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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

PARAMOUNT COMMUNICATIONS INC. and KDS ACQUISITION CORP., Plaintiffs,	:	
- against -	:	
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., Defendants.	:	C.A. No.

PLAINTIFFS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION FOR A TEMPORARY RESTRAINING ORDER

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

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PRELIMINARY STATEMENT

Today, Plaintiffs commenced an all cash tender offer for all shares of Time Inc. ("Time"), at a price of $175 per share, which represents a $49 (38.9%) premium over the current market price of Time shares and a $66 (60.4%) premium over the market price of Time shares immediately preceding the announcement on March 3, 1989, of a proposed merger between Time and Warner Communications Inc. ("Warner").

Plaintiffs also today filed this action seeking declaratory and injunctive relief against a series of defensive measures adopted by Defendants that will deprive stockholders of any opportunity to consider alternatives to the proposed merger, including Plaintiffs' premium all cash offer. By this motion, Plaintiffs seek a temporary restraining order to prevent the imminent implementation of a particularly onerous defensive measure -- a Lock-Up Stock Swap.

The essence of the Lock-Up Stock Swap is an exchange of shares between Time and Warner which results in Warner owning approximately 11.1% of Time's outstanding shares (or 7,080,016 shares). As amended, the Lock-Up Stock Swap is "triggered" by the commencement of a tender offer for as little as 25% of the stock of Time. Either Time or Warner may then demand that the stock swap occur at a closing not more than five business days from the date of the demand.1/ Once effectuated, the exchange of shares becomes permanent even if the merger between Time and Warner is rejected by the Time stockholders. Paramount's premium cash tender offer has triggered the lock-up provisions.

The exchange of shares will have the following adverse effects:

- It will provide Warner with a block of shares sufficient, as a practical matter, to block any competing bid for Time including Paramount's bid;
- It will immediately and prohibitively increase the cost of acquiring Time by over $1.25 billion in the case of the Paramount bid;

1/ The lock-up agreement provides that the exchange "shall take place . . . at a closing . . . on . . . the fifth business day following the giving of written notice subsequent to a Trigger Date." See Plaintiffs' Appendix of Exhibits, (hereafter "Plaintiffs' Exhibit D") ¶ 3 at 2. However, the agreement provides that its terms may be amended or waived, thus allowing for a closing earlier than five business days after the demand. (Id. ¶ 21 at 8).

- It will significantly dilute both the value and voting power of the publicly-held shares of Time;

- It will prevent the proposed Time-Warner merger from receiving "pooling of interests" accounting treatment. Without this treatment the value of the merger will be so significantly undermined that Time and Warner have specifically reserved the right to terminate the merger if the swap occurs.

This extraordinary lock-up, which deters competing bids and threatens the very merger it was designed to lock-up, was approved by the Time directors on the same day that they approved the Merger Agreement. Under the terms of that agreement the merger will transfer control of Time from its existing public stockholders to the stockholders of Warner. Notwithstanding this self-evident sale of Time, the lock-up was approved without any effort by the Time directors to consider or solicit alternative proposals for Time.

As a defensive device, the Lock-Up Stock Swap is both unnecessary and unreasonable. It is unnecessary because Plaintiffs' all cash, non-coercive offer poses no threat to Time stockholders. It is unreasonable because it:

- provides no opportunity for negotiation or consideration of competing bids;

- indiscriminately obstructs all types of offers without regard to their terms or structure;

- leaves Warner with a commanding advantage over any other bidder for Time stock.

In short, the Lock-Up Stock Swap is an illegal device that will cause irreparable harm to Plaintiffs and all other Time stockholders. This Court should enjoin its implementation pending discovery and a hearing on Plaintiffs' motion for a preliminary injunction.

STATEMENT OF FACTS

The Time-Warner "Merger" Agreement

On March 3, 1989 Time and Warner entered into an agreement ("Merger Agreement") to combine the two companies to form a new entity, Time Warner. The agreement, if implemented, will radically alter Time's corporate structure and will fundamentally affect the rights and interests of Time stockholders by transferring control of Time to Warner.

The proposed merger will result in a newly-named Time Warner in which a majority of the shares are owned by Warner stockholders and a minority of the shares are owned by Time stockholders. Affidavit of Stephen M. Waters, dated June 6, 1989, ¶ 5 ("Waters Aff."). Thus, as a result of the merger, the present stockholders of Time will have lost control of Time and its assets. This transfer of control will be accomplished through the following steps:

(i) A wholly-owned subsidiary of Time will be merged with Warner;

(ii) Each outstanding share of the common stock of Warner will be exchanged for 0.465 of a share of newly issued Time stock;

(iii) The Time certificate of incorporation will be amended to change the corporation's name from Time to Time Warner Inc.; and

(iv) As a result of the 0.465 exchange, Warner stockholders will own 62% of Time Warner and Time stockholders will own 38% of Time Warner.

