ORIGINAL
NEW APPLICATION

0000041220

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
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IN THE MATTER OF JOINT APPLICATION AND PETITION FOR WAIVER OF TIME WARNER NY CABLE LLC, TIME WARNER CABLE INFORMATION SERVICES (ARIZONA), LLC, AND ACC TELECOMMUNICATIONS, LLC, FOR APPROVAL OF ASSIGNMENT OF ASSETS	Docket No. T-04282A-06-0161 T-20448A-06-0161 T-20449A-06-0161

JOINT APPLICATION AND PETITION FOR WAIVER

(Expedited Consideration Requested)

By this Joint Application and Petition for Waiver ("Application"), and pursuant to A.R.S. § 40-285, Time Warner NY Cable LLC ("TWNY"), Time Warner Cable Information Services (Arizona), LLC, d/b/a Time Warner Cable ("TWCIS"), and ACC Telecommunications, LLC ("ACC Telecom") (collectively, "Applicants"), request Commission consent to the proposed assignment from ACC Telecom to TWNY, and, immediately thereafter, to TWCIS, of certain customer contracts and related assets of ACC Telecom used in connection with the provision of intrastate telecommunications services in Arizona (the "Transaction").

Applicants also request that the Commission waive any applicable "anti-slamming" regulations that the Transaction potentially could violate in the absence of a waiver and in the absence of individual subscriber authorizations. In particular, Applicants hereby request that the Commission waive A.A.C. R14-2-1904 and R14-2-1905, to the extent these rules apply to the Transaction. Applicants submit as

Exhibit 1 to this Application, for the Commission's consideration, a copy of the form customer notification letter that TWCIS intends to provide to the three affected subscribers. This notice fulfills the Federal Communications Commission's regulations governing a telecommunications carrier's acquisition of another carrier's subscriber base without obtaining each subscriber's authorization and verification for the change in provider.

I. BRIEF OVERVIEW

The Arizona customers affected by this Application are few in number. As described more specifically below, only three non-residential, point-to-point dedicated transport customers will be transferred from ACC Telecom to TWNY, and, immediately thereafter, to TWCIS. These customers purchase only data telecommunications services from ACC Telecom and receive no voice services. This Transaction will cause no change to the terms and conditions of the services provided to these customers. The three customers affected are located in and around the cities of Yuma and San Luis, in southwestern Arizona.

II. DESCRIPTION OF THE TRANSACTION

On June 25, 2002, Adelphia Communications Corporation ("Adelphia") filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code. On April 20, 2005, Adelphia, TWNY, a wholly-owned subsidiary of Time Warner Cable Inc. ("TWC"), and Comcast Corporation ("Comcast") entered into an Asset Purchase Agreement pursuant to which TWNY and Comcast propose to acquire substantially all of the assets of Adelphia and its affiliates and subsidiaries, including Adelphia's cable television systems and other facilities, equipment and personnel used in markets across the United States. The transaction is valued in excess of $17 billion.

Pursuant to the Agreement, it is anticipated that substantially all of Adelphia's operations, including those of ACC Telecom, will be transferred to TWNY and to certain Comcast affiliates. In Arizona, TWNY will acquire the regulatory authorizations and customer contracts held by ACC Telecom related to the provision of regulated telecommunications services in the state. TWNY thereafter will assign those assets to TWCIS. The network assets used to deliver services to ACC Telecom customers, which today are part of the cable facilities owned and controlled by Adelphia, will be acquired by TWNY and assigned to TWC for use by TWCIS. TWCIS therefore will effectively be stepping into the shoes of ACC Telecom in all material respects and ACC Telecom will no longer offer regulated telecommunication services in the state. Organizational charts illustrating the corporate ownership chain leading to the regulated utility in Arizona both before and after the Transaction are attached as Exhibit 2.

TWCIS will assume responsibility for fulfilling, during their remaining terms, the customer contracts held today by ACC Telecom to provide Arizona subscribers with intrastate telecommunications services regulated by the Commission.

Applicants respectfully request the Commission's expedited approval for the Transaction as described herein.

III. DESCRIPTION OF APPLICANTS AND RELATED ENTITIES

A. Adelphia Communications Corporation

Adelphia is the fifth largest cable operator in the United States. As of the end of 2004, Adelphia's consolidated managed cable operations served more than five million basic subscribers. Adelphia anticipates exiting bankruptcy late in the second quarter of 2006 and plans to immediately sell its assets to TWNY and Comcast upon bankruptcy court approval.

B. ACC Telecom

ACC Telecom is a wholly-owned subsidiary of Adelphia that provides telecommunications services in Arizona. The Commission is aware of ACC Telecom's existing telecommunications operations in the state, and ACC Telecom's application to formalize its authority to provide such service is pending in Docket No. T-04282A-04-0763. ACC Telecom's application has been pending since its file date on October 22, 2004. Following the hearing on ACC Telecom's application, a special briefing was requested by the presiding judge, and a supplemental staff report was issued January 20, 2006.

C. TWC

TWC is a division of Time Warner Inc., a publicly-traded media and entertainment company with a market capitalization as of February 2006 in excess of $79 billion. A copy of Time Warner Inc.'s most recent Form 10-K, which contains detailed financial information about the company, is attached to this Application as Exhibit 3. Pursuant to the completion of the various transactions described above, TWC also will become a publicly-traded company, with Time Warner Inc. holding 82 percent of TWC's common stock. TWC is the second largest cable operator in the United States, owning or managing cable systems serving approximately 10.9 million subscribers in 27 states.

D. TWNY

TWNY is a wholly-owned subsidiary of TWC, established for the purpose of completing the Transaction and other transactions contemplated by the Agreement.

E. TWCIS

TWCIS is a wholly-owned subsidiary of TWNY, and is authorized to do business in Arizona as a foreign LLC. At this time, TWCIS intends to assume responsibility for the provision of only those services being provided by ACC Telecom.

III. CONTACT INFORMATION

For the purposes of this Application, contacts for the Applicants are as follows:

For TWNY and TWCIS:	For ACC Telecom:
Julie Y. Patterson Vincent M. Paladini Time Warner Cable Information Services (Arizona), LLC 290 Harbor Drive Stamford, CT 06902 Phone: 203-328-0600 Fax: 203-328-4042 e-mail: julie.patterson@twcable.com vincent.paladini@twcable.com	Jo Gentry Adelphia Communications Corporation ACC Telecommunications, LLC 5619 DTC Parkway, Suite 800 Greenwood Village, CO 80111 Phone: 303-268-6684 Fax: 720-293-0222 e-mail: jo.gentry@adelphia.com
Joan S. Burke Osborn Maledon, P.A. 2929 North Central Avenue, Suite 2100 Phoenix, AZ 85012 Tel: 602-640-9356 Fax: 602-640-6074 e-mail: jburke@omlaw.com	Daniel Waggoner Davis Wright Tremaine 2600 Century Square 1501 Fourth Avenue Seattle, WA 98101-1688 Phone: 206-622-3150 Fax: 206-628-7699 e-mail: danielwaggoner@dwt.com
Yaron Dori Matthew F. Wood Hogan & Hartson LLP 555 Thirteenth Street, NW Washington, DC 20004 Phone: 202-637-5458 Fax: 202-637-5910 e-mail: ydori@hhlaw.com mfwood@hhlaw.com	

IV. PUBLIC INTEREST STATEMENT

The Transaction will serve the public interest. As part of its exit from bankruptcy, Adelphia and its subsidiaries will no longer be in a position to provide the services currently being provided by ACC Telecom. TWCIS's ultimate acquisition of the ACC Telecom business, subject to the completion of the Transaction and *pro forma* assignment of Adelphia's Arizona customer contracts from TWNY to TWCIS, will ensure that ACC Telecom customers continue to receive high-quality service without interruption, under the same terms and conditions for the duration of each applicable service contract. The Transaction will not adversely affect competition in Arizona because TWCIS currently does not provide service within the state and therefore effectively will be stepping into the shoes of ACC Telecom.

The post-Transaction entity will better serve existing and new customers in Arizona. The Transaction will generate substantial cost savings because of the existing resources of TWCIS and its corporate parent, TWC, with direct efficiencies that will be passed on to customers.

V. <u>PETITION FOR WAIVER</u>

Applicants request a waiver at this time of any of the Commission's applicable "anti-slamming" regulations that the Transaction potentially could violate in the absence of a waiver and in the absence of individual subscriber authorizations. In particular, Applicants hereby request that the Commission waive A.A.C. R14-2-1904 and R14-2-1905, concerning Authorized Telecommunications Company Change Procedures and Verification of Orders for Telecommunications Service, as these rules may apply to the Transaction. Attached to this Application as Exhibit 1 is a copy of the form customer notification letter that TWCIS intends to provide to the three ACC Telecom subscribers that will be affected by the Transaction.

Following guidelines adopted by the Federal Communications Commission, TWCIS will provide timely notice to all affected subscribers that the rates, terms, and conditions of service in existing customer contracts will not change as a result of the Transaction.

VI. CONCLUSION

For the reasons stated above, Applicants respectfully submit that the public interest, convenience and necessity would be furthered by grant of this Application pursuant to A.R.S. 40-285. Moreover, in light of the need to ensure continuity of service to ACC Telecom's customers, Applicants request expedited approval of this Application along with a waiver of any other applicable statutory or regulatory requirements, so that Applicants may complete the Transaction immediately upon bankruptcy court approval.

RESPECTFULLY SUBMITTED this 10th day of March, 2006.

TIME WARNER NY CABLE LLC

TIME WARNER CABLE INFORMATION SERVICES (ARIZONA), LLC

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ACC TELECOMMUNICATIONS, LLC

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ORIGINAL +13 copies filed this
10th day of March, 2006:

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, AZ 85007

COPY of the foregoing hand-delivered
this 10th day of March, 2006, to:

Ernest G. Johnson, Director
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Maureen Scott
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Teena Wolfe
Administrative Law Judge
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Brenda Wendt
____

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DRAFT

Dear Customer:

YOUR ACC TELECOMMUNICATIONS, LLC SERVICES WILL BE TRANSFERRED TO TIME WARNER CABLE BY [transfer date – 30 days] UNLESS YOU CHOOSE A NEW SERVICE PROVIDER

Thank you for being a loyal ACC Telecommunications, LLC customer. After many years of providing regulated telephone services in Arizona, we now plan to exit the market. As of [DATE], 2006, ACC Telecommunications, LLC ("ACC Telecom"), will no longer be providing data services in Arizona. ACC Telecom is in the process of selling (has sold) its Arizona regulated telecommunications assets to Time Warner Cable Information Services (Arizona), LLC d/b/a Time Warner Cable ("Time Warner Cable"), an affiliate of Time Warner Cable. This provider transition from ACC Telecom to Time Warner Cable requires no action on your part.

As your new service provider, Time Warner Cable will continue to provide you with the same telecommunications services you currently receive in accordance with the rates, terms and conditions of your existing contract or effective tariffs on file with the Arizona Corporation Commission. If in the future Time Warner Cable determines that rates, terms, or conditions require modification, it will follow the contract terms or the Arizona Corporation Commission rules regarding such changes, including, where required, written 30 day notice to customers. ACC Telecom will continue to be responsible for the resolution of any complaints filed or otherwise raised until the sale is finalized.

The transfer of your service to Time Warner Cable will be invisible to you because Time Warner Cable will utilize the same facilities that currently serve your account. Moreover, there will be no change in your services. The transfer of your services to Time Warner Cable will be seamless and without down time or modification to existing services or rates. This transfer requires no action on your part and the only difference will be the name of the carrier on the monthly bill you receive for your telecommunications services. The local ACC Telecom employees who service your account today will also transfer to Time Warner Cable and will continue to provide you the excellent service that you have experienced to date.

Instead of becoming a Time Warner Cable customer, you may, in accordance with the terms of your contract, select another service provider on or before ________[Transfer date – 30 days]. If you do not select another provider Time Warner Cable will automatically become your service provider effective ___________. You will not incur any charges for the change to Time Warner Cable. However, should you select another provider, you may incur additional charges. Please be aware that you are responsible for paying all bills rendered to you by ACC Telecom during this transition. You may be subject to termination of your service in accordance with the terms of your contract and applicable Commission rules if you fail to pay your telephone bill.

If you do not want service from Time Warner Cable you must select a new provider as soon as possible. Otherwise, you need do nothing and your service will seamlessly transfer to Time Warner Cable.

If you have any questions regarding this notice please call 888-XXX-XXXX.

