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Client Alert

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DELAWARE COURT REFUSES TO ENJOIN DOLLAR THRIFTY MERGER WITH HERTZ

Determines That Directors Satisfied Their Revlon Duties Despite Failing to Conduct Pre-Signing Market Check and Agreeing to Deal Protections

A recent ruling by the Delaware Court of Chancery¹ provides valuable insight into how the Court will analyze a claim that directors did not fulfill their *Revlon*² duties. Stockholders of Dollar Thrifty Automotive Group, Inc. sought to preliminarily enjoin Dollar Thrifty's proposed merger with industry competitor Hertz Global Holdings, Inc., alleging that the Dollar Thrifty board breached its fiduciary duty by "failing to conduct a pre-signing auction and for signing up a Merger Agreement that yielded only a modest premium..." The plaintiffs also attacked the termination fee and matching rights included in the merger agreement, which they argued had a "quelling effect on any topping bidder."

In a detailed analysis of the steps taken by the Dollar Thrifty board to satisfy its *Revlon* duties – an analysis which relies heavily on the particular facts before him – Vice Chancellor Strine denied plaintiffs' preliminary injunction motion on the basis that the Dollar Thrifty board's approach to value maximization was not unreasonable, even if the board did not secure a premium as large as might have been attainable at a different time or under different circumstances. In the Vice Chancellor's view, the board was justified in taking into consideration other important factors, such as deal certainty and the history of its bargaining with the competing bidders, when deciding how best to approach the sale process.

Background

Dollar Thrifty is the fourth-largest rental car company in the United States and, together with Hertz, Enterprise and Avis, accounts for over 90% of the industry's total revenue. Dollar Thrifty and Avis "focus on value-conscious, leisure travelers," whereas Hertz "focuses mainly on weekday business travelers, and only recently entered the leisure market with its purchase of Advantage Rent A Car."

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¹ *In Re Dollar Thrifty Shareholder Litigation*, Cons. C.A. No. 5458-VCS (Del. Ch. Sept. 8, 2010)

² *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

Enterprise's 2007 acquisition of an industry competitor "ignited discussions between the other major players in the industry about strategic combinations," including Dollar Thrifty and Hertz. In October 2007, after earlier talks with Hertz had fallen apart, Dollar Thrifty received a non-binding indication of interest from Avis regarding a possible mixed cash and stock merger valued at \$44 per share. Consistent with Dollar Thrifty's philosophy that "deal certainty was of 'paramount importance,'" these discussions were terminated the following January when Avis would not agree to Dollar Thrifty's demands for a reverse termination fee if antitrust approval could not be obtained.

Despite these failed discussions, Dollar Thrifty reached out to both Hertz and Avis in March 2008 and entered into confidentiality agreements with both companies to allow them to conduct due diligence. Although Dollar Thrifty received non-binding indications of interest from both suitors in late May, by August, both Hertz and Avis walked away from the discussions.

In October 2008, Scott Thompson was promoted from CFO to CEO of Dollar Thrifty. By then, Dollar Thrifty was teetering on the brink of insolvency; its shares had plummeted to a trading price below \$1 and it was on the verge of defaulting on approximately \$1.5 billion of debt. Shortly after Thompson's promotion, Hertz contacted Dollar Thrifty to reopen discussions, offering \$3.50 per share. Sensing that Dollar Thrifty was "a valuable company in a consolidating industry" and not wanting to allow anyone to "buy [Dollar Thrifty] on the cheap," the Dollar Thrifty board (consisting of five independent members, each well-versed in the workings of the industry, plus CEO Thompson) determined that "it was in the best interest of the company to focus on everyday operations..." Nevertheless, Hertz reached out to Dollar Thrifty nine months later, and the two companies entered into a new confidentiality agreement. By this time, Thompson had navigated Dollar Thrifty through "a skillful economic u-turn."

On December 22, 2009, Hertz presented a formal expression of interest to acquire Dollar Thrifty in a 50% Hertz stock/50% cash merger valued at \$30 per share. At a meeting held eight days later to consider this offer, the Dollar Thrifty board also discussed the prudence of contacting Avis. Ultimately, the board decided against such an approach, citing the uncertainty attendant to antitrust concerns ("Hertz had a less substantial leisure market presence than Avis"), the board's perception that Avis would have greater difficulty in obtaining financing, and the presumed need for Avis stockholder approval under NYSE rules if Avis' financial condition required it to include a relatively large stock component in the merger consideration. The next day, Dollar Thrifty rejected Hertz's offer, but indicated a willingness to discuss a higher, all-cash price.