Moreover, besides losing control of Time, the Time stockholders will also suffer a more immediate economic loss: they will receive less than the market equivalent in Warner shares for the newly issued shares. For the year preceding the Time-Warner transaction the exchange ratio for an equal exchange of shares based upon the respective market prices of Time and Warner ranged from 0.30 of a Time share for each Warner share to 0.42 of a Time share for each Warner share. However, in order to induce Warner to enter the merger, Time management agreed to an exchange ratio of 0.465, a severe penalty to Time even when compared to the 0.42 high. Waters Aff., ¶ 6.

Based upon the March 3, 1989 price of the respective stocks and the exchange ratio fixed in the Merger Agreement, Warner stockholders are to receive $4.87 per share or $810,527,327 in the aggregate over the then-market value of their holdings. Since there are 56,977,150 outstanding shares of Time stock, this cost translates into a per share loss for Time stockholders on the sale of control to Warner of $14.23 per Time share or 13%. Thus, the Time stockholders are receiving substantially less than market value for surrendering control of Time. Waters Aff., ¶ 7.

The Merger Agreement was presented to the Time directors and approved by them at a single meeting held on March 3, 1989. <u>See</u> Time Warner Joint Proxy Statement, dated May 22, 1989 (the "Proxy Statement") (Plaintiffs' Exhibit C). At the same board meeting, the Time directors approved the Time

Warner Share Exchange Agreement ("Lock-Up Stock Swap") (Plaintiffs' Exhibit D) and certain employment agreements with Messrs. Munro (the Chairman and Chief Executive Officer of Time), Nicholas (the President and Chief Operating Officer of Time) and Ross (the Chairman of the Board and Chief Executive Officer of Warner), which establish the senior management of Time Warner for ten years after the merger is completed.

In addition to entrenching Time's current senior management, the Merger Agreement also ensures continued positions for most of the current members of the Time board. Time Warner will have a twenty-four member board of directors, an increase of nine seats over Time's current fifteen member board. Pursuant to the Merger Agreement, Time and Warner will each appoint twelve directors. According to the Proxy Statement, defendants Bere, Dingman, Finkelstein, Horner, Kearns, Levin, Luce, McManus, Munro, Nicholas, Opel and Perkins, the great majority of Time's current directors, will keep their positions on the new board.

The Proxy Statement does not report any effort by the Time directors to solicit or consider alternative bids or transactions before approving the Merger Agreement. Nor does the Proxy Statement disclose whether the management or directors of Time received any inquiries or proposals concerning potential alternative transactions.

Prior to the commencement of negotiations with Warner, Time had certain "defensive" mechanisms in place. As described in the Verified Complaint, Article V of Time's

Certificate of Incorporation contains a discriminatory voting requirement. In April of 1986, Time adopted a Preferred Stock Purchase Rights Plan which was significantly amended in January of 1989.

In connection with the merger, the Time board also approved a variety of additional measures explicitly designed to preclude alternatives to the Merger Agreement regardless of the price, terms or structure of those alternatives. These measures include the Lock-Up Stock Swap and a black-out provision in the Merger Agreement which prevents Time from endorsing, approving, soliciting, encouraging, or facilitating any alternatives to the merger transaction.

Time's determination to prevent any competing bids is further demonstrated by the fact, revealed in its Proxy Statement, that it has arranged $5 billion in financing from certain banks, obviously for defensive purposes in the event of a competing offer. In addition, Time revealed that it has paid "dry-up" fees to certain of the banks providing this financing specifically to assure that they will <u>refuse</u> to finance competing offers not approved by Time or Warner. Time is thus using its stockholders' money to pay banks <u>not</u> to fund competing offers that will provide Time stockholders with a superior alternative to the management transaction.

<u>The Lock-Up Stock Swap</u>

Under the terms of the Lock-Up Stock Swap, Time and Warner agreed to exchange 7.1 million shares of Time's outstanding common stock for 17.3 million shares of Warner's outstanding common stock.[2/] As originally conceived, the Lock-Up Stock Swap permitted Time and Warner to effect the exchange at any time after satisfying several nominal conditions. Waters Aff., ¶ 8.

Soon after entering the Lock-Up Stock Swap, however, Defendants were informed by the Securities and Exchange Commission ("SEC") of serious accounting consequences that attached to the contemplated exchange of shares. Specifically, the SEC determined that the merger could not receive "pooling of interests" accounting treatment if the Lock-Up Stock Swap occurred. Without the benefit of pooling of interests treatment, Time Warner will be forced to charge substantial amounts of non-deductible goodwill against the income of the combined company. These annual charges -- and corresponding reductions in current earnings -- are likely to significantly impair the value of Time Warner shares. Waters Aff., ¶ 9.