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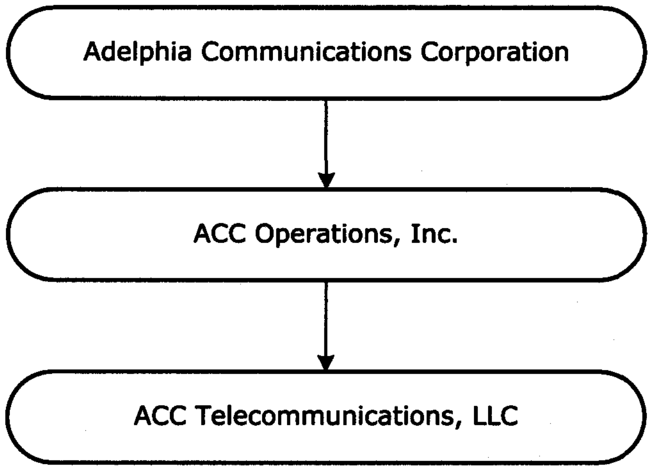
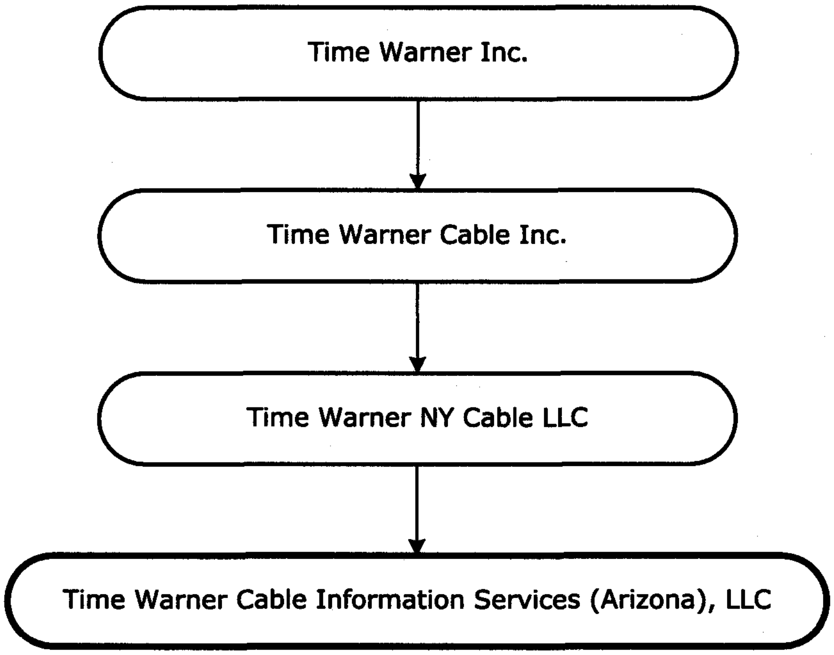
Pre-Transfer



Post-Transfer



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TIME WARNER INC.
CONSOLIDATED BALANCE SHEET
December 31,
(millions)

	2005	2004
ASSETS		
Current assets		
Cash and equivalents	$ 4,220	$ 6,139
Restricted cash	—	150
Receivables, less allowances of $2.225 and $2.109 billion	6,411	5,512
Inventories	1,806	1,737
Prepaid expenses and other current assets	1,026	920
Total current assets	13,463	14,458
Noncurrent inventories and film costs	4,916	4,415
Investments, including available-for-sale securities	3,518	4,703
Property, plant and equipment, net	13,676	13,094
Intangible assets subject to amortization, net	3,522	3,892
Intangible assets not subject to amortization	39,813	39,656
Goodwill	40,416	39,667
Other assets	3,151	3,273
Total assets	$ 122,475	$ 123,158
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 1,380	$ 1,339
Participations payable	2,426	2,452
Royalties and programming costs payable	1,074	1,018
Deferred revenue	1,473	1,653
Debt due within one year	92	1,672
Other current liabilities	6,100	6,468
Current liabilities of discontinued operations	43	50
Total current liabilities	12,588	14,652
Long-term debt	20,238	20,703
Deferred income taxes	15,138	14,943
Deferred revenue	681	749
Mandatorily convertible preferred stock	—	1,500
Other liabilities	5,324	4,288
Noncurrent liabilities of discontinued operations	7	38
Minority interests	5,784	5,514
Commitments and contingencies (Note 17)		
Shareholders' equity		
Series LMCN-V common stock, $0.01 par value, 87.2 and 105.7 million shares outstanding	1	1
Time Warner common stock, $0.01 par value, 4.498 and 4.483 billion shares outstanding	45	45
Paid-in-capital	155,927	156,252
Accumulated other comprehensive income (loss), net	(64)	106
Accumulated deficit	(93,194)	(95,633)
Total shareholders' equity	62,715	60,771
Total liabilities and shareholders' equity	$ 122,475	$ 123,158

See accompanying notes.

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TIME WARNER INC.
CONSOLIDATED STATEMENT OF OPERATIONS
Years Ended December 31,
(millions, except per share amounts)

	2005	2004	2003
Revenues:			
Subscription	$ 22,222	$ 21,605	$ 20,448
Advertising	7,612	6,955	6,180
Content	12,615	12,350	11,446
Other	1,203	1,179	1,489
Total revenues[(a)]	43,652	42,089	39,563
Costs of revenues[(a)]	(25,075)	(24,449)	(23,422)
Selling, general and administrative[(a)]	(10,478)	(10,274)	(9,778)
Amortization of intangible assets	(597)	(626)	(640)
Amounts related to securities litigation and government investigations	(2,865)	(536)	(56)
Merger-related and restructuring costs	(117)	(50)	(109)
Asset impairments	(24)	(10)	(318)
Gains on disposal of assets, net	23	21	14
Operating income	4,519	6,165	5,254
Interest expense, net[(a)]	(1,266)	(1,533)	(1,734)
Other income, net	1,124	521	1,210
Minority interest expense, net	(285)	(246)	(214)
Income before income taxes, discontinued operations and cumulative effect of accounting change	4,092	4,907	4,516
Income tax provision	(1,187)	(1,698)	(1,370)
Income before discontinued operations and cumulative effect of accounting change	2,905	3,209	3,146
Discontinued operations, net of tax	—	121	(495)
Income before cumulative effect of accounting change	2,905	3,330	2,651
Cumulative effect of accounting change, net of tax	—	34	(12)
Net income	$ 2,905	$ 3,364	$ 2,639
Basic income per common share before discontinued operations and cumulative effect of accounting change	$ 0.62	$ 0.70	$ 0.70
Discontinued operations	—	0.03	(0.11)
Cumulative effect of accounting change	—	0.01	—
Basic net income per common share	$ 0.62	$ 0.74	$ 0.59
Average basic common shares	4,648.2	4,560.2	4,506.0
Diluted income per common share before discontinued operations and cumulative effect of accounting change	$ 0.62	$ 0.68	$ 0.68
Discontinued operations	—	0.03	(0.11)
Cumulative effect of accounting change	—	0.01	—
Diluted net income per common share	$ 0.62	$ 0.72	$ 0.57
Average diluted common shares	4,710.0	4,694.7	4,623.7
Cash dividends declared per share of common stock	$ 0.10	$ —	$ —

(a) Includes the following income (expenses) resulting from transactions with related companies:

	2005	2004	2003
Revenues	$ 283	$ 282	$ 415
Costs of revenues	(206)	(158)	(132)
Selling, general and administrative	36	32	23
Interest income, net	35	25	19

See accompanying notes.

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TIME WARNER INC.
CONSOLIDATED STATEMENT OF CASH FLOWS
Years Ended December 31,
(millions)

	2005	2004	2003
OPERATIONS			
Net income[(a)]	$ 2,905	$ 3,364	$ 2,639
Adjustments for noncash and nonoperating items:			
Cumulative effect of accounting change, net of tax	—	(34)	12
Depreciation and amortization	3,277	3,207	3,139
Amortization of film costs	3,513	3,547	2,959
Asset impairments	25	10	318
Gain on investments and other assets, net	(1,086)	(432)	(598)
Equity in (income) losses of investee companies, net of cash distributions	(14)	20	154
Amounts related to securities litigation and government investigations	111	300	—
Changes in operating assets and liabilities, net of acquisitions:			
Receivables	(552)	(853)	(310)
Inventories	(3,910)	(3,841)	(3,707)
Accounts payable and other liabilities	(598)	(36)	(120)
Other balance sheet changes	1,304	1,364	1,270
Adjustments relating to discontinued operations	(10)	2	845
Cash provided by operations[(b)(c)]	4,965	6,618	6,601
INVESTING ACTIVITIES			
Investments and acquisitions, net of cash acquired	(680)	(877)	(570)
Investments and acquisitions from discontinued operations	—	—	(52)
Capital expenditures and product development costs from continuing operations	(3,246)	(3,024)	(2,761)
Capital expenditures from discontinued operations	—	—	(126)
Investment proceeds from available-for-sale securities	991	532	1,079
Investment proceeds from discontinued operations	—	—	1,056
Other investment proceeds	439	2,866	1,451
Cash provided (used) by investing activities	(2,496)	(503)	77
FINANCING ACTIVITIES			
Borrowings	6	1,320	2,371
Debt repayments	(1,995)	(4,523)	(7,109)
Redemption of redeemable preferred securities of subsidiary	—	—	(813)
Proceeds from exercise of stock options	307	353	372
Principal payments on capital leases	(118)	(191)	(178)
Repurchases of common stock	(2,141)	—	—
Dividends paid	(466)	—	—
Other	19	25	(11)
Cash used by financing activities	(4,388)	(3,016)	(5,368)
INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(1,919)	3,099	1,310
CASH AND EQUIVALENTS AT BEGINNING OF PERIOD	6,139	3,040	1,730
CASH AND EQUIVALENTS AT END OF PERIOD	$ 4,220	$ 6,139	$ 3,040

(a) Includes net income (loss) from discontinued operations of $121 million in 2004 and $(495) million in 2003.

(b) 2005 reflects $2.754 billion in payments related to securities litigation and the government investigations. 2004 reflects $236 million in payments related to securities litigation and the government investigations.

(c) 2005 includes an approximate $36 million use of cash related to changing the fiscal year end of certain international operations from November 30 to December 31.

See accompanying notes.

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TIME WARNER INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(millions)

	Common Stock	Paid-In Capital	Retained Earnings (Accumulated Deficit)	Total
BALANCE AT DECEMBER 31, 2002	$ 45	$155,134	$ (102,188)	$ 52,991
Net income	—	—	2,639	2,639
Foreign currency translation adjustments	—	—	(77)	(77)
Unrealized loss on securities, net of $34 million tax benefit[(a)]	—	—	(50)	(50)
Realized and unrealized losses on derivative financial instruments, net of $9 million tax benefit	—	—	(6)	(6)
Reversal of unfunded accumulated benefit obligation, net of $180 million income tax provision	—	—	270	270
Comprehensive income	—	—	2,776	2,776
Shares issued pursuant to stock options, restricted stock and benefit plans, including $23 million income tax benefit	1	445	—	446
BALANCE AT DECEMBER 31, 2003	46	155,579	(99,412)	56,213
Net income	—	—	3,364	3,364
Foreign currency translation adjustments	—	—	(66)	(66)
Unrealized gain on securities, net of $388 million tax provision[(b)]	—	—	582	582
Realized and unrealized losses on derivative financial instruments, net of $0.6 million tax provision	—	—	1	1
Reversal of unfunded accumulated benefit obligation, net of $3 million income tax provision	—	—	4	4
Comprehensive income	—	—	3,885	3,885
Shares issued pursuant to stock options, restricted stock and benefit plans, including $244 million income tax benefit	—	673	—	673
BALANCE AT DECEMBER 31, 2004	46	156,252	(95,527)	60,771
Net income	—	—	2,905	2,905
Foreign currency translation adjustments[(c)]	—	—	430	430
Change in unrealized gain on securities, net of $402 million tax benefit[(d)]	—	—	(603)	(603)
Realized and unrealized losses on derivative financial instruments, net of $14.8 million tax provision	—	—	22	22
Reversal of unfunded accumulated benefit obligation, net of $11 million income tax provision	—	—	(19)	(19)
Comprehensive income	—	—	2,735	2,735
Conversion of mandatorily convertible preferred stock	1	1,499	—	1,500
Cash dividends ($0.10 per common share)	—	—	(466)	(466)
Common stock repurchases	(1)	(2,249)	—	(2,250)
Shares issued pursuant to stock options, restricted stock and benefit plans, including $37 million income tax benefit	—	425	—	425
BALANCE AT DECEMBER 31, 2005	$ 46	$155,927	$ (93,258)	$ 62,715

(a) Includes a $218 million pretax reduction (tax effect of $87 million) related to realized gains on the sale of securities in 2003 and an increase of $11 million pretax (tax effect $4 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2003 net income.

(b) Includes a $268 million pretax reduction (tax effect of $107 million) related to realized gains on the sale of securities in 2004 and an increase of $4 million pretax (tax effect $2 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2004 net income.

(c) Includes an adjustment of $439 million for foreign currency translation related to goodwill and intangible assets, including amounts that relate to prior periods (Note 2).

(d) Includes a $959 million pretax reduction (tax effect of $384 million) related to realized gains on the sale of securities in 2005, primarily Google, and an increase of $3 million pretax (tax effect $1 million) related to impairment charges on investments that had experienced other-than-temporary declines. These changes are included in the 2005 net income.

See accompanying notes.

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business and Basis of Presentation

Description of Business

Time Warner Inc. ("Time Warner" or the "Company") is a leading media and entertainment company, whose businesses include interactive services, cable systems, filmed entertainment, television networks and publishing. Time Warner classifies its business interests into five reportable segments: *AOL:* consisting principally of interactive services; *Cable:* consisting principally of interests in cable systems that provide video, high-speed data and Digital Phone services; *Filmed Entertainment:* consisting principally of feature film, television and home video production and distribution; *Networks:* consisting principally of cable television and broadcast networks; and *Publishing:* consisting principally of magazine publishing and, subject to a pending sale, book publishing. Financial information for Time Warner's various reportable segments is presented in Note 16.