On January 25, 2010, Hertz submitted a revised offer increasing the price to \$35 per share and committing to use reasonable best efforts to obtain antitrust clearance. The board reconvened to consider the new offer, and once again debated whether to contact Avis. For the reasons cited earlier, the board continued to believe that contacting Avis was not prudent. The board also decided not to accept Hertz's revised offer, but authorized Thompson to enter into a 45-day exclusivity agreement with Hertz to permit further negotiations and directed management to update the board at least every two weeks.

Although various drafts of a merger agreement were circulated over the next several weeks, the exclusivity period expired without definitive agreement between the parties. Nevertheless, the Dollar Thrifty board met in March to discuss the latest terms from Hertz, addressing (among other considerations) how the risk of

non-consummation should be factored into a *Revlon* analysis. The board also considered whether it was time to contact Avis, but Thompson expressed concern that an auction posed a substantial risk that no deal would get done with either potential suitor. Despite its concern that a merger agreement with Hertz could chill a topping bid from Avis, the board elected to continue negotiations with Hertz and to refrain from contacting Avis.

The negotiations with Hertz broke down, however, when Dollar Thrifty pushed for \$44.96 per share, representing a 25% premium over the then-current trading price. At this very late stage of negotiations with Hertz, Avis reappeared through what the Court dubbed an “awkward and oblique overture.” Instead of contacting Thompson directly, on April 19th the CEO of Avis employed an intermediary to set up an April 28th dinner meeting with Thompson that had no stated agenda. Thompson initially conjectured that they would discuss a possible merger, but after confirming with Dollar Thrifty’s financial advisors that there had been no recent indications of interest from Avis, Thompson concluded that the likely purpose of the dinner was for Avis to present him with an offer of employment.

Meanwhile, on April 21st, Hertz raised its offer to \$40 per share and pressed for an agreement in advance of its quarterly earnings announcement scheduled for April 26th. Dollar Thrifty’s board concluded that it was the right time to ink a deal with Hertz, but only after Thompson convinced Hertz to increase the price to \$41 per share and to commit to another \$75 million in antitrust divestitures. Due to a run-up in Dollar Thrifty’s stock price, the merger price now reflected only “a relatively modest 5.5% premium” over the prior day’s closing price (although the merger price was “near the top of the discounted cash flow valuations presented to the Board”). The board also negotiated a fiduciary out so that Avis would not be precluded from making a counter-offer, subject to matching rights and payment of a termination fee for the benefit of Hertz. On April 25th, Dollar Thrifty and Hertz signed the merger agreement and the deal was publicly announced. In early May, a group of Dollar Thrifty stockholders sought injunctive relief, alleging that the Dollar Thrifty board breached its fiduciary duty to “take a reasonable approach to immediate value maximization” by executing a merger agreement with Hertz without taking “affirmative steps to draw Avis into a bidding contest.”

The Court’s Analysis

Vice Chancellor Strine began his analysis of the board’s actions by reviewing the standard of judicial review in a *Revlon* transaction, observing that:

- A board’s *Revlon* “obligation to secure the best value reasonably attainable for its shareholders... does not require that a board, in determining the value-maximizing transaction, follow any specific plan or roadmap in meeting its duty to take reasonable steps to secure — i.e., actually attain — the best immediate value.” Rather, “*Revlon* commands that directors, consistent with their traditional fiduciary duties, act reasonably, ‘by undertaking a sound process to get the best deal available.’” In other words, the key question is “whether the directors made a reasonable decision, not a perfect decision.”
- *Revlon*, however, does require an “enhanced” level of judicial scrutiny on the part of a reviewing court. This scrutiny is “more exacting than the deferential rationality standard applicable to run-of-the-mill decisions governed by the business judgment rule,” but gives the court more “leeway to examine

the reasonableness of the board's actions... than the entire fairness standard" applicable to self-dealing transactions. This intermediate level of scrutiny involves two key features:

- o A determination regarding the "adequacy of the decisionmaking process employed by the directors," which includes a review of the information on which the board relied; and
- o An "examination of the reasonableness of the directors' action in light of the circumstances then existing," with the directors having the burden of proving that they "were adequately informed and acted reasonably."