Rather than abandon the Lock-Up Stock Swap, however, Time and Warner chose instead to delay its implementation until the announcement of a competing bid for either Time or Warner. Thus, the Lock-Up Stock Swap was amended to provide that either party can trigger the exchange (and, presumably, the substantial accounting charges flowing from the loss of "pooling" treatment) upon the mere announcement of a competing bid for Time or Warner. Waters Aff., ¶ 13.

2/ Immediately prior to the merger, Time will transfer an additional 961,111 shares to Warner pursuant the Merger Agreement so that the total number of Time shares issued equals the total number of Warner shares multiplied by the exchange ratio.

Obviously, given the substantial negative effects on Time Warner in the event that an exchange of shares occurs, the Lock-Up Stock Swap serves but one purpose: to deter competing bids. The restrictions placed on the Lock-Up shares confirm that the transaction has no legitimate business purpose. Waters Aff., ¶ 11. For example: (i) the shares have no independent voting rights, <u>except</u> in the event of third-party proxy solicitations concerning matters unrelated to the proposed merger (including the business combination Plaintiffs intend to effect if their offer is consummated); (ii) neither Time nor Warner may sell, assign, pledge or otherwise dispose of or transfer the shares it has acquired pursuant to the Lock-Up Stock Swap prior to the termination of the Merger Agreement, and thereafter significant restrictions limit alienation; and (iii) the Lock-Up Stock Swap prohibits each party from acquiring additional shares or joining a group owning additional shares in, proposing a business combination with, soliciting proxies with respect to the shares of, or acquiring material assets of the other party. Waters Aff., ¶ 12.

The Lock-Up Stock Swap accomplishes its deterrent purpose in the following ways:

> (i) In their Proxy Statement Time and Warner admit that the Lock-Up Stock Swap "could have the effect of making an acquisition of either Time or WCI [Warner] by a third party more costly." This is an understatement. By increasing the number of outstanding Time shares by the number of exchange shares issued to Warner, 7,080,016, the Lock-Up Stock Swap would increase the price of an acquisition of Time by more than $1.25 billion, based on the per share price of the offer.
>
> (ii) By placing a block of 7,080,016 shares in friendly hands, together with the 3,432,954 shares owned

or controlled by management, the Lock-Up Stock Swap will give Warner an instant and commanding advantage over any other bidder.

(iii) The Lock-Up Stock Swap increases the total number of outstanding shares of Time by over 11%. It thus dilutes the holdings of any other bidder and all other stockholders.

If the Lock-Up Stock Swap occurs and has its intended effect -- deterring competitive bids -- all Time stockholders will sustain a double loss. First, Time stockholders will be deprived of the above-market tender offer price. Moreover, the loss of "pooling of interests" accounting treatment means that all Time stockholders will suffer the market impact flowing from reduced reported earnings of the combined company.

Although the Lock-Up Stock Swap imposes a substantial deterrent on competing offers, Time stockholders have never been given an opportunity to approve or disapprove it. Instead, the Defendant directors presented the Lock-Up Stock Swap to the stockholders as a fait accompli. As a result of this unilateral action, Time stockholders will be deprived of the opportunity to consider an alternative to the merger transaction.

ARGUMENT

I. PLAINTIFFS SATISFY THE LEGAL STANDARDS FOR A TEMPORARY RESTRAINING ORDER

A temporary restraining order "is an extremely limited form of injunction designed to preserve the status quo for a short period of time until the matter can be presented in an orderly way on a motion for a preliminary injunction." Robert M. Bass Group, Inc. v. Evans, C.A. Nos. 9953 and 9909, Jacobs, V.C., transcript at 4 (Del. Ch. June 10, 1988) (bench ruling). Because a motion for a temporary restraining order must be decided without the benefit of discovery, "the primary emphasis is upon the irreparability of the injury, and only secondarily on the merits of the claims." Id. at 5. To prevail, the moving party must show "a threat of imminent irreparable damage and claims that are colorable, litigable, or that raise questions deserving serious attention." Id.; see also Cottle v. Carr, C.A. No. 9612, Allen, C., slip op. at 5-6 (Del. Ch. Feb. 9, 1988).

As shown below, the Lock-Up Stock Swap threatens Plaintiffs and all Time stockholders with imminent, irreparable harm, and Plaintiffs raise colorable and litigable legal claims. Therefore, a temporary restraining order should be granted.