Pending Transactions

Adelphia/Comcast

Refer to Note 5 for further details.

Sale of Time Warner Book Group

On February 6, 2006, the Company announced an agreement to sell Time Warner Book Group Inc. ("TWBG") to Hachette Livre SA, a wholly-owned subsidiary of Lagardère SCA, for approximately $538 million in cash, not including working capital adjustments. This transaction is expected to close in the first half of 2006 and the Company expects to record a pretax gain of approximately $180 million to $220 million. In 2005, TWBG had revenues of $571 million and Operating Income of $74 million.

Sale of Canal Satellite Digital

On February 7, 2006, Warner Bros. Entertainment Inc. ("Warner Bros.")entered into an agreement for the sale of its equity investment interest in Canal Satellite Digital ("CSD"), a Spanish satellite pay television operator, together with its interest in Cinemania, the Spanish library movie channel, for approximately $90 million in cash and stock. This transaction is expected to close in the second quarter of 2006 and the Company expects to record a pretax equity investment gain of approximately $40 million.

Sale of Turner South

On February 23, 2006, the Company announced an agreement to sell the Turner South network ("Turner South"), a subsidiary of Turner, to Fox Cable Networks, Inc. ("Fox") for approximately $375 million in cash. This transaction is expected to close in the second or third quarter of 2006 and the Company expects to record a pretax gain of approximately $110 million to $130 million. In 2005, Turner South had revenues of $49 million and an Operating Loss of $7 million.

The WB Network

On January 24, 2006, Warner Bros. and CBS Corp. ("CBS") announced an agreement in principle to form a new fully-distributed national broadcast network, to be called The CW. At the same time, Warner Bros. and CBS are preparing to cease the standalone operations of The WB Network and UPN, respectively, at the end of the 2005/2006 television season (September 2006). Warner Bros. and CBS will each own 50% of the new network and will have joint and equal control. In addition, Warner Bros. has reached an agreement in principle with Tribune Corp. ("Tribune"), currently a subordinated 22.25% limited partner in The WB Network, under which Tribune will surrender its ownership interest in The WB Network and will be relieved

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TIME WARNER INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

of funding obligations. In addition, Tribune will become one of the principal affiliate groups for the new network.

Upon the closing of this transaction, the Company will account for its investment in The CW under the equity method of accounting. The Company anticipates that prior to the closing of this transaction the Company is expected to incur restructuring charges ranging from $15 million to $20 million related to employee terminations. In addition, the Company may incur costs in terminating certain programming arrangements that will not be contributed to the new network or utilized in another manner.

AOL-Google Alliance

During December 2005, the Company announced that America Online, Inc. ("AOL") is expanding its current strategic alliance with Google Inc. ("Google") to enhance its global online advertising partnership and make more of AOL's content available to Google users. Under the alliance, Google and AOL will continue to provide search technology to AOL's network of Internet properties worldwide. Other key aspects of the alliance include:

- Creating an AOL Marketplace through white labeling of Google's advertising technology, which enables AOL to sell search advertising directly to advertisers on AOL-owned properties;
- Expanding display advertising available for AOL to sell throughout the Google network;
- Making AOL content more accessible to Google Web crawlers;
- Collaborating in video search and showcasing AOL's premium video service within Google Video;
- Enabling Google Talk and AIM instant messaging users to communicate with each other, provided certain conditions are met; and
- Providing AOL marketing credits for promotion of AOL's content on Google's Internet properties.

In addition, Google will invest $1 billion for a 5% equity interest in a limited liability company that will own all of the outstanding equity interests in AOL. The Company expects these transactions with Google to close during the first quarter of 2006.

Amounts Related to Securities Litigation

In July 2005, the Company reached an agreement in principle for the settlement of the securities class action lawsuits included in the matters consolidated under the caption *In re: AOL Time Warner Inc. Securities & "ERISA" Litigation* described in Note 17 herein. The settlement is reflected in a written agreement between the lead plaintiff and the Company. On September 30, 2005, the court issued an order granting preliminary approval of the settlement and certified the settlement class. The court held a final approval hearing on February 22, 2006, and the parties are now awaiting the court's ruling. At this time, there can be no assurance that the settlement of the securities class action litigation will receive final court approval. In connection with reaching the agreement in principle on the securities class action, the Company established a reserve of $2.4 billion during the second quarter of 2005. Ernst & Young LLP also has agreed to a settlement in this litigation matter and will pay $100 million. Pursuant to the settlement, in October 2005, Time Warner paid $2.4 billion into a settlement fund (the "MSBI Settlement Fund") for the members of the class represented in the action. In addition, the $150 million previously paid by Time Warner into a fund in connection with the settlement of the investigation by the U.S. Department of Justice ("DOJ") was transferred to the MSBI Settlement Fund, and Time Warner is using its best efforts to have the $300 million it previously paid in connection with the settlement of its Securities and Exchange Commission ("SEC") investigation, or at least a substantial portion thereof, transferred to the MSBI Settlement Fund.

In addition to the $2.4 billion reserve established in connection with the agreement in principle regarding the settlement of the MSBI consolidated securities class action, during the second quarter of 2005, the

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Company established an additional reserve totaling $600 million in connection with the other related securities litigation matters described in Note 17 herein that are pending against the Company. This $600 million amount continues to represent the Company's current best estimate of the amounts to be paid in resolving these matters, including the remaining individual shareholder suits (including suits brought by individual shareholders who decided to "opt-out" of the settlement in the primary securities class action), the derivative actions and the actions alleging violations of The Employee Retirement Income Security Act ("ERISA"). Of this amount, subsequent to December 31, 2005, the Company has paid, or has agreed to pay, approximately $335 million, before providing for any remaining potential insurance recoveries, to settle certain of these claims.

The Company reached an agreement with the carriers on its directors and officers insurance policies in connection with the securities and derivative action matters described above (other than the actions alleging violations of ERISA). As a result of this agreement, in the fourth quarter, the Company recorded a recovery of approximately $185 million (bringing the total 2005 recoveries to $206 million), which is expected to be collected in the first quarter of 2006 and is reflected as a reduction to "Amounts related to securities litigation and government investigations" in the accompanying consolidated statement of operations for the year ended December 31, 2005.

Government Investigations

As previously disclosed by the Company, the SEC and the DOJ had been conducting investigations into accounting and disclosure practices of the Company. Those investigations focused on advertising transactions, principally involving the Company's AOL segment, the methods used by the AOL segment to report its subscriber numbers and the accounting related to the Company's interest in AOL Europe prior to January 2002. During 2004, the Company established $510 million in legal reserves related to the government investigations, the components of which are discussed in more detail in the following paragraphs.

The Company and its subsidiary, AOL, entered into a settlement with the DOJ in December 2004 that provided for a deferred prosecution arrangement for a two-year period. As part of the settlement with the DOJ, in December 2004, the Company paid a penalty of $60 million and established a $150 million fund, which the Company could use to settle related securities litigation. The fund was reflected as restricted cash on the Company's accompanying consolidated balance sheet at December 31, 2004. During October 2005, the $150 million was transferred by the Company into the MSBI Settlement Fund described above under the heading "Amounts Related to Securities Litigation."

In addition, on March 21, 2005, the Company announced that the SEC had approved the Company's proposed settlement, which resolved the SEC's investigation of the Company.

Under the terms of the settlement with the SEC, the Company agreed, without admitting or denying the SEC's allegations, to be enjoined from future violations of certain provisions of the securities laws and to comply with the cease-and-desist order issued by the SEC to AOL in May 2000. The settlement also required the Company to:

- Pay a $300 million penalty, which will be used for a Fair Fund, as authorized under the Sarbanes-Oxley Act;
- Adjust its historical accounting for Advertising revenues in certain transactions with Bertelsmann, A.G. ("Bertelsmann") that were improperly or prematurely recognized, primarily in the second half of 2000, during 2001 and during 2002; as well as adjust its historical accounting for transactions involving three other AOL customers where there were Advertising revenues recognized in the second half of 2000 and during 2001;
- Adjust its historical accounting for its investment in and consolidation of AOL Europe; and

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- Agree to the appointment of an independent examiner, who will either be or hire a certified public accountant. The independent examiner will review whether the Company's historical accounting for transactions with 17 counterparties identified by the SEC staff, principally involving online advertising revenues and including three cable programming affiliation agreements with related advertising elements, was in conformity with GAAP, and provide a report to the Company's audit and finance committee of its conclusions, originally within 180 days of being engaged. The transactions that would be reviewed were entered into between June 1, 2000 and December 31, 2001, including subsequent amendments thereto, and involved online advertising and related transactions for which revenue was principally recognized before January 1, 2002.

The Company paid the $300 million penalty in March 2005; however, it is unable to deduct the penalty for income tax purposes, be reimbursed or indemnified for such payment through insurance or any other source, or use such payment to setoff or reduce any award of compensatory damages to plaintiffs in related securities litigation pending against the Company. As described above, in connection with the pending settlement of the consolidated securities class action, the Company is using its best efforts to have the $300 million, or a substantial portion thereof, transferred to the MSBI Settlement Fund. The historical accounting adjustments were reflected in the restatement of the Company's financial results for each of the years ended December 31, 2000 through December 31, 2003, which were included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004 (the "2004 Form 10-K").

The independent examiner has begun its review, which has been extended and is expected to be completed in the second quarter of 2006. Depending on the independent examiner's conclusions, a further restatement might be necessary. It is also possible that, so long as there are unresolved issues associated with the Company's financial statements, the effectiveness of any registration statement of the Company or its affiliates may be delayed.

Basis of Presentation

Basis of Consolidation

The consolidated financial statements include 100% of the assets, liabilities, revenues, expenses and cash flows of Time Warner and all entities in which Time Warner has a controlling voting interest ("subsidiaries") and variable interest entities ("VIE") required to be consolidated in accordance with U.S. generally accepted accounting principles ("GAAP"). Intercompany accounts and transactions between consolidated companies have been eliminated in consolidation.

The financial position and operating results of substantially all foreign operations are consolidated using the local currency as the functional currency. Local currency assets and liabilities are translated at the rates of exchange on the balance sheet date, and local currency revenues and expenses are translated at average rates of exchange during the period. Resulting translation gains or losses are included in the accompanying consolidated statement of shareholders' equity as a component of Accumulated other comprehensive income, net.

The effects of any changes in the Company's ownership interests resulting from the issuance of equity capital by consolidated subsidiaries or equity investees to unaffiliated parties are accounted for as capital transactions pursuant to the SEC's Staff Accounting Bulletin No. 51, "Accounting for Sales of Stock by a Subsidiary."

Discontinued Operations

The Company disposed of its entire Music segment effective March 1, 2004. Accordingly, the Company has presented the financial condition and results of operations of the Music segment as discontinued operations for all periods presented.

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TIME WARNER INC.
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Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes thereto. Actual results could differ from those estimates.

Significant estimates inherent in the preparation of the accompanying consolidated financial statements include reserves established for securities litigation matters, accounting for asset impairments, allowances for doubtful accounts, depreciation and amortization, film ultimate revenues, home video and magazine returns, business combinations, pensions and other postretirement benefits, income taxes, contingencies and certain programming arrangements.

Recently Issued Accounting Guidance

Accounting for Rental Costs

In October 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") 13-1, "Accounting for Rental Costs Incurred during a Construction Period" ("FSP 13-1"). FSP 13-1 requires rental costs associated with ground or building operating leases that are incurred during a construction period be recognized as rental expense and included in income from continuing operations. FSP 13-1 is effective for fiscal periods beginning after December 15, 2005. The provisions of FSP 13-1 are not expected to have a material impact on the Company's consolidated financial statements.

Conditional Asset Retirement Obligations

In March 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations — an Interpretation of FASB Statement No. 143" ("FIN 47"). FIN 47 clarifies the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and/or method of settlement are conditional on a future event. The Company adopted the provisions of FIN 47 during 2005. The application of FIN 47 did not have a material impact on the Company's consolidated financial statements.

Stock-Based Compensation

In December 2004, the FASB issued FASB Statement 123 (Revised 2004), "Share-Based Payment" ("FAS 123R"). FAS 123R requires all companies to measure compensation costs for all share-based payments (including employee stock options) at fair value and recognize such costs in the statement of operations. The Company will adopt FAS 123R beginning January 1, 2006 and elect the modified retrospective method of transition. This method of transition requires that the financial statements of all prior periods be adjusted on a basis consistent with the pro forma disclosures required for those periods by FASB Statement No. 123, "Accounting for Stock-Based Compensation," the predecessor to FAS 123R. Through December 31, 2005, the Company has accounted for stock-based compensation using the intrinsic value method set forth in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). In accordance with APB 25 and related interpretations, compensation expense for stock options is generally recognized in income based on the excess, if any, of the quoted market price of the stock at the grant date of the award or other measurement date over the amount an employee must pay to acquire the stock. The compensation costs related to stock options recognized by the Company pursuant to APB 25 were minimal. As a result, the application of the provisions of FAS 123R will have a significant impact on reported net income and earnings per share. See "Stock-Based Compensation" for the pro forma impact if compensation costs for the Company's stock option plans had been determined based on the fair value method set forth in FAS 123.

