Thank you, Mr. Cantor.

Well, this application is difficult principally for the reason that I haven't had a chance to think about it, haven't had a chance to really read the papers with reflection. The defendants have not had the time to consult in a significant way, I suppose, with their counsel -- that is, the parties -- or to counsel among themselves. I don't criticize the plaintiffs for that.

The condition in the agreement that makes a triggering event the announcement of a tender offer apparently creates or could be understood to create a situation in which it is necessary for the plaintiffs to come into court without very

significant discussions among the parties beforehand. But it does leave me in a position, and other demands on my own schedule, in which this application must be dealt with without a great deal of confidence.

I am obviously mindful of the special nature of a restraining order. It is, as all counsel have indicated, granted with primary emphasis on the Court's point of view being upon the imminence of irreparable injury and with a less careful scrutiny of the merits than is made in a preliminary injunction.

What I propose is that -- I am, by the way, sensitive, as that Northwest case that was referred to indicates, sensitive to the implications and sometimes incorrect implications that may possibly be drawn by others, specifically shareholders, from action by the Court and how such inferences may affect shareholder choices. One of the missions, I think, of a court in a case of this kind is to apply the law in the way that it understands it but not to act in a way that unduly interferes with the decisions of shareholders or other participants in these transactions.

I am also impressed in the

provisional and sort of almost superficial way that is necessary for my reactions to be this morning with the defendants' argument that we have here no real likelihood of imminent irreparable injury because the stock that would be issued if the exchange occurred is restricted stock and that the parties are before the Court and this could be undone, and that might be done -- while it wasn't said, that the question of whether or not that is to be done could be done on a relatively quick schedule.

However, I am sympathetic to the defendants' notion that if there is something objectionable about this contract, they ought to have a chance to litigate it before it is fully effectuated. I say sympathetic not to mean I am accepting the arguments and rejecting the irreparability arguments but, simply given my lack of confidence, that is not a position that I am prepared to reject either at this moment.

What I would like is a little more time to think about this. And what I think the parties could use is a little more time to communicate with each other and consider alternatives before any action is taken. I will reserve 11:00 on

Friday morning as a time to meet with counsel again, and in the interim I will ask them to communicate with each other with respect to scheduling.

My provisional reaction is that a rather prompt hearing is in order, that expedited discovery is in order in a case such as this. I think that TW Services, the history of that case suggests that I will not regard the July 5 date as a sacred date simply because that is the date on which the offer made by the plaintiff is scheduled to close.

Is it July 2? What is the closing date?

MR. CANTOR: July 5, Your Honor.

THE COURT: July 5. I spoke correctly. So one question, the question that the parties really hadn't gotten around to address but I don't think is altogether necessary that they do, is how promptly can these issues be presented to the Court in a responsible way. And I think that's something that you can address among yourselves, and we can discuss it again on Friday.

The question presented this morning is, well, in the interim is there going to be

restraint against the parties to this contract from executing the contract. That's a question that I am disinclined to want to answer this morning but I will, if necessary, answer on Friday morning.

In the interim I will assume, unless counsel tells me promptly hereafter, that the parties will voluntarily undertake not to execute their rights under the contract or amend the contract until we have this further session, until they have a chance to consult with all their lawyers and so forth and so on.

I put it on that basis because I don't think it is necessary for the Court to issue a restraining order in these circumstances unless I am told that that is not the case, and then I will reconsider that question.

On Friday morning we can consider a schedule, but I hope that you will have had some success in working through and coming up with a proposal on a schedule. And my more optimistic hope is that events having occurred as they have, and the execution of the exchange agreement having apparently some unhappy consequences for the defendants in all events, that perhaps the matter can stay in some kind

of a status quo on a voluntary basis until a relatively prompt hearing is made. I say that just out of a judge's hope of avoiding a decision really. I don't mean to imply that I have a predisposition of entering that kind of restraint, because that's just simply a question I don't feel confident enough to even imply an answer to at this time.

All right. So I will, as they say in the vernacular, punt.

Is there anything further? All right.

MR. RICHARDS: Your Honor, can we consult with our clients about what you have asked us to do voluntarily before responding?

THE COURT: Oh, certainly so. What I said is, I will assume that your clients will do that, and I will ask you to get back to me if they won't. And I will be at the Bench and Bar, so somebody will have to notify Mr. Stargatt of that fact and me of it.

My inclination, then, would be to maintain the status quo until Friday, but I am not going to enter that order right now.

Thank you. Court will stand in

recess.

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CERTIFICATE

I, LORRAINE B. MARINO, Official Reporter for the Court of Chancery of the State of Delaware and Notary Public, do hereby certify that the foregoing pages numbered 3 through 30 contain a true and correct transcription of the proceedings as stenographically reported by me at the hearing in the above cause before the Chancellor of the State of Delaware, on the date therein indicated.

IN WITNESS WHEREOF I have hereunto set my hand at Wilmington, this 7th day of June, 1989.

Official Reporter for the
Court of Chancery of the
State of Delaware