II. UNLESS A TEMPORARY RESTRAINING ORDER IS GRANTED, PLAINTIFFS AND TIME STOCKHOLDERS WILL SUFFER IRREPARABLE HARM

A. Irreparable Harm

The Lock-Up Stock Swap presents a threat of imminent, irreparable harm to Plaintiffs and to other Time stockholders. The harm threatened is imminent because there can be no assurance that Defendants will not immediately trigger the exchange of Time and Warner shares. The harm is irreparable because the exchange will chill, if not preclude, an acquisition proposal by Paramount or any other third party and will immediately dilute the value and voting rights of Time's publicly traded shares. By contrast, the temporary restraint will not injure the defendants. Rather, it is the exchange of shares that will cause irreparable injury to the very merger Time and Warner are urging upon their stockholders.

Courts considering challenges to anti-takeover devices have recognized that illegal anti-takeover tactics that defeat or delay an offeror's ability to complete an acquisition threaten irreparable harm to both the offeror and other stockholders. As this Court has explained, "unless [the offeror] is permitted to market its bid free of [illegal] restrictions . . . its acquisition effort is at an end." MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239, 1251 (Del. Ch. 1985), aff'd, 506 A.2d 173 (Del. 1986) (finding that a target's issuance of an illegal lock-up option to a "white knight" irreparably harmed an offeror); see also Minstar Acquiring Corp. v. AMF Inc., 621 F. Supp. 1252, 1257 (S.D.N.Y. 1985) (if a "tender offer is defeated due to [anti-takeover] tactics which are in fact illegal, the plaintiff will suffer irreparable harm"); Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406, 419 (N.D. Ill.), aff'd, 794 F.2d 250 (7th Cir. 1986), rev'd on other grounds, 481 U.S. 69 (1987) (same).

Other stockholders are also irreparably harmed if they are denied the opportunity to sell their shares at a price of their own choosing in response to an offer. See AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 115-16 (Del. Ch. 1986); Asarco Inc. v. Court, 611 F. Supp. 468, 480 (D.N.J. 1985); Amalgamated Sugar v. NL Indus., 644 F. Supp. 1229, 1238-39 (S.D.N.Y. 1986), aff'd, 825 F.2d 634 (2d Cir.), cert. denied, 108 S. Ct. 511 (1987).

Thus, the cases leave no doubt that irreparable harm occurs when "in the absence of an injunction, [the offeror] will lose the opportunity to bid for [the target] and [the target's] stockholders will lose the opportunity to achieve the highest value for their shares." In Re Holly Farms Corp., [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,181, at 91,645 Hartnett, V.C. (Del. Ch. December 30, 1988).

In Holly Farms, a company's board of directors entered into a merger agreement that provided a lock-up, termination fees, and expense reimbursement to its proposed merger partner. The court found that by precluding competing bids, these provisions would cause irreparable harm to (1) the offeror who had commenced an all cash tender offer for all of the company's shares and (2) the company's stockholders. The offeror would lose the opportunity to continue its bid for the company and the stockholders would lose the opportunity to chose an alternative to management's merger transaction. Id. See also Elias v. Wilson Foods Corp., C.A. No. 10,107, 10,108, 10,095 and 10,106, Berger, V.C., slip op. at 4 (Del. Ch. August 4, 1988) (irreparable harm found where issuance of preferred stock with cash redemption option "constitutes a substantial impediment to any potential acquiror, regardless of the price it is willing to pay").

Similarly, in Bass Group, this Court recently found irreparable harm where the target company, in response to an all-cash-for-all-shares tender offer, proposed a restructuring to be accomplished through the issuance of a stock and cash dividend. Management would emerge from the restructuring with a stock interest sufficient to deter acquisition proposals. The Court found that the proposed transaction would result in irreparable harm to all stockholders, including the offeror, "because the restructuring will irretrievably alter [the target's] capital and corporate structure and would adversely affect the quality of the shareholders' investment and prevent or drastically reduce the shareholders' opportunity to realize greater value for their shares . . . all without any opportunity for the shareholders to have any say." Bass Group, transcript at 9.

Here, the Lock-Up Stock Swap -- adopted without any opportunity for stockholders to have any say -- will cause the same irreparable harm that would have resulted in Holly Farms: Plaintiffs will lose the opportunity to continue their bid for Time, and Time stockholders will lose an opportunity to chose an alternative offering greater value than the management sponsored merger transaction. In addition, the Lock-Up Stock Swap will advance the consummation of a transaction that will visit upon Time stockholders the same evils that concerned the court in Bass Group. A merger that results in Time stockholders becoming minority stockholders in a new entity certainly will "irretrievably alter" Time's corporate structure and "adversely affect the stockholders' investment." Moreover, by making the cost of any competing offer prohibitively more expensive and diluting the stockholders voting power by placing a substantial block of stock in hands friendly to management, the Lock-Up Stock Swap will "prevent or drastically reduce the [Time stockholders'] opportunity to realize greater value for their shares."