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Use of Residual Method in Fair Value Determinations

In September 2004, the Emerging Issue Task Force ("EITF") issued Topic No. D-108, "Use of the Residual Method to Value Acquired Assets Other than Goodwill" ("Topic D-108"). Topic D-108 requires the direct value method, rather than the residual value method, be used to value intangible assets other than goodwill for such assets acquired in business combinations completed after September 29, 2004. Under the residual value method, the fair value of the intangible asset is determined to be the difference between the enterprise value and the fair value of all other separately identifiable assets; whereas, under the direct value method all intangible assets are valued separately and directly. Topic D-108 also requires that registrants who have applied the residual method to the valuation of intangible assets for purposes of impairment testing shall perform an impairment test using the direct value method on all intangible assets. Previously, the Company had used a residual value methodology to value cable franchise and sports franchise intangible assets. Pursuant to the provisions of Topic D-108, the income methodology used to value the cable franchises entails identifying the discrete cash flows related to such franchises and discounting them back to the valuation date. Market and income-based methodologies are used to value sports franchises. The provisions of Topic D-108 did not affect the consolidated financial statements.

Consolidation of Variable Interest Entities

Pursuant to the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities — an Interpretation of ARB No. 51," (as revised, "FIN 46R"), the Company began consolidating the operations of America Online Latin America, Inc. ("AOLA") as of March 31, 2004. AOLA is a publicly traded entity whose significant shareholders include the Company, AOL, the Cisneros Group (a private investment company) and Banco Itau (a leading Brazilian bank). AOLA provides online services principally to customers in Brazil, Mexico, Puerto Rico and Argentina. During 2005, AOLA filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code and has announced that it intends to liquidate, sell or wind up its operations. For the year ended December 31, 2005, the Company recorded a $24 million noncash goodwill impairment charge related to the wind down of AOLA's operations. The Company has no obligation to provide additional funding for AOLA's operations, and the creditors of AOLA have no recourse to the Company.

In accordance with the transition provisions of FIN 46R, the assets and liabilities of AOLA were recorded in the Company's consolidated balance sheet as of March 31, 2004, in the amounts at which they would have been carried if FIN 46R had been effective when the Company first met the conditions to be considered the primary beneficiary of AOLA. Upon consolidating the balance sheet of AOLA, the Company recorded incremental assets of approximately $85 million and liabilities of $29 million, with the difference of $56 million recognized as the pretax cumulative effect of an accounting change ($34 million on an after-tax basis). Prior periods have not been restated. The Company consolidated the operating results of AOLA's operations commencing April 1, 2004. In order to provide the time necessary to consolidate and evaluate the AOLA financial information, the AOLA financial statements are consolidated by the Company on a one-quarter time lag. For the year ended December 31, 2005 and 2004, the Company recognized revenues of $50 million and $40 million, respectively, and an Operating Loss of $11 million and $20 million, respectively, associated with AOLA.

At December 31, 2005, the Company had two entities deemed to be VIEs for which the Company is not considered the primary beneficiary. At December 31, 2005, these entities had total assets of $35 million and total liabilities of $30 million. In addition, in 2005 these entities had total revenues of $159 million and a net loss of $85 million.

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TIME WARNER INC.
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Summary of Significant Accounting Policies

Cash and Equivalents

Cash equivalents consist of commercial paper and other investments that are readily convertible into cash and have original maturities of three months or less. Cash equivalents are carried at cost, which approximates fair value.

Restricted Cash

In 2004, as part of the Company's settlement with the DOJ, the Company established a $150 million fund to be used to settle any related shareholder or securities litigation. The fund was reflected as Restricted cash on the Company's accompanying consolidated balance sheet at December 31, 2004. During October 2005, the $150 million was transferred by the Company into the MSBI Settlement Fund for the members of the class covered by the consolidated securities class action as described in Note 17.

Investments

Investments in companies in which Time Warner has significant influence, but less than a controlling voting interest, are accounted for using the equity method. This is generally presumed to exist when Time Warner owns between 20% and 50% of the investee. However, in certain circumstances, Time Warner's ownership percentage exceeds 50% but the Company accounts for the investment using the equity method because the minority shareholders hold certain rights that allow them to participate in certain operations of the business.

Under the equity method, only Time Warner's investment in and amounts due to and from the equity investee are included in the consolidated balance sheet; only Time Warner's share of the investee's earnings (losses) is included in the consolidated operating results; and only the dividends, cash distributions, loans or other cash received from the investee, additional cash investments, loan repayments or other cash paid to the investee are included in the consolidated cash flows. In circumstances in which the Company's ownership in an investee is in the form of a preferred security or otherwise senior security, Time Warner's share in the investee's income or loss is determined by applying the equity method of accounting using the "hypothetical-liquidation-at-book-value" method. Under the hypothetical-liquidation-at-book-value method, the investor's share of earnings or losses is determined based on changes in the investor's claim in the book value of the investee. Additionally, the carrying value of investments accounted for using the equity method of accounting is adjusted downward to reflect any other-than-temporary declines in value (see "Asset Impairments" below).

Investments in companies in which Time Warner does not have a controlling interest or is unable to exert significant influence are accounted for at market value if the investments are publicly traded and any resale restrictions are less than one year ("available-for-sale investments"). If there are resale restrictions greater than one year or if the investment is not publicly traded then the investment is accounted for at cost. Unrealized gains and losses on investments accounted for at market value are reported, net-of-tax, in the accompanying consolidated statement of shareholders' equity as a component of Accumulated other comprehensive income, net until the investment is sold or considered impaired (see "Asset Impairments" below), at which time the realized gain or loss is included in Other income, net. Dividends and other distributions of earnings from both at-market-value investments and investments accounted for at cost are included in Other income, net when declared.

Accounts Receivable Securitization Facilities

Time Warner has certain accounts receivable securitization facilities that provide for the accelerated receipt of cash on available accounts receivable. These securitization transactions are accounted for as sales in accordance with FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and

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Extinguishments of Liabilities — a replacement of FASB Statement No. 125" ("FAS 140"), because the Company has relinquished control of the receivables. For further information, see Note 8.

Derivative Instruments

The Company accounts for derivative instruments in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), FASB Statement No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities — an amendment of FASB Statement No. 133" ("FAS 138"), and FASB Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" ("FAS 149"). These pronouncements require that all derivative instruments be recognized on the balance sheet at fair value. In addition, these pronouncements provide that for derivative instruments that qualify for hedge accounting, changes in the fair value will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in shareholders' equity as a component of accumulated other comprehensive income, net until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. The Company uses derivative instruments principally to manage the risk associated with movements in foreign currency exchange rates, the risk that changes in interest rates will affect the fair value or cash flows of its debt obligations and equity price risk in the Company's investment holdings. See Note 15 for additional information regarding derivative instruments held by the Company and risk management strategies.

Financial Instruments

Based on the level of interest rates prevailing at December 31, 2005, the fair value of Time Warner's fixed-rate debt exceeded its carrying value by $1.531 billion (Note 8). Additionally, certain differences exist between the carrying value and fair value of the Company's other financial instruments; however, these differences are not significant at December 31, 2005. The fair value of financial instruments is generally determined by reference to market values resulting from trading on a national securities exchange or in an over-the-counter market. In cases where quoted market prices are not available, fair value is based on estimates using present value or other valuation techniques.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Additions to property, plant and equipment generally include material, labor and overhead. Depreciation, which includes amortization of capital leases, is provided generally on the straight-line method over useful lives ranging up to 40 years for buildings and related improvements and up to 16 years for furniture, fixtures and other equipment. For cable television plant upgrades and cable converters and modems, depreciation is provided generally over useful lives of 16 and 3-4 years, respectively. Time Warner evaluates the depreciation periods of property, plant and equipment to

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determine whether events or circumstances warrant revised estimates of useful lives. Property, plant and equipment, including capital leases, consists of:

	December 31, 2005	December 31, 2004
	(millions)	
Land and buildings	$ 3,292	$ 3,203
Cable television equipment	11,415	10,168
Furniture, fixtures and other equipment	7,527	6,696
	22,234	20,067
Less accumulated depreciation	(8,558)	(6,973)
Total	$ 13,676	$ 13,094

Capitalized Software Costs

Time Warner capitalizes certain costs incurred for the development of internal use software. These costs, which include the costs associated with coding, software configuration, upgrades and enhancements, are included in Property, plant and equipment in the accompanying consolidated balance sheet.

AOL's subscription services are comprised of various features, which contribute to the overall functionality of the services. AOL capitalizes costs incurred for the production of computer software that generates the functionality within its products. Capitalized costs typically include direct labor and related overhead for software produced by AOL, as well as the cost of software purchased from third parties. Costs incurred for a product prior to the determination that the product is technologically feasible (research and development costs), as well as maintenance costs for established products, are expensed as incurred. Once technological feasibility has been established, such costs are capitalized until the software has completed testing and is mass-marketed. Amortization is provided on a product-by-product basis using the greater of the straight-line method or the current year revenue as a percentage of total revenue estimates for the related software product, not to exceed five years, commencing the month after the date of the product release. Included in costs of revenues are research and development costs totaling $123 million in 2005, $134 million in 2004 and $139 million in 2003. The total net book value of capitalized software costs was $189 million and $237 million as of December 31, 2005 and December 31, 2004, respectively. Such amounts are included in Other assets in the accompanying consolidated balance sheet. Amortization of capitalized software costs was $165 million in 2005, $210 million in 2004 and $194 million in 2003.

Intangible Assets

As a creator and distributor of branded information and copyrighted entertainment products, Time Warner has a significant number of intangible assets, including cable television and sports franchises, film and television libraries and other copyrighted products, trademarks and customer subscriber lists. In accordance with GAAP, Time Warner does not recognize the fair value of internally generated intangible assets. Costs incurred to create and produce copyrighted product, such as feature films and television series, generally are either expensed as incurred or capitalized as tangible assets, as in the case of cash advances and inventoriable product costs. However, accounting recognition is not given to any increase in asset value that may be associated with the collection of the underlying copyrighted material. Additionally, costs incurred to create or extend brands, such as magazine titles and new television networks, generally result in losses over an extended development period and are recognized as a reduction of income as incurred, while any corresponding brand value created is not recognized as an intangible asset in the consolidated balance sheet. However, intangible assets acquired in business combinations accounted for under the purchase method of accounting are recorded at fair value on the Company's consolidated balance sheet.

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Asset Impairments

Investments

The Company's investments consist of fair-value investments, including available-for-sale investments, investments accounted for using the cost method of accounting and investments accounted for using the equity method of accounting. The Company regularly reviews its investment securities for impairment based on criteria that include the extent to which carrying value exceeds its related market value, the financial condition of the investee, and the intent and ability to retain the investment for a sufficient period of time to allow for recovery in the market value of the investments. For more information, see Note 6.

Long-Lived Assets

Long-lived assets are tested for impairment whenever events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Determining the extent of an impairment, if any, typically requires various estimates and assumptions including cash flows directly attributable to the asset, the useful life of the asset and residual value, if any. When necessary, we use internal cash flow estimates, quoted market prices and appraisals, as appropriate, to determine fair value.

Goodwill and Indefinite-Lived Intangible Assets

Goodwill and other indefinite-lived intangible assets, primarily certain franchise assets, trademarks and brand names, are tested annually as of December 31 and whenever events or circumstances make it more likely than not that an impairment may have occurred, such as a significant adverse change in the business climate or a decision to sell or dispose of the unit. Estimating fair value is performed by utilizing various valuation techniques, with the primary technique being a discounted cash flow. The use of a discounted cash flow model often involves the use of significant estimates and assumptions. For more information, see Note 2.

Accounting for Pension Plans

Time Warner and certain of its subsidiaries have defined benefit pension plans covering a majority of domestic employees and, to a lesser extent, international employees. Pension benefits are based on formulas that reflect the employees' years of service and compensation during their employment period and participation in the plans. The pension expense recognized by the Company is determined using certain assumptions, including the expected long-term rate of return on plan assets, the discount rate used to determine the present value of future pension benefits and the rate of compensation increases. The determination of these assumptions is discussed in more detail in Note 13.

Revenues and Costs

AOL

Subscription revenues are recognized over the period that services are provided. Advertising and Other revenues are recognized as the services are performed or when the goods are delivered. AOL generates Advertising revenues by directly selling advertising or through transaction-based arrangements. Advertising revenues related to advertising sold by AOL is generally categorized into two types of contracts: standard and nonstandard. The revenues derived from standard advertising contracts, in which AOL provides a minimum number of impressions for a fixed fee, are recognized as the impressions are delivered. The revenues derived from nonstandard advertising contracts, which provide carriage, advisory services, premier placements and exclusivities, navigation benefits, brand affiliation and other benefits, are recognized on a straight-line basis over the term of the contract, provided that AOL is meeting its obligations under the contract (e.g., delivery of impressions). In cases where refund arrangements exist, upon the expiration of the condition related to the refund, revenue directly related to the refundable fee is recognized on a straight-line basis over the remaining

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term of the agreement. Transaction-based arrangements generally involve either arrangements in which AOL performs advertising and promotion through prominent display of a customer's content or search results on one of AOL's services, or arrangements in which AOL's Advertising.com, Inc. ("Advertising.com") subsidiary purchases and resells advertising on a third-party website. As compensation for display of a partner's content or search results, AOL is paid a share of the partner's advertising revenues. For performance-based advertising, AOL is paid an agreed to fee based on customer specified results, such as registrations or sales leads. Advertising revenues related to these transaction-based arrangements is recognized when the amount is determinable (i.e., generally when performance reporting is received from the partner). Deferred revenue consists primarily of prepaid advertising fees and monthly and annual prepaid subscription fees billed in advance.

