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To Our Clients

The "Scorched Earth" Defense

While the court in the Brunswick case cites the St. Joe case for the proposition that a target cannot have a scorched earth policy merely to thwart a hostile tender offer, the Brunswick court in fact reached the opposite result from St. Joe. The Brunswick case sustains the sale of a major division and the use of the proceeds of the sale for a competing tender offer designed to defeat the hostile tender offer. This is precisely what the St. Joe court, without a reasoned opinion, held to be a prohibited scorched earth defense. As we said at the time, whatever scorched earth may mean, it does not prevent the board of a target company from exercising its business judgment to obtain what it believes to be a better deal for the shareholders. We believe that the Brunswick case is correct and reflects the law as it is today.

The Brunswick case emphasizes the importance of advance preparation to deal with a hostile tender offer. In Brunswick the sale of the division is pursuant to an agreement by the buyer to tender for Brunswick shares at a price higher than the hostile tender offer and then to exchange those shares for the division. This type of transaction is facilitated if a company in advance identifies a division that would sell for a higher multiple than the company itself, there are separate financials for such a division, and loan agreements are structured so that the sale and stock repurchase can be accomplished without delay or undue penalty.

As the legal defenses to a hostile tender offer have become less and less effective, the structural defenses have become of increasing importance. (The Brunswick court rejected antitrust and disclosure defenses of the type accepted in other cases.) In many cases a structural response is in fact the very best deal for the shareholders. Structural defenses are difficult and in many cases will be possible only if there has been careful advance preparation by the company and its investment banker and counsel.

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