The immediately preclusive effect of the increase in the cost of an acquisition is clear. The effect of a dilution of stockholders' voting power may be less obvious, but it is just as immediately harmful to Plaintiffs and other stockholders. By placing an 11% block with Time's proposed "merger" partner, the Lock-Up Stock Swap will permit the combined voting power of Time's management and board (6.6% as of May 1, 1989) and Warner to block any future business combination pursuant to Article V of Time's Restated Certificate of Incorporation ("Certificate"). Article V requires that, in the absence of board approval, business combinations with any outside person must be approved by an affirmative vote of at least 80% of the company's voting shares and a majority of the minority stockholders. The combined voting power of Warner and Time insiders would be almost 18%, more than enough to defeat the majority of the minority requirement under the Certificate.3/

3/ Section 3(d) of Article V purports to create a "fair market value" price exception to the 80% supermajority requirement. But this exception is in reality yet another device intended to deter uninvited offers. Under (continued...)

In summary, both the increased cost of acquiring Time and the dilution of the stockholders' voting power will cause Plaintiffs and other Time stockholders immediate and irreparable harm: Plaintiffs will be deprived of an opportunity to pursue their bid for Time, and all Time stockholders will lose the opportunity to choose Plaintiffs' premium offer as an alternative to management's "merger" proposal.4/

B. Balancing the Equities

In balancing the equities, the scales tip heavily in Plaintiffs' favor. A temporary delay of the stock swap will not cause any injury to Defendants or to Time stockholders. The Lock-Up Stock Swap is not a condition precedent to the Time Warner merger -- as its subsequent amendment and postponement make clear -- and any additional delay in its implementation will not harm either Time or Warner. Rather, the stock swap will substantially undermine any value that even the Defendants see in the merger and potentially lead to its abandonment.

3/ (...continued)
Section 3(d), no matter what price is offered, the price ultimately required to purchase all the shares is dependent upon market fluctuations for a 30-day period which will begin some time in the future, well after the announcement of any offer.

4/ The extreme difficulty, if not impossibility, of calculating money damages to remedy the harm inflicted on Plaintiffs is an additional factor compelling injunctive relief. See Revlon v. MacAndrews & Forbes Holding, 506 A.2d 173, 185 (Del. 1986) (where offeror's opportunity to bid was threatened by lock-up, "obstacles to [offeror] obtaining a meaningful legal remedy are immense").

Simply put, there is no competing equity or irreparable harm that justifies denying the restraining order.

Of course, if the Court later determines that the Lock-Up Stock Swap is permissible, Defendants may then implement the swap with the same preclusive effect it would have if implemented now. In the meantime, Defendants are free to pursue legitimate responses to Plaintiffs' offer. As the court recognized in Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264, 283 (2d Cir. 1986), in granting a preliminary injunction, "[t]his remedy, of course, does not preclude [the target] from renewing its [anti-takeover] efforts on other legitimate terms or on a basis that is beyond challenge."

Moreover, it cannot be disputed that the immediate triggering of the Lock-Up Stock Swap will provide no conceivable benefit to Time stockholders. The management and directors of Time will have assured themselves positions in the new company, and Warner may have assured itself of a windfall profit. However, Time stockholders, deprived of Plaintiffs' offer by the Lock-Up Stock Swap, gain nothing. See Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772, 788 (D. Del. 1988) ("balance . . . tips in favor of [offeror] . . . [since] . . . the Court cannot conclude at this time that the effect of the [anti-takeover device] would inure to the benefit of the shareholders of the [target]").

In short, Plaintiffs will suffer immediate, irreparable harm if the Lock-Up Stock Swap is not enjoined, and Defendants will suffer no harm if the Lock-Up Stock Swap is enjoined.

III. THE COMPLAINT RAISES COLORABLE AND LITIGABLE CLAIMS

In order to obtain a temporary restraining order, Plaintiffs at this stage need only show "claims that are colorable, litigable, or that raise questions deserving serious attention." Bass Group, transcript at 5; accord Cottle, slip op. at 5-6.

Plaintiffs here, as in Bass Group, challenge the validity of an anti-takeover device adopted after the company proposed a change of control transaction fundamentally altering its corporate structure and adversely affecting its stockholders' rights. Adopted under these circumstances without any effort to solicit or consider alternative bids, the device runs afoul of the limitations Revlon and its progeny impose on a board once a decision has been made to sell a company. Moreover, even if the "merger" is found not to be a "sale" triggering Revlon responsibilities, the Lock-Up Stock Swap cannot survive scrutiny under Unocal since it is an unreasonable and disproportionate response to an offer that poses no threat to Time stockholders.