For promotional programs in which consumers are typically offered a subscription to AOL's subscription services at no charge as a result of purchasing a product from the commerce partner, AOL records Subscription revenues, based on net amounts received from the commerce partner, if any, on a straight-line basis over the term of the service contract with the subscriber.

The accounting rules for advertising barter transactions require that historical cash advertising of a similar nature exist in order to support the recognition of advertising barter revenues. The criteria used by the accounting rules used to determine if a barter and cash transaction are considered "similar" include circulation, exposure or saturation within an intended market, timing, prominence, demographics and duration. In addition, when a cash transaction has been used to support an equivalent quantity and dollar amount of barter revenues, the same cash transaction cannot serve as evidence of fair value for any other barter transaction. While not required by the accounting rules, AOL management adopted a more conservative policy by establishing an additional size criterion to the determination of "similar." Pursuant to such criterion, beginning in the second quarter of 2003, an individual cash advertising transaction of comparable average value or higher value must exist in order for revenue to be recognized on an intercompany advertising barter transaction. Said differently, no intercompany advertising barter revenue is recognized if a cash advertising transaction of comparable average value or higher value has not been entered into in the past six months, even if all of the other accounting criteria have been satisfied.

Cable

Subscriber fees (for video programming, high-speed data and Digital Phone) are recorded as revenue in the period that the service is provided, and Advertising revenues, including advertising purchased by programming vendors, are recognized in the period that the advertisements are exhibited. Video programming costs are recognized as the services are provided based on TWC Inc.'s contractual agreements with programming vendors. However, circumstances may arise for which management is required to estimate the programming costs due to the expiration of a programming contract. During periods in which a programming contract has expired and TWC Inc. continues to carry the programming vendor, management must utilize its best judgment to record the appropriate amount of programming expense. When the programming contract terms are finalized, an adjustment to programming expense is recorded, if necessary, to reflect the terms of the new contract. Management must also make estimates in the recognition of programming expense related to other items, such as the accounting for free periods, "most favored nation" clauses and service interruptions.

Launch fees received by the Company from programming vendors are recognized as a reduction of expense on a straight-line basis over the life of the related programming arrangement. Fees received from programming vendors representing the reimbursement of marketing costs specifically incurred by TWC Inc. in promoting the programming service are recognized as a reduction in marketing expense as the marketing services are provided.

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Publishing

Magazine Subscription and Advertising revenues are recognized at the magazine cover date. The unearned portion of magazine subscriptions is deferred until the magazine cover date. Upon cover date, a proportionate share of the gross subscription price is included in revenues, net of any commissions paid to subscription agents. Also included in Subscription revenues are revenues generated from single-copy sales of magazines through retail outlets such as newsstands, supermarkets, convenience stores and drugstores, which may or may not result in future subscription sales.

Certain products, such as books and other merchandise, are sold to customers with the right to return unsold items. Revenues from such sales are recognized when the products are shipped, based on gross sales less a provision for future estimated returns based on historical experience.

Inventories of books and other merchandise are stated at the lower of cost or estimated realizable value. Cost is determined using primarily the first-in, first-out method, or alternatively the average cost method. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost. See Note 7 for additional discussion of inventory.

Networks

The Networks segment recognizes Subscription revenues as services are provided based on the per subscriber negotiated contractual programming rate for each affiliate and the estimated number of subscribers at the respective affiliate.

In the normal course of business, the Networks segment enters into long-term license agreements to acquire programming rights. An asset and liability related to these rights are created (on a discounted basis) when (i) the cost of each program is reasonably determined, (ii) the program material has been accepted in accordance with the terms, and (iii) the program is available for its first showing or telecast. As discussed below, there are slight variations in the accounting depending on whether the network is advertising supported (e.g., TNT, TBS, The WB Television Network ("The WB Network") or not advertising supported (e.g., HBO).

For advertising-supported networks, the Company's general policy is to amortize the programming costs on a straight-line basis (or per play basis if greater) over the licensing period. There are, however, exceptions to this general rule. For example, because of the significance of the rights fees paid for sports programming licensing arrangements (e.g., NBA and MLB), programming costs are amortized using an income-forecast model, in which total revenue generated under the sports programming is estimated and the costs associated with this programming are amortized as revenue is earned, based on the relationship that the programming costs bear to total estimated revenues, which approximates the pattern with which the network will utilize and benefit from providing the sports programming. In addition, based on historical advertising sales, the Company believes that, for certain types of programming, the initial airing has more value than subsequent airings. In these circumstances, the Company will use an accelerated method of amortization. Additionally, if the Company is licensing the right to air a movie multiple times over a certain period and the movie is being shown to the public for the first time on a Company network (a "Premiere Movie"), a portion of the licensing cost is amortized on the initial airing of the movie, with the remaining cost amortized on a straight-line basis (or per play basis, if greater) over the remaining licensing period. The determination of the amount of amortization to accelerate in the first showing versus subsequent showings has been determined based on a study of historical advertising sales for similar programming.

For a premium cable network that is not advertising supported (e.g., HBO), programming costs are generally amortized on a straight-line basis in the year that the related shows are exhibited. When the Company has the right to exhibit feature theatrical programming in multiple windows over a number of years,

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the Company uses historical audience performance as its basis for determining the amount of a film's programming amortization attributable to each window.

The Company records programming arrangements (e.g., film inventory, sports rights, etc.) at the lower of unamortized cost or estimated net realizable value. For broadcast television networks (e.g., The WB Network) whose primary source of revenue is advertising, the Company estimates the net realizable value of unamortized cost based on the estimated advertising that can be sold during the season in which the package of programming is aired. For cable networks (e.g., TBS, TNT, etc.), that earn both Advertising and Subscription revenues, the Company evaluates the net realizable value of unamortized cost based on the package of programming provided to the subscribers by the network. Specifically, in determining whether the programming arrangements for a particular network are impaired, the Company determines the net realizable value for all of the network's programming arrangements based on a projection of the network's estimated combined subscription revenues and advertising revenues. Similarly, given the premise that customers subscribe to a premium service because of the overall quality of its programming, the Company performs its evaluation of the net realizable value of unamortized programming costs based on the package of programming provided to the subscribers by the network. Specifically, the Company determines the net realizable value for all of its premium service programming arrangements based on projections of estimated subscription revenues.

Filmed Entertainment

Feature films are produced or acquired for initial exhibition in theaters, followed by distribution in the pay-per-view, home video, pay cable, basic cable, broadcast network and syndicated television markets. Generally, distribution to the theatrical, home video, pay cable and broadcast network markets is completed principally within three years of initial release. Thereafter, feature films are distributed to the basic cable and syndicated television markets. Theatrical revenues are recognized as the films are exhibited. Revenues from home video sales are recognized at the later of the delivery date or the date that video units are made widely available-for-sale or rental by retailers based on gross sales less a provision for estimated future returns. Revenues from the distribution of theatrical product to cable, broadcast network and syndicated television markets are recognized when the films are available to telecast.

Television films and series are initially produced for broadcast networks, cable networks or first-run television syndication and may be subsequently licensed to foreign or domestic cable and syndicated television markets, as well as sold on home video. Revenues from the distribution of television product are recognized when the films or series are available to telecast, except for barter agreements where the recognition of revenue is deferred until the related advertisements are exhibited. Similar to theatrical home video sales, revenue from home video sales of television films and series is recognized at the later of the delivery date or the date that video units are made widely available-for-sale or rental by retailers less a provision for estimated returns.

License agreements for the telecast of theatrical and television product in the cable, broadcast network and syndicated television markets are routinely entered into well in advance of the available date for telecast, which is generally determined by the telecast privileges granted under previous license agreements. Accordingly, there are significant contractual rights to receive cash and barter under these licensing agreements. For cash contracts, the related revenues (which are discounted based on when cash will be collected) will not be recognized until such product is available for telecast under the contractual terms of the related license agreement. For barter contracts, the related revenues will not be recognized until the product is available for telecast and the advertising spots received under such contracts are either used or sold to third parties. All of these contractual rights for which revenue is not yet recognizable are referred to as "backlog."

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Inventories of theatrical and television product consist of videocassettes, DVDs and compact video discs and are stated at the lower of cost or net realizable value. Returned goods included in inventory are valued at estimated realizable value, but not in excess of cost.

Film costs include the unamortized cost of completed theatrical films and television episodes, theatrical films and television series in production and film rights acquired for the home video market. Film costs principally consist of direct production costs, production overhead, development and pre-production costs, and are stated at the lower of cost, less accumulated amortization, or fair value. The amount of capitalized film costs recognized as cost of revenues for a given film as it is exhibited in various markets, throughout its life cycle, is determined using the film forecast method. Under this method, the amount of capitalized costs recognized as expense is based on the proportion of the film's revenues recognized for such period to the film's estimated remaining ultimate revenues. Similarly, the recognition of expenses for participations and residuals is recognized based on the proportion of the film's revenues recognized for such period to the film's estimated remaining ultimate revenues. These estimates are revised periodically and losses, if any, are provided in full. See Note 7 for additional details of film costs.

From time to time, the Company enters into arrangements with third parties to jointly finance theatrical production. These arrangements, which are referred to as co-financing arrangements, take various forms; however, in most cases, the form of the arrangements is the sale of a copyright interest in a film to a joint venture investor. The Filmed Entertainment segment records the amounts received for the sale of the copyright interest as a reduction of the cost of the film, as such investors assume full risk for that portion of the film asset acquired in these transactions.

A portion of the costs of acquiring Historic TW Inc. ("Historic TW") in 2001 and of acquiring the remaining Time Warner Entertainment Company, L.P. ("TWE") content assets in 2003 were allocated to theatrical and television product, including purchased program rights and product that had been exhibited at least once in all markets ("Library"). Library product is amortized in amortization expense using the film-forecast method. See Note 2 for additional details of Library.

Barter Transactions

Time Warner enters into transactions that either exchange advertising for advertising ("Advertising Barter") or advertising for other products and services ("Non-advertising Barter"). Advertising Barter transactions are recorded at the lesser of estimated fair value of the advertising received or given in accordance with the provisions of EITF Issue No. 99-17, "Accounting for Advertising Barter Transactions." Revenue from barter transactions is recognized when advertising is provided, and services received are charged to expense when used. Revenues for Non-advertising Barter transactions are recognized at the estimated fair value when the product is available for telecast and the advertising spots received under such contracts are either used or sold to third parties. Revenue from barter transactions is not material to the Company's consolidated statement of operations for any of the periods presented herein.

Multiple-Element Transactions

Multiple-element transactions within Time Warner fall broadly into three categories:

1. Contemporaneous purchases and sales. The Company sells a product or service (e.g., advertising services) to a customer and at the same time purchases goods or services and/or makes an investment in that customer.
2. Sales of multiple products or services. The Company sells multiple products or services to a counterparty (e.g., Cable sells video, digital phone and high-speed Internet access services to a customer).

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3. Purchases of multiple products or services, or the settlement of an outstanding item contemporaneous with the purchase of a product or service. The Company purchases multiple products or services from a counterparty (e.g., the Networks segment licenses a group of films from a counterparty to show over a period of time).

Contemporaneous Purchases and Sales

In the normal course of business, Time Warner enters into transactions in which it purchases a product or service and/or makes an investment in a customer and at the same time negotiates a contract for the sale of advertising, or other product, to the customer. Contemporaneous transactions may also involve circumstances where the Company is purchasing or selling goods and services and settling a Company dispute. For example, the AOL segment may have negotiated for the sale of advertising at the same time it purchased goods or services and/or made an investment in a counterparty. Similarly, when negotiating programming arrangements with cable networks, the Company's Cable segment may negotiate for the sale of advertising to the cable network.

Arrangements, although negotiated contemporaneously, may be documented in one or more contracts. In accounting for such arrangements, the Company looks to the guidance contained in the following authoritative literature:

- APB Opinion No. 29, "Accounting for Nonmonetary Transactions" ("APB 29");
- FASB Statement 153, "Exchanges of Nonmonetary Assets — an amendment of APB Opinion No. 29" ("FAS 153");
- Emerging Issues Task Force ("EITF") Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer" ("EITF 01-09"); and
- EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" ("EITF 02-16").

The Company accounts for each transaction negotiated contemporaneously based on the respective fair values of the goods or services purchased and the goods or services sold. If the Company is unable to determine the fair value of one or more of the elements being purchased, revenue recognition is limited to the total consideration received for the products or services sold less supported payments. For example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously enters into an arrangement to acquire software for $2 million from the same customer, but fair value for the software cannot be reliably determined, the Company would limit the recognized advertising revenue to $8 million and would ascribe no value to the software acquisition. As another example, if the Company sells advertising to a customer for $10 million in cash and contemporaneously invests $2 million in the equity of that same customer at fair value, the Company would recognize advertising revenue of $10 million and would ascribe $2 million to the equity investment. Accordingly, the judgments made in determining fair value in such arrangements impact the amount and period in which revenues, expenses and net income are recognized over the term of the contract.