These claims are clearly colorable and litigable and, together with the threat of irreparable harm shown above, require that the status quo be preserved until the issues can be developed and considered more fully.

A. The Lock-Up Stock Swap Violates the Director Defendants' Duty to Maximize Value for the Stockholders

In Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), the Delaware Supreme Court explained that when a company's board of directors decides to sell the company, the board's duty is "the maximization of the company's value at a sale for the stockholders' benefit." Id. at 182. In effect, the directors must become auctioneers and may not implement any devices that foreclose, rather than enhance, further bidding. Id.

In Mills Acquisition Co. v. Macmillan, Inc., Del. Supr., ___ A.2d ___(May 3, 1989), the court examined at length the scope of a board's Revlon responsibilities. The court explained that:

> Revlon requires that there be the most scrupulous adherence to ordinary principles of fairness in the sense that stockholder interests are enhanced, rather than diminished, in the conduct of an auction for the sale of corporate control. This is so whether the "sale" takes the form of an active auction, a management buy-out, or a "restructuring" . . . The sole responsibility of the directors in such a sale is for the shareholders' benefit.

Slip op. at 56-57. Applying this standard to a lock-up, the court reiterated its Revlon instruction that lock-ups that "foreclose further bidding operate to the detriment of shareholders" and are impermissible. Id. at 57 (citing Revlon, 506 A.2d 183).

There can be no doubt that under the Revlon standard, the Lock-Up Stock Swap, which clearly forecloses bidding without any benefit for the stockholders, is improper. Moreover, as the Macmillan passage quoted above makes clear, Revlon responsibilities may arise in cases other than an outright sale of all of a company's shares. In Revlon, in fact, the court found that the "board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale." 506 A.2d at 182 (emphasis added). At this point, the directors became "auctioneers charged with getting the best price for the stockholders at a sale of the company." Id. at 187.

In Holly Farms, a post-Revlon case, the corporation and a white knight entered into a merger agreement that was to be consummated by a stock swap. Several of the target's directors testified that they did not believe that the merger was a sale of the company. Despite this testimony, the court noted that "[i]t is now not contested that the stock swap [merger] transaction . . . will constitute a 'sale' of [the target]." Holly Farms, ¶ 94,181 at 91,643.

Like the decisions to enter merger transactions in Revlon and Holly Farms, the decision by Time's board to enter the Merger Agreement was a recognition that Time was for sale and that the merger, if completed, "will constitute a sale" of Time. The board's approval of the Merger Agreement therefore triggered its Revlon responsibilities.

Moreover, this is a merger in which Time stockholders will be selling control to Warner stockholders. This aspect of the merger -- the transfer of control -- provides an independent basis for triggering Revlon responsibilities. American Standard, 682 F. Supp. 772.

In American Standard, the district court, applying Delaware law, concluded "that a sale of control amounts to a 'sale' under Revlon." Id. at 781. There, a corporation proposed a recapitalization plan, including the creation of an ESOP, that, if implemented, would have effectively reduced the percentage of common stock held by its public stockholders from 92.6% to 45.5%. Id. at 782. The court noted that under the terms of the plan "the shareholders are transferring control" Id. at 783 (emphasis added). This transfer triggers Revlon duties and "[c]onsequently, any action taken by the Board must be directed at obtaining the highest price for the benefit of the stockholders." Id. at 784. See also Macmillan, slip op. at 56 (Revlon duties arise "whether 'sale' takes the form of an active auction, a management buy-out, or a 'restructuring'").

In Macmillan, the Supreme Court made clear that the formal structure of the transaction does not control the determination of whether the board's Revlon duties have been triggered. The essence of the inquiry is the effect of the transaction upon the stockholders and the corporation and the degree to which the transaction works a substantial change on the nature of the stockholders' equity investment.

Here, Time stockholders are transferring control in Time. Under the terms of the merger, Time stockholders will become minority stockholders, just as the American Standard stockholders would have become minority stockholders pursuant to a recapitalization. Unlike the stockholders in American Standard, however, who were to receive a cash dividend payment and other value in the recapitalization, Time stockholders will receive no direct benefit from the merger. Indeed, since the Time board has agreed, in effect, to accept a discounted exchange ratio, the Time stockholders appear to be losing value as a result of the merger.

Judged under the Revlon standard, the lock-up at issue in this case is significantly worse than those at issue in Revlon, Holly Farms or Macmillan. In each of those cases, unlike in the present case, lock-ups were granted only after there had been some negotiation with competing bidders and some effort to solicit higher offers for stockholders. In the present case, the lock-up was granted without any effort to consider or obtain alternative bids either before the Merger Agreement was executed or afterwards.