In determining the fair value of the respective elements, the Company refers to quoted market prices (where available), historical transactions or comparable cash transactions. In addition, the existence of price protection in the form of "most favored nation" clauses or similar contractual provisions are generally indicative that the stated terms of a transaction are at fair value.

Further, in a contemporaneous purchase and sale transaction, evidence of fair value for one element of a transaction may provide support for the fair value of the other element of a transaction. For example, if the Company sells advertising to a customer and contemporaneously invests in the equity of that same customer,

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evidence of the fair value of the investment may implicitly support the fair value of the advertising sold, since there are only two elements in the arrangement.

Sales of Multiple Products or Services

The Company's policy for revenue recognition in instances where multiple deliverables are sold contemporaneously to the same counterparty is in accordance with EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," and SEC Staff Accounting Bulletin No. 104, "Revenue Recognition." Specifically, if the Company enters into sales contracts for the sale of multiple products or services, then the Company evaluates whether it has objective fair value evidence for each deliverable in the transaction. If the Company has objective fair value evidence for each deliverable of the transaction, then it accounts for each deliverable in the transaction separately, based on the relevant revenue recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more undelivered elements of the transaction, the Company generally recognizes revenue on a straight-line basis over the term of the agreement. For example, the AOL division might enter into an agreement for broadband service that includes AOL providing a modem in connection with the service and the subscriber paying an upfront fee as well as monthly charges. Because AOL is providing both a product and a service, revenue is allocated to the modem and service based on relative fair value.

Purchases of Multiple Products or Services

The Company's policy for cost recognition in instances where multiple products or services are purchased contemporaneously from the same counterparty is consistent with its policy in instances where the Company sells multiple deliverables to a customer. Specifically, if the Company enters into a contract for the purchase of multiple products or services, the Company evaluates whether it has objective fair value evidence for each product or service being purchased. If the Company has objective fair value evidence for each product or service being purchased, it accounts for each separately, based on the relevant cost recognition accounting policies. However, if the Company is unable to determine objective fair value for one or more of the purchased elements, the Company generally recognizes the cost of the transaction on a straight-line basis over the term of the agreement. For example, the Networks segment licenses from a film production company the rights to a group of films and episodic series to run as content on its segment. Because the Networks segment is purchasing multiple products that will be aired over varying times and periods, the cost is allocated among the films and episodic series based on the relative fair value of each product being purchased. Each allocated amount is then accounted for in accordance with the Networks segment's accounting policy for that specific type of deliverable.

This policy would also apply in instances where the Company settles an outstanding disagreement at the same time the Company purchases a product or service from that same counterparty. For example, the Cable segment settles a dispute on an existing programming contract with a programming vendor at the same time that it is renegotiating a new programming contract with the same programming vendor. Because the Cable segment is making payments for both the settlement of an existing programming contract and for carriage under a new programming contract, the amount agreed to be paid is allocated between the settlement of the preexisting programming contract and the carriage under the new programming contract. The amount allocated to the settlement of the preexisting programming contract would be recognized immediately, whereas the amount allocated to the carriage under the new programming contract would be accounted for prospectively, consistent with the accounting for other similar programming agreements.

Gross versus Net Revenue Recognition

In the normal course of business, the Company acts as or uses an intermediary or agent in executing transactions with third parties. Pursuant to EITF No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," such transactions are recorded on a gross or net basis depending on whether the Company is acting as the principal in a transaction or acting as an agent in the transaction. The Company serves as the principal in transactions in which it has substantial risks and rewards of ownership and, accordingly, records revenue on a gross basis. For those transactions in which the Company does not have substantial risks and rewards of ownership, the Company is considered an agent in the transaction and, accordingly, records revenue on a net basis. To the extent that revenues are recorded on a gross basis, any commissions or other payments to third parties are recorded as expenses so that the net amount (gross revenues less expenses) is reflected in Operating Income. Accordingly, the impact on Operating Income is the same whether the Company records revenue on a gross or net basis.

Advertising Costs

Time Warner expenses advertising costs as they are incurred, which is when the advertising is exhibited or aired. Advertising expense to third-parties was $5.171 billion in 2005, $4.952 billion in 2004 and $4.557 billion in 2003. In addition, the Company had advertising costs of $129 million at December 31, 2005 and $145 million at December 31, 2004 recorded in Prepaid and other current assets on its consolidated balance sheet, which primarily related to prepaid advertising.

Income Taxes

Income taxes are provided using the asset and liability method prescribed by FASB Statement No. 109, "Accounting for Income Taxes." Under this method, income taxes (i.e., deferred tax assets, deferred tax liabilities, taxes currently payable/refunds receivable and tax expense) are recorded based on amounts refundable or payable in the current year and include the results of any difference between GAAP and tax reporting. Deferred income taxes reflect the tax effect of net operating loss, capital loss and general business credit carryforwards and the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial statement and income tax purposes, as determined under enacted tax laws and rates. Valuation allowances are established when management determines that it is more likely than not that some portion or all of the deferred tax asset will not be realized. The financial effect of changes in tax laws or rates is accounted for in the period of enactment. The subsequent realization of net operating loss and general business credit carryforwards acquired in acquisitions accounted for using the purchase method of accounting is recorded as a reduction of goodwill. Investment tax credits earned are offset against the cost of inventory or property acquired or produced. Research and development credits are recorded based on the amount of benefit the Company believes is probable of being earned. The majority of such research and development benefits were recorded to shareholders' equity as they resulted from stock option deductions for which such amounts are recorded as an increase to additional paid-in-capital.

Comprehensive Income (Loss)

Comprehensive income (loss) is reported on the accompanying consolidated statement of shareholders' equity as a component of retained earnings (accumulated deficit) and consists of net income (loss) and other gains and losses affecting shareholders' equity that, under GAAP, are excluded from net income (loss). For Time Warner, such items consist primarily of unrealized gains and losses on marketable equity investments, gains and losses on certain derivative financial instruments, foreign currency translation gains (losses) and unfunded accumulated benefit obligations.

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The following summary sets forth the components of other comprehensive income (loss), net of tax, accumulated in shareholders' equity (in millions):

	Foreign Currency Translation Gains (Losses)[a]	Net Unrealized Gains (Losses) on Securities	Net Derivative Financial Instrument Gains (Losses)	Net Unfunded Accumulated Benefit Obligation	Net Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2002	$ (328)	$ 122	$ (27)	$ (319)	$ (552)
2003 activity	(77)	(50)	(6)	270	137
Balance at December 31, 2003	(405)	72	(33)	(49)	(415)
2004 activity	(66)	582	1	4	521
Balance at December 31, 2004	(471)	654	(32)	(45)	106
2005 activity	430	(603)	22	(19)	(170)
Balance at December 31, 2005	$ (41)	$ 51	$ (10)	$ (64)	$ (64)

[a] 2005 includes an adjustment of $439 million for foreign currency translation related to goodwill and intangible assets, including amounts that relate to prior periods (Note 2).

Stock-Based Compensation

The Company follows FAS 123, and FASB Statement No. 148, "Accounting for Stock-Based Compensation, Transition and Disclosure." The provisions of FAS 123 allow companies either to expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in APB 25, but disclose the pro forma effect on net income (loss) had the fair value of the options been expensed. Time Warner has elected to continue to apply APB 25 in accounting for its stock option incentive plans.

The Company uses the attribution method under FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option Award Plans," in recognizing any compensation cost for its stock option incentive plans under APB 25 and in the FAS 123 pro forma disclosure below. Had compensation cost for Time Warner's stock option plans been determined based on the fair value method set forth in FAS 123 (or FAS 123R, which will be adopted on January 1, 2006), Time Warner's net income and

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basic and diluted net income per common share would have been changed to the pro forma amounts indicated below:

	Years Ended December 31,		
	2005	2004	2003
	(millions, except per share amounts)		
Net income, as reported	$ 2,905	$ 3,364	$ 2,639
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(184)	(298)	(548)
Pro forma net income	$ 2,721	$ 3,066	$ 2,091
Basic net income per share:			
As reported	$ 0.62	$ 0.74	$ 0.59
Pro forma	$ 0.59	$ 0.67	$ 0.46
Diluted net income per share:			
As reported	$ 0.62	$ 0.72	$ 0.57
Pro forma	$ 0.58	$ 0.65	$ 0.45

For purposes of applying FAS 123 for the 2005 period, the Company has refined certain of its valuation approaches and inputs and believes such refinements are consistent with valuation techniques required under FAS 123R. As guidance and interpretations in the area of equity-based compensation evolve, the Company will continually assess its methodologies and processes in this area to ensure compliance with FAS 123R. Before the first quarter of 2005, the Company estimated the expected term of an option by computing the average period of time such options would remain outstanding from the grant date to the exercise date. The historical expected term was previously computed by segregating the employee base into two groups (senior executives and all other employees). Beginning in the first quarter of 2005, the Company began to use historical exercise patterns of previously granted options in relation to stock price movements to derive an employee behavioral pattern used to forecast expected exercise dates. In evaluating expected employee exercise behavior and related expected exercise dates, the Company separated employees into four groups based on the number of options they were granted. The weighted average expected term assumption used for 2005 was 4.79 years from the date of grant as compared to 3.60 years from the date of grant for 2004 and 3.11 years from the date of grant in 2003. In addition, historically during 2004, the volatility assumption was calculated using an average of historic and implied volatilities. Expected volatility in 2003 was based on historic volatilities. Beginning in the first quarter of 2005, the Company determined the volatility assumption using implied volatilities based primarily on traded Time Warner options. The weighted average volatility assumption used for 2005 was 24.5% as compared to a weighted average volatility assumption of 34.9% for 2004 and 53.9% for 2003. Had the Company used the methodologies employed in 2004 to estimate stock option valuation assumptions, the weighted average fair value of an option granted in 2005 would have increased by approximately 1%.

Historically, the Company recognized pro forma stock-based compensation expense related to retirement-age-eligible employees over the award's contractual vesting period. During the first quarter of 2005, based on recent accounting interpretations, the Company recorded a pro forma charge related to the accelerated amortization of the fair value of options granted in prior periods to certain retirement-age-eligible employees with no subsequent substantive service requirement (e.g., no substantive non-compete agreement). As a result, pro forma stock-based compensation expense for the year ended December 31, 2005 reflects approximately $20 million, net of tax, related to the accelerated amortization of the fair value of options

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granted in prior years to certain retirement-age-eligible employees with no subsequent substantive service requirement. In May 2005, the staff of the SEC announced that companies that previously followed the contractual vesting period approach must continue following that approach prior to adopting FAS 123R and apply the recent accounting interpretation to new grants that have retirement eligibility provisions only upon adoption of FAS 123R. As a result, pro forma stock-based compensation expense related to awards granted subsequent to March 31, 2005 has been determined using the contractual vesting period. For the year ended December 31, 2005, the impact of applying the contractual vesting period approach as compared to the approach noted in the recent accounting interpretations is not significant.

Income Per Common Share

Basic income per common share is computed by dividing the net income applicable to common shares after preferred dividend requirements, if any, by the weighted average of common shares outstanding during the period. Weighted-average common shares include shares of Time Warner's common stock and Series LMCN-V common stock. Diluted income per common share adjusts basic income per common share for the effects of convertible securities, stock options, restricted stock and other potentially dilutive financial instruments, only in the periods in which such effect is dilutive.

Set forth below is a reconciliation of basic and diluted income per common share before discontinued operations and cumulative effect of accounting change:

	Years Ended December 31,		
	2005	2004	2003
	(millions, except per share amounts)		
Income before discontinued operations and cumulative effect of accounting change — basic and diluted	$ 2,905	$ 3,209	$ 3,146
Average number of common shares outstanding — basic	4,648.2	4,560.2	4,506.0
Dilutive effect of stock options and restricted stock	41.4	57.4	55.2
Dilutive effect of mandatorily convertible preferred stock	20.4	77.1	62.5
Average number of common shares outstanding — diluted	4,710.0	4,694.7	4,623.7
Income per common share before discontinued operations and cumulative effect of accounting change:			
Basic	$ 0.62	$ 0.70	$ 0.70
Diluted	$ 0.62	$ 0.68	$ 0.68

Reclassifications

Certain reclassifications have been made to the prior years' financial information to conform to the 2005 presentation.

2. GOODWILL AND INTANGIBLE ASSETS

As a creator and distributor of branded information and copyrighted entertainment products, Time Warner has a significant number of intangible assets, including cable television and sports franchises, film and television libraries and other copyrighted products, trademarks and customer lists. FAS 142 requires that goodwill and intangible assets deemed to have an indefinite useful life be reviewed for impairment at least annually.

Goodwill impairment is determined using a two-step process. The first step of the goodwill impairment test is to identify a potential impairment by comparing the fair value of a reporting unit with its carrying

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amount, including goodwill. The estimates of fair value of a reporting unit, generally the Company's operating segments, are determined using various valuation techniques, with the primary technique being a discounted cash flow analysis. A discounted cash flow analysis requires one to make various judgmental assumptions, including assumptions about future cash flows, growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company's operating segments' budget and business plans, and varying perpetual growth rate assumptions for periods beyond the long-term business plan period. Discount rate assumptions are based on an assessment of the risk inherent in the future cash flows of the respective reporting units. In estimating the fair values of its reporting units, the Company also uses research analyst estimates, as well as comparable market analyses. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not deemed impaired and the second step of the impairment test is not performed. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, the fair value of the reporting unit is allocated to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit.

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess. The estimates of fair value of intangible assets not subject to amortization are determined using various discounted cash flow valuation methodologies. The most common among these is a "relief from royalty" methodology, which is used in estimating the fair value of the Company's brands and trademarks, and income methodologies, which are used to value cable franchises. The income methodology used to value the cable franchises entails identifying the discrete cash flows related to such franchises and discounting them back to the valuation date. Market and income-based methodologies are used to value sports franchises. Significant assumptions inherent in the methodologies employed include estimates of royalty rates and discount rates. Discount rate assumptions are based on an assessment of the risk inherent in the respective intangible assets. Assumptions about royalty rates are based on the rates at which similar brands and trademarks are being licensed in the marketplace.

During 2003, the Company recorded impairment losses of $318 million to reduce the carrying value of certain intangible assets of the Turner winter sports teams and certain goodwill and intangible assets of TWBG, which were recorded at the time of the merger of AOL and Historic TW (the "AOL-Historic TW Merger"). In addition, in December 2003, the Company recognized an impairment charge of approximately $1.1 billion to reduce the carrying value of the Music segment's intangible assets, which is included in discontinued operations. These impairment charges were computed based on information received during the negotiations for sale of these businesses. The Company determined during its annual impairment reviews for goodwill, which occur in the fourth quarter, that no additional impairments existed at December 31, 2005, 2004 or 2003.

The impairment charges were noncash in nature and did not affect the Company's liquidity or result in non-compliance with respect to any debt covenants.

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A summary of changes in the Company's goodwill during the years ended December 31, 2005 and 2004 by reportable segment is as follows (millions):

	December 31, 2004	Acquisitions & Adjustments[a]	Impairment[b]	Translation Adjustments[c]	December 31, 2005
AOL	$ 3,027	$ (14)	$ (24)	$ 113	$ 3,102
Cable	1,921	(15)	—	—	1,906
Filmed Entertainment	5,218	38	—	—	5,256
Networks[d]	20,626	128	—	—	20,754
Publishing[e]	8,875	256	—	267	9,398
Total	$ 39,667	$ 393	$ (24)	$ 380	$ 40,416

	December 31, 2003	Acquisitions & Adjustments[a]	December 31, 2004
AOL[f]	$ 2,784	$ 243	$ 3,027
Cable	1,909	12	1,921
Filmed Entertainment	5,245	(27)	5,218
Networks[d]	20,742	(116)	20,626
Publishing[e]	8,779	96	8,875
Total	$ 39,459	$ 208	$ 39,667

[a] Includes changes in estimates in deferred tax assets and liabilities acquired in purchase business combinations, with the net impact of increasing goodwill by approximately $207 million in 2005 and decreasing goodwill by approximately $219 million in 2004. The adjustments affected multiple segments.

[b] Relates to the $24 million impairment charge of AOLA goodwill in the first quarter of 2005.

[c] Includes an adjustment related to periods prior to January 1, 2005. This adjustment had no impact on consolidated net income or cash flows in the current or any prior period. In addition, the adjustment is not considered material to the consolidated assets or equity of the current or any prior period.

[d] 2005 primarily includes $174 million related to changes in valuation of net deferred tax liabilities related to historical purchase business combinations offset by a $39 million reduction, net of tax, related to reversals of purchase accounting reserves as well as the adjustments discussed in (a) above. 2004 primarily includes $31 million related to the purchase of the remaining interest in Warner Channel Latin America and $29 million related to the consolidation of Cartoon Network Japan, offset by $25 million related to the sale of the winter sports teams assets as well as the adjustments discussed in (a) above.

[e] 2005 includes $111 million at the Publishing segment related to the preliminary purchase price allocation for the acquisition of the remaining ownership interest in Essence Communications Partners ("Essence") and $75 million related to the preliminary purchase price allocation for the acquisition of Grupo Editorial Expansión as well as the adjustments discussed in (a) above. 2004 primarily includes $94 million related to the purchase of an additional interest in Synapse Group, Inc as well as the adjustments discussed in (a) above.

[f] 2004 primarily includes $269 million related to the purchase of Advertising.com and $24 million related to the consolidation of AOLA, which was subsequently impaired as discussed in (b) above, as well as the adjustments discussed in (a) above.

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The Company's intangible assets and related accumulated amortization consisted of the following (millions):

	As of December 31, 2005			As of December 31, 2004		
	Gross	Accumulated Amortization[a]	Net	Gross	Accumulated Amortization[a]	Net
Intangible assets subject to amortization:						
Film library	$ 3,967	$ (1,064)	$ 2,903	$ 3,967	$ (830)	$ 3,137
Customer lists and other intangible assets [b]	2,569	(1,950)	619	2,316	(1,561)	755
Total	$ 6,536	$ (3,014)	$ 3,522	$ 6,283	$ (2,391)	$ 3,892
Intangible assets not subject to amortization:						
Cable television franchises	$ 31,368	$ (1,489)	$ 29,879	$ 31,241	$ (1,489)	$ 29,752
Sports franchises	282	(20)	262	282	(20)	262
Brands, trademarks and other intangible assets [c]	9,935	(263)	9,672	9,905	(263)	9,642
Total	$ 41,585	$ (1,772)	$ 39,813	$ 41,428	$ (1,772)	$ 39,656

(a) Amortization of customer lists and other intangible assets subject to amortization is provided generally on the straight-line method over their respective useful lives. The weighted-average useful life for customer lists is 5 years. The film library is amortized using the film forecast method. The Company evaluates the useful lives of its finite-lived intangible assets each reporting period to determine whether events or circumstances warrant revised estimates of useful lives.

(b) The change in 2005 includes $79 million related to the Truevo, Inc. acquisition for acquired technology, $34 million related to the preliminary allocation of Essence goodwill to tradename and subscriber lists, $31 million related to the Wildseed, Ltd. acquisition for acquired technology and $30 million related to foreign currency translation of intangibles at AOLE and IPC. The change in 2004 includes $206 million related to the purchase of Advertising.com for technology ($98 million), advertiser and publisher relationships ($50 million), tradename ($40 million) and non-compete agreements ($18 million).

(c) The change in 2005 includes $29 million related to intangibles at IPC. As a result of increased competition in the publishing business related to certain magazine titles, indefinite-lived tradename intangibles totaling approximately $1.3 billion will be assigned a 25 year finite life and begin to be amortized starting January 2006. The impact of amortizing such tradenames in 2006 and beyond will be approximately $50 million annually.

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3. SALE OF MUSIC SEGMENT

On October 24, 2003, the Company completed the sale of Warner Music Group's ("WMG") CD and DVD manufacturing, printing, packaging and physical distribution operations (together, "Warner Manufacturing") to Cinram International Inc. ("Cinram") for approximately $1.05 billion in cash.

On March 1, 2004, the Company sold its WMG recorded music and Warner/ Chappell music publishing operations to a private investment group ("Investment Group") for approximately $2.6 billion in cash and an option to reacquire a minority interest in the operations to be sold. This option was accounted for in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." The initial value of the consideration ascribed to the option was approximately $35 million. In the fourth quarter of 2004, the value of the option was increased to $85 million based primarily on the results of the WMG recorded music and publishing business. The $50 million increase in value was recorded in Other income, net in the 2004 consolidated statement of operations.

In the first quarter of 2005, the Company entered into an agreement with WMG pursuant to which WMG agreed to a cash purchase of the Company's option at the time of the WMG public offering at a price based on the initial public offering price per share, net of any underwriters' discounts. As a result of the estimated public offering price range, the Company adjusted the value of the option in the first quarter of 2005 to $165 million. In the second quarter of 2005, WMG's registration statement was declared effective at a reduced price from its initial estimated range, and the Company received approximately $138 million from the sale of its option. As a result of these events, during 2005 the Company recorded a $53 million net gain related to this option, which is included as a component of Other income, net, in the accompanying 2005 consolidated statement of operations.

As these transactions resulted in the disposition of its music operations, the Company has presented the results of operations and financial condition of the Music segment as discontinued operations for all periods presented.

The 2004 income (charges) recorded in the accompanying consolidated statement of operations relate primarily to adjustments to the initial estimates of the assets sold to and liabilities assumed by the acquirors in such transactions and to the resolution of various tax matters surrounding the music business dispositions.

Financial data of the Music operations, included in discontinued operations for 2004 and 2003, is as follows:

	For the Year Ended December 31,	
	2004	2003
	(millions)	
Total revenues	$ 780	$ 4,312
Pretax loss	(2)	(567)
Income tax benefit	123	72
Net income (loss)	121	(495)

As of December 31, 2005 and 2004, there are $50 million and $88 million, respectively, of liabilities associated with the former music operations recorded on the Company's balance sheet. The liabilities are principally related to severance payments to former employees of the music operations, and at December 31, 2004, pension obligations to former employees of the Music segment, which were retained by Time Warner.

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4. OTHER SIGNIFICANT BUSINESS ACQUISITIONS AND DISPOSITIONS

2004 Transactions

Acquisition of Advertising.com

On August 2, 2004, AOL completed the acquisition of Advertising.com for $445 million (net of cash acquired). Advertising.com purchases online advertising inventory from third-party websites and principally sells this inventory using performance-based advertising arrangements. During 2005, the purchase price allocation was finalized and the Company recorded $269 million of goodwill, $206 million of intangible assets subject to amortization for technology ($98 million), advertising and publisher relationships ($50 million), tradename ($40 million) and non-compete agreements ($18 million) related to the purchase of Advertising.com (Note 2). From the time it was acquired through December 31, 2004, Advertising.com contributed Advertising revenues of $97 million from sales of advertising run on third-party websites.

Sale of the Winter Sports Teams

On March 31, 2004, the Company completed the sale of the Turner winter sports teams (the Atlanta Thrashers, an NHL team, and the Atlanta Hawks, an NBA team) and the entity holding the operating rights to Philips Arena, an Atlanta sports and entertainment venue, to Atlanta Spirit LLC ("Atlanta Spirit"). In addition to the $219 million of impairment charges recognized in 2003, the Company recorded an approximate $7 million loss on the closing of the sale in the first quarter of 2004. As of December 31, 2005, Turner owns an approximate 10% interest in Atlanta Spirit and accounts for its interest in the limited liability company under the equity method of accounting.

Through the date of the sale on March 31, 2004, the winter sports teams had revenues of $66 million and an Operating Loss of $8 million. For the full year of 2003, the winter sports teams contributed approximately $160 million of revenues and an Operating Loss of $37 million.

Consolidation of Warner Village Cinemas S.P.A.

Warner Village Cinemas S.P.A. ("Warner Village") is a joint-venture arrangement that operates cinemas in Italy. Prior to December 2004, this entity was owned 45% by Warner Bros., 45% by Village Cinemas International Pty. Ltd. ("Village Cinemas") and 10% by a third-party investor. The 10% owner was bought out by Warner Bros. and Village Cinemas in December 2004. As previously announced, in April 2004, Warner Bros. and Village Cinemas agreed that: (i) Warner Bros. would control the voting rights associated with Village Cinemas' interest and (ii) beginning in March 2007 and continuing for one year, Village Cinemas can require that both Warner Bros. and Village Cinemas place their collective interests for sale and, to the extent that a bona fide offer is received, can require Warner Bros. to acquire the Village Cinemas interest at that value in the event that Warner Bros. elects not to proceed with such sale. If such right is not exercised by Village Cinemas, the voting rights associated with its interest will revert to Village Cinemas in March 2008.

As a result of controlling Village Cinemas' voting interest, Warner Bros. began consolidating the results of Warner Village in the second quarter of 2004. As permitted by U.S. GAAP, Warner Village results have been consolidated retroactive to the beginning of the year. For the year ended December 31, 2004, Warner Village revenues were $101 million and its Operating Income was $3 million.

2003 Transactions

Sale of Time Life

In December 2003, the Company sold its Time Life Inc. ("Time Life") operations to Direct Holdings Worldwide LLC ("Direct Holdings"), a venture of Ripplewood Holdings LLC and ZelnickMedia Corporation. In connection with the transaction, the Company recognized a loss of $29 million. Under the terms of the

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sale transaction, the Company did not receive any cash consideration and instead agreed to a contingent consideration arrangement under which it will receive payments in the future if the business sold meets certain performance targets. Specifically, the Company would receive consideration equal to four times the amount by which the average annual earnings before interest, taxes, depreciation and amortization ("EBITDA") over a two-year period exceeds $10 million. Based on the recent performance of Time Life, the Company does not believe, at this time, that it is probable that significant additional consideration will be received under this arrangement. The Company will not record this contingent payment as incremental proceeds on the sale of the Time Life business unless and until the point at which all contingencies with regard to the payment have been resolved.