In these circumstances, Time stockholders deserve the same protection extended to Revlon stockholders. Having decided to radically alter the corporate structure by proposing a merger that will result in Time stockholders giving up control at a loss, the Time directors have a duty to assure that market forces will "operate freely to bring the target's shareholders the highest price available for their equity." Revlon, 506 A.2d at 184. The exchange of shares with Warner pursuant to the Lock-Up Stock Swap will interfere with market forces and preclude Time stockholders from achieving the best price for their shares. The exchange therefore violates the directors' duties under Revlon and must be enjoined.[5/]

B. The Lock-Up Stock Swap Is an Improper Defensive Device

Even if this court were to find that the "merger" agreement does not trigger Revlon responsibilities, the directors of Time do not have unlimited discretion to implement anti-takeover devices. Under the standard set forth in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), directors have the burden of establishing (1) a threat to the company, and (2) that the anti-takeover device is reasonable in relation to the threat. See Henley Group, Inc. v. Santa Fe Southern Pacific Corp., C.A. No. 9589, Jacobs, V.C., slip op. at 34 (Del. Ch. Mar. 11, 1988) (applying Unocal analysis to anti-takeover device).

The Lock-Up Stock Swap is an anti-takeover device whose only purpose is to deter competing bids. The fact that Time directors modified the Lock-Up to provide that the exchange would take place only in the event of a competing bid following the SEC's ruling vividly demonstrates the true purpose of the Lock-Up.

Although the actual Lock-Up Stock Swap was entered into before the Plaintiffs' offer was announced, the share

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5/ As a knowing participant in a breach of fiduciary duty, Warner cannot be heard to complain about an injunction that would prevent the consummation of the illegal plan. See Ivanhoe Partners v. Newmont Mining Corporation, 535 A.2d 1334, 1344 (Del. 1987) (one who knowingly joins in breach of fiduciary duties is also liable for breach).

exchange contemplated by the agreement will not take place until after that announcement. Indeed, it is a doomsday machine specifically triggered by that announcement. Thus, if the exchange does take place, it will be in direct response to the Plaintiffs' offer. As a blatant anti-takeover device, therefore, the Lock-Up Stock Swap must be evaluated under the Unocal standard.

1. Plaintiffs' All Cash Offer Poses No Threat to Time Stockholders

The stock swap is triggered by any bid for more than 25% of Time regardless of the price, structure or terms of that bid. Apparently, the directors of Time perceived any bid for Time (other than the favored merger) as a "threat." However, when Time and Warner entered into the Lock-Up Stock Swap on March 3, 1989, Defendants had no reasonable basis for believing that any offer, regardless of its terms, would pose a threat to Time. Moreover, when the Lock-Up Stock Swap was amended following the SEC ruling, Defendants again had no reasonable basis for believing that any threat existed or that the possibility of any threat justified a response that forecloses all competing offers. Thus, by authorizing and approving the Lock-Up Stock Swap and its subsequent amendment, the Time board breached its Unocal duties.

Now that Plaintiffs have announced an actual offer, the Time directors have no reasonable grounds whatsoever for believing that the offer poses a threat to Time or its shareholders. The offer is an all cash offer for all of the company's shares with a back-end commitment at the same price in cash.

In Shamrock Holdings, Inc. v. Polaroid Corp., C.A. Nos. 10,075, 10,079, 10,582 and 10,585, Berger, V.C., slip op. (Del. Ch. March 17, 1989), the court noted that the only possible "threat" posed by an all cash offer is that the price might be inadequate. Even in that case, Vice Chancellor Berger explained that:

> It is difficult to understand how, as a general matter, an inadequate all cash, all shares tender offer . . . can be considered a continuing threat under Unocal.

Id. at 29.

Here, of course, the all cash offer is neither coercive nor inadequate. The offer provides a $66 premium over the pre-"merger" market price and all stockholders will be treated equally. Indeed, what Plaintiffs seek is to have Time stockholders, free of the coercive impediment of the Lock-Up Stock Swap, decide which proposed transaction they prefer.

Clearly, the real threat to Time stockholders is the possibility that Plaintiffs will be forced to withdraw their premium offer if the share exchange occurs. In that case, the stockholders will have been denied an opportunity to obtain the highest value for their shares.

2. The Transfer of $1.25 Billion in Time Stock is Not a Reasonable Response to Plaintiffs' Offer

Given the absence of any threat posed by Plaintiffs' offer, the transfer of a massive block of Time stock to Warner cannot possibly be a reasonable response to

Plaintiffs' offer.[6/] The transfer -- replete with its negative accounting consequences -- serves no conceivable corporate purpose and provides absolutely no benefit to Time stockholders. In fact, by deterring all bids for the company, the Lock-Up Stock Swap unreasonably denies Time stockholders the opportunity to consider alternatives. Further, the share exchange threatens to leave Time shareholders with neither the proposed merger nor the Paramount bid, but only with the dilution that the stock swap creates.