In conjunction with this transaction, the Company entered into multi-year service agreements with Direct Holdings to provide certain fulfillment, customer service and related services primarily for Time Life's European operations. In addition, the Company agreed to license the name "Time Life" to Direct Holdings for ten years, with an additional ten-year renewal option. The Company will receive royalty payments from Direct Holdings beginning in 2005. The Company believes that the terms of the licensing arrangement and fulfillment service agreements are at market rates and, accordingly, no amounts have been allocated to either agreement. Finally, as part of the transaction, the Company provided for up to $13 million in financing to Direct Holdings, of which only $8 million was funded and subsequently repaid in the first quarter of 2005.

Sale of U.K. Cinemas

In the second quarter of 2003, the Company recognized a $43 million gain on the sale of its interest in U.K. cinemas, which had previously been consolidated by the Filmed Entertainment segment.

5. TIME WARNER CABLE INC.

Ownership

Comcast Corporation ("Comcast") has a 21% economic interest in Time Warner Cable Inc.'s ("TWC Inc.") cable business held through a 17.9% direct common ownership interest in TWC Inc. (representing a 10.7% voting interest) and a limited partnership interest in TWE representing a 4.7% residual equity interest. Time Warner's 79% economic interest in TWC Inc.'s cable business is held through an 82.1% common ownership interest in TWC Inc. (representing an 89.3% voting interest) and a limited partnership interest in TWE representing a 1% residual equity interest. Time Warner also holds a $2.4 billion mandatorily redeemable preferred equity interest in TWE. The remaining interests in TWE are held indirectly by TWC Inc.

Adelphia/Comcast

Adelphia Acquisition Agreement

On April 20, 2005, a subsidiary of the Company, Time Warner NY Cable LLC ("TW NY"), and Comcast each entered into separate definitive agreements with Adelphia to, collectively, acquire substantially all the assets of Adelphia Communications Corporation ("Adelphia") for a total of $12.7 billion in cash (of which TW NY will pay $9.2 billion and Comcast will pay the remaining $3.5 billion) and 16% of the common stock of TWC Inc. (the "Adelphia Acquisition").

At the same time that Comcast and TW NY entered into the Adelphia agreements, Comcast, TWC Inc. and/or their respective affiliates entered into agreements providing for the redemption of Comcast's interests in TWC Inc. and TWE (the "TWC Inc. Redemption Agreement" and the "TWE Redemption Agreement," respectively, and, collectively, the "TWC Inc. and TWE Redemption Agreements"). Specifically, Comcast's 17.9% interest in TWC Inc. will be redeemed in exchange for stock of a subsidiary of TWC Inc. holding cable systems serving approximately 587,000 subscribers (as of December 31, 2004), as well as approximately

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$1.9 billion in cash. In addition, Comcast's 4.7% interest in TWE will be redeemed in exchange for interests in a subsidiary of TWE holding cable systems serving approximately 168,000 subscribers (as of December 31, 2004), as well as approximately $133 million in cash. TWC Inc., Comcast and their respective subsidiaries will also swap certain cable systems to enhance their respective geographic clusters of subscribers ("Cable Swaps").

After giving effect to the transactions, TWC Inc. will gain systems passing approximately 7.5 million homes (as of December 31, 2004), with approximately 3.5 million basic subscribers. TWC Inc. will then manage a total of approximately 14.4 million basic subscribers. Time Warner will own 84% of TWC Inc.'s common stock (including 83% of the outstanding TWC Inc. Class A Common Stock, which will become publicly traded at the time of closing, and all outstanding shares of TWC Inc. Class B Common Stock) and own a $2.9 billion indirect economic interest in TW NY, a subsidiary of TWC Inc.

The transactions are subject to customary regulatory review and approvals, including antitrust review by the Federal Trade Commission ("FTC") pursuant to the Hart-Scott-Rodino Act, review by the Federal Communications Commission ("FCC") and local franchise approvals, as well as, in the case of the Adelphia Acquisition, the Adelphia bankruptcy process, which involves approvals by the bankruptcy court having jurisdiction over Adelphia's Chapter 11 case and Adelphia's creditors. On January 31, 2006, the FTC completed its antitrust review of the transaction and closed its investigation without further action. The parties are awaiting final clearance from the FCC and local franchise approvals, as well as completion of the bankruptcy process. The parties expect to close the Adelphia Acquisition during the second quarter of 2006.

The closing of the Adelphia Acquisition is not dependent on the closing of the Cable Swaps or the transactions contemplated by the TWC Inc. and TWE Redemption Agreements. Furthermore, if Comcast fails to obtain certain necessary governmental authorizations, TW NY has agreed to acquire the cable operations of Adelphia that would have been acquired by Comcast, with the purchase price payable in cash or TWC Inc. stock at the Company's discretion.

Amendments to Existing Arrangements

In addition to entering into the agreements relating to the Adelphia Acquisition, the Redemption Agreements and Cable Swap agreements described above, in April 2005 TWC Inc. and Comcast amended certain pre-existing agreements. The objective of these amendments is to terminate these agreements contingent upon the completion of the transactions provided for in the Redemption Agreements. The following brief description of these agreements does not purport to be complete and is subject to, and is qualified in its entirety by reference to, the provisions of such agreements.

Registration Rights Agreement. In conjunction with the restructuring of TWE completed in 2003 (the "TWE Restructuring"), TWC Inc. granted Comcast and certain affiliates registration rights related to the shares of TWC Inc. Class A common stock acquired by Comcast in the TWE Restructuring. In connection with the entry into the TWC Redemption Agreement, Comcast generally has agreed not to exercise or pursue registration rights with respect to the TWC Class A Common Stock owned by it until the earlier of the date upon which the TWC Redemption Agreement is terminated in accordance with its terms and the date upon which TWC Inc.'s offering of equity securities to the public for cash for its own account in one or more transactions registered under the Securities Act of 1933 exceeds $2.1 billion. TWC Inc. does, however, have an obligation to file a shelf registration statement on June 1, 2006, covering all of the shares of the TWC Class A Common Stock if the TWC Redemption has not occurred as of such date.

Tolling and Optional Redemption Agreements. On April 20, 2005, subsidiary of TWC Inc., Comcast and certain of its affiliates entered into an amendment (the "Second Tolling Amendment") to the Tolling and Optional Redemption Agreement, dated as of September 24, 2004, as amended, pursuant to which the parties agreed that if both of the Redemption Agreements terminate, TWC Inc. will redeem 23.8% of Comcast's 17.9% ownership of TWC Class A Common Stock in exchange for 100% of the common stock of a TWC Inc.

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subsidiary that will own certain cable systems serving approximately 148,000 basic subscribers (as of December 31, 2004) plus approximately $422 million in cash. In addition, on May 31, 2005, a subsidiary of TWC Inc., Comcast and certain of its affiliates entered into the Alternate Tolling and Optional Redemption Agreement (the "Alternate Tolling Amendment"). Pursuant to the Alternate Tolling Amendment, the parties agreed that if the TWC Inc. Redemption Agreement terminates, but the TWE Redemption Agreement is not terminated, TWC Inc. will redeem 23.8% of Comcast's 17.9% ownership of TWC Inc. Class A common stock in exchange for 100% of the common stock of a TWC Inc. subsidiary which will own certain cable systems serving approximately 148,000 basic subscribers (as of December 31, 2004) plus approximately $422 million in cash.

Cable Television System Joint Ventures

On May 1, 2004, the Company completed the restructuring of two joint ventures that it manages, Kansas City Cable Partners ("KCCP"), previously a 50-50 joint venture between Comcast and TWE serving approximately 297,000 basic video subscribers as of December 31, 2005, and Texas Cable Partners, L.P. ("TCP"), previously a 50-50 joint venture between Comcast and the TWE-Advance/Newhouse Partnership ("TWE-A/N") serving approximately 1.260 million basic video subscribers as of December 31, 2005. Prior to the restructuring, the Company accounted for its investment in these joint ventures using the equity method. Under the restructuring, KCCP was merged into TCP, which was renamed "Texas and Kansas City Cable Partners, L.P." Following the restructuring, the combined partnership was owned 50% by Comcast and 50% collectively by TWE and TWE-A/N. In February 2005, TWE's interest in the combined partnership was contributed to TWE-A/N in exchange for preferred equity in TWE-A/N. Since the net assets of the combined partnership were owned 50% by TWC Inc. and 50% by Comcast both before and after the restructuring and there were no changes in the rights or economic interests of either party, the Company viewed the transaction as a non-substantive reorganization to be accounted for at book value, similar to the transfer of assets under common control. TWC Inc. continues to account for its investment in the restructured joint venture using the equity method. Beginning on June 1, 2006, either TWC Inc. or Comcast can trigger a dissolution of the partnership. If a dissolution is triggered, the non-triggering party has the right to choose and take full ownership of one of two pools of the combined partnership's systems — one pool consisting of the Houston systems and the other consisting of the Kansas City, southwest Texas and New Mexico systems — with an arrangement to distribute the partnership's debt between the two pools. The party triggering the dissolution would own the remaining pool of systems and any debt associated with that pool.

In conjunction with the Adelphia Acquisition, TWC Inc. and Comcast agreed that if the Adelphia Acquisition and Cable Swaps occur and if Comcast receives the pool of assets consisting of the Kansas City, southwest Texas and New Mexico systems upon distribution of the Texas and Kansas City Cable Partners, L.P. assets as described above, Comcast will have an option, exercisable for 180 days commencing one year after the date of such distribution, to require TWC Inc. or a subsidiary to transfer to Comcast, in exchange for the southwest Texas and New Mexico systems, certain cable systems held by TWE and its subsidiaries.

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6. INVESTMENTS, INCLUDING AVAILABLE-FOR-SALE SECURITIES

The Company's investments consist of equity-method investments, fair-value investments, including available-for-sale investments, and cost-method investments. Time Warner's investments, by category, consist of:

	December 31,	
	2005	2004
	(millions)	
Equity-method investments	$ 2,574	$ 2,624
Fair-value investments, including available-for-sale investments[a]	820	1,958
Cost-method investments[a]	124	121
Total	$ 3,518	$ 4,703

(a) The fair value and cost basis of Time Warner's fair-value and cost-method investments were approximately $944 million and $861 million, respectively, as of December 31, 2005, and $2.079 billion and $991 million, respectively, as of December 31, 2004.

Equity-Method Investments

Investments in companies in which Time Warner has the ability to exert significant influence, but less than a controlling voting interest, are accounted for using the equity method. This is generally presumed to exist when Time Warner owns between 20% and 50% of the investee. However, in certain circumstances, Time Warner's ownership percentage exceeds 50% but the Company accounts for the investment using the equity method because the minority shareholders hold certain rights that allow them to participate in the day-to-day operations of the business.

At December 31, 2005, investments accounted for using the equity method, and the ownership percentage held by Time Warner, primarily include the following: certain cable joint ventures (50% owned), Courtroom Television Network ("Court TV") (50% owned), certain network and filmed entertainment joint ventures (generally 25-50% owned) and Time Warner Telecom Inc. ("Time Warner Telecom") (44% owned). Time Warner has investments accounted for using the equity method of accounting that are publicly traded, including Time Warner Telecom. Based on the closing share price as of December 31, 2005, the value of Time Warner's investment in Time Warner Telecom approximated $496 million. As of December 31, 2005, the Company's investment in Time Warner Telecom had a carrying value of zero primarily due to impairments recognized in previous years.

At December 31, 2005, the Company's recorded investment in certain cable joint ventures and Court TV were greater than its equity in the underlying net assets of these equity method investees by approximately $1.9 billion. This difference was primarily due to fair value adjustments recorded in connection with the AOL-Historic TW Merger.

Fair-Value Investments, Including Available-for-Sale Investments

Investments in companies in which Time Warner does not have a controlling interest or is unable to exert significant influence are accounted for at fair value if the investments are publicly traded and resale

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restrictions of less than one year exist ("available-for-sale investments"). The cost basis, unrealized gains, unrealized losses and fair market value of available-for-sale investments are set forth below:

	December 31, 2005	December 31, 2004
	(millions)	
Cost basis of available-for-sale investments	$ 50	$ 77
Gross unrealized gain[(a)]	85	1,089
Gross unrealized loss	(2)	(1)
Fair-value of available-for-sale investments	$ 133	$ 1,165
Deferred tax liability	$ 33	$ 435

(a) 2004 includes a gross unrealized gain of approximately $965 million related to Google. During 2005, the Company sold its remaining 5.1 million shares of Google's Class B common stock. The Company received total cash consideration of approximately $940 million, resulting in a gain of approximately $925 million recognized in the second quarter of 2005, which is included as a component of Other income, net.

During 2005, 2004 and 2003 there were $995 million, $25 million and $169 million, respectively, of unrealized gains reclassified from Accumulated other comprehensive income, net to Other income, net in the consolidated statement of operations, based on the specific identification method.

Also included within fair-value investments at December 31, 2005 and 2004 are equity derivatives of $6 million and $92 million, respectively, and amounts related to the Company's deferred compensation program of $681 million and $701 million, respectively. Equity derivatives are recorded at fair value in the accompanying consolidated balance sheet, and the related gains and losses are included as a component of Other income, net. The deferred compensation program is an elective program whereby eligible employees may defer a portion of their annual compensation. A corresponding liability is included within current or noncurrent other liabilities as appropriate.

Cost-Method Investments

Investments in companies that are not publicly traded or have re