Where anti-takeover devices have operated to prevent stockholders from considering a noncoercive, all cash offer as an alternative to management proposed transactions, such devices have been stricken as unreasonable. For example, in AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, the Court enjoined a self tender for shares by a target that prevented the stockholders from choosing a superior offer made by an unsolicited bidder. The Court held that, in the face of an all cash offer at a concededly fair price, any alternative to the offer by management must allow the stockholders the ability to choose between the two alternatives.

Similarly, in Bass Group, the Court granted a temporary restraining order against a management sponsored recapitalization that would have denied stockholders an

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6/ As noted above, either Time or Warner may trigger the share exchange now that Plaintiffs have announced an offer for Time. Thus, if triggered, the share exchange will be a direct response to Plaintiffs' offer.

opportunity to choose a tender offer of higher value. The court stated:

> With respect to the reasonableness of the response, the record indicates that the board had available less drastic weapons to resist a coercive or inadequate offer. What requires exploration is why the board found it necessary to respond with a restructuring that, insofar as this record indicates, may well be worth less to shareholders than the present Bass proposal and that would preclude consideration of that proposal by shareholders, all without the shareholders having an opportunity for a choice on the matter.

Bass Group, transcript at 16.

The target's board attempted to justify the recapitalization as a transaction that would improve the long-run value of the company and provide increased incentives for efficient management. In its later opinion preliminarily enjoining the recapitalization plan, the court rejected these arguments noting:

> [T]hese rationales, even if accepted, do not justify forcing shareholders to accept an economically inferior transaction while, at the same time, precluding them from considering an economically superior one.

Robert M. Bass Group, Inc. v. Evans, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,924, at 90,200 Jacobs, V.C. (Del. Ch. July 14, 1988).

In other cases reviewing the reasonableness of measures taken in response to control threats, the Delaware courts have been particularly skeptical of share transfers accomplished for the purpose of defeating challenges to an incumbent board or management. Where the transfer (or issuance) of stock serves no legitimate corporate purpose, i.e., raising necessary or desirable capital, the courts have not hesitated to enjoin such transfer. As Vice Chancellor Jacobs explained in Packer v. Yampol, C.A. No. 8432, slip op. at 14 (Del. Ch. April 18, 1986):

> In cases where management has wrongfully attempted to perpetuate itself in office by issuing securities that would adversely impact on a shareholder legitimately seeking to obtain majority control or to assert majority control already obtained, this Court has not hesitated to grant appropriate relief against such conduct.

See also EAC Industries v. Frantz Manufacturing Company, C.A. No. 8003, Walsh, V.C., slip op. (Del. Ch. June 28, 1985) (no purpose for transfer other than diluting majority control); Phillips v. Insituform of North America, Inc., C.A. No. 9173, Allen, C., slip op. (Del. Ch. August 22, 1987) (not reasonable to issue shares for admitted purpose of impeding the exercise of stockholder rights).

Here, the Lock-Up Stock Swap has precisely the same consequence as the anti-takeover measure found to be offensive in Bass Group: it precludes Time stockholders from considering an offer economically superior to management's chosen transaction. Moreover, the Lock-Up Stock Swap is clearly intended to block any attempt by Plaintiffs to seek control of Time. By transferring a block of shares to friendly hands, the Lock-Up Stock Swap will dilute Plaintiffs' holdings and provide a means for Defendants to impede Plaintiffs by making it virtually impossible for Plaintiffs to obtain the supermajority and majority of the minority approval required by Article V of the Certificate to complete a business combination. If successful in their efforts to preclude alternatives to the merger transaction, Defendants will perpetuate their own control, since, under the terms of the Merger Agreement, the current senior management and a majority of the boards of both Warner and Time are assured of similar positions in Time Warner. Where, as here, the issuance of stock provides no economic benefit to the issuer and serves only to deprive all stockholders of an opportunity to maximize the value of their shares, that action cannot be reasonable.

In summary, the Lock-Up Stock Swap fails the Unocal test because it is not a reasonable response to any conceivable "threat" posed by Plaintiffs' offer.

CONCLUSION

If not temporarily enjoined, the Lock-Up Stock Swap will cause immediate irreparable harm: Plaintiffs will lose the opportunity to make a premium offer for Time, and Time stockholders will lose the opportunity to achieve the highest value for their shares. Plaintiffs' challenges to the Lock-Up Stock Swap raise colorable and litigable claims. Plaintiffs, therefore, respectfully request that this Court issue a temporary restraining order in the form presented and grant such further and different relief as this Court deems just and proper.

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