In denying plaintiffs' motion for a preliminary injunction, the Vice Chancellor offered a number of important observations regarding the make-up of the Dollar Thrifty board, as well as the steps taken and factors considered by the board in order to fulfill its *Revlon* duties:

- The Dollar Thrifty board did not "harbor personal motivations in the sale context that differ from what is best for the corporation and its stockholders." Specifically, the Vice Chancellor noted that:
 - o Five members of the six-member board are independent and "will [not] receive any compensation other than as stockholders as a result of the Merger."
 - o The directors owned "material amounts of stock" and therefore each had a personal incentive to seek the highest price.
 - o The board "displayed a willingness to talk to anyone" who came forward with a "serious overture about a sale."
 - o The record showed "no hint... that the Board preferred to do a deal with Hertz at some lower value if a better deal was actually attainable from Avis or another source."
 - o At a crucial board meeting, "the Board's independent directors met alone for almost an hour."
 - o CEO Thompson "has a huge incentive not to sell at a suboptimal price because he has a large chunk of actual common stock and has no apparent desire to work for an industry competitor."
 - o The investment banking arrangement negotiated by the board, "which provided for a possible \$2 million discretionary bonus, gave the banker an incentive to secure an excellent outcome."
- The Dollar Thrifty board "was diligently attending to its duties," insofar as it "was closely engaged at all relevant times in making decisions about how to handle the negotiations with Hertz and whether to try to bring Avis into the process." Moreover, the directors had "substantial experience in finance and business" and "an impressive knowledge of the company, the industry and the benefits and risks that different approaches entailed." As such, "[e]ven in the realm of heightened scrutiny, judicial (law-trained) second guessing of the means chosen by such a (business-experienced) board to maximize value should, one would think, be rare."

- The board’s decision not to seek other bidders to “stimulate an immediate auction” – a course of action repeatedly debated at board meetings – was supported by the facts that:
 - The board “was genuinely concerned” that a public sale process would result in “distracting and creating anxiety among company employees, who had been through difficulty in recent years involving downsizing and increased expectations for personal productivity.”
 - The board’s concern over the long history of failed merger attempts with both Hertz and Avis and the negative impact that failed M&A discussions could have on the company, “both in terms of operating performance and market valuation...”
 - The board “received advice that Avis was not well positioned to make a cash bid for Dollar Thrifty because it was heavily leveraged already and subject to severe covenants that could only be amended with creditor approval,” and that a deal with Avis presented “somewhat greater antitrust risk...”
 - “Avis’s seriousness about making a viable bid has to be discounted by its lack of owning one share, its failure to make anything other than a tepid dinner invitation, and the fact that it took it three months to actually get lender approval to make a bid...”
 - Based on the substantial history of negotiations with Hertz, “the strong possibility that Hertz would go away if the company went into auction mode, a possibility buttressed by Hertz’s willingness to take a pass on Dollar Thrifty at lower price levels and its demand for exclusivity.”
 - The merger agreement with Hertz included a fiduciary out designed to enable the board to entertain and accept a superior proposal post-signing.

Indeed, the board’s “decision to secure a valuable deal [with Hertz] and to conduct a passive, post-signing check was a reasonable, indeed perhaps the most savvy, way to induce Avis to decide whether it wanted to make a real deal for Dollar Thrifty.” Vice Chancellor Strine also credited the facts that Avis ultimately did come forward with a bid, and did not itself bring suit against Dollar Thrifty and “subject itself to discovery,” as being supportive of his ruling.

- With respect to the timing of the board’s decision to accept Hertz’s offer, “the Board was entitled to use its reasonable judgment whether it was a good time to sell and at what price. Of course, in signing up a deal without a pre-signing market check, it was incumbent upon the Board to consider whether it had extracted all the value it could and whether it was ensuring the viability of a post-signing market check.”
- Although Dollar Thrifty’s stock price had risen to such a level that the Hertz merger provided Dollar Thrifty shareholders with “a mere 5.5% premium,” the “law does not require a well-motivated board to simply sell the company whenever a high market premium is available... or to eschew selling when a sales price is attractive in the board’s view, but the market premium is comparatively low, because the board believes the company is being valued quite fully.” Indeed, “[t]o pretend there are not dangers in holding out for an even bigger blow out price when the market is fully valuing a target is equally obtuse.”

- With respect to the deal protections included in the merger agreement:
 - In determining whether a termination fee would have a preclusive effect on any potential bidder's decision to make a topping bid, the fee "must be measured against the entire value of the Merger, which is logically quantified as the amount of consideration flowing into... shareholders' pockets – not by the amount of money coming exclusively from [the buyer]."
 - In addition, the termination fee "represents a very small percentage cost" to a bidder in making a topping bid.
 - The back-and-forth nature of the lengthy negotiations with Hertz revealed that "Dollar Thrifty attempted, but failed to get Hertz to accept a lower fee," Hertz "insisted that the standard and reverse termination fees be symmetrical," and Dollar Thrifty "accepted the 3.9% termination fee" only "[a]s part of an overall package that included a price bump and a substantial increase in Hertz's obligation to divest assets if necessary to secure antitrust approval..."
 - "[T]he deal protections are not in any way coercive"; the Dollar Thrifty stockholders were given "the chance to accept a deal with Hertz or the chance to turn it down," a decision that "would not be hampered by the termination fee, because the fee would not be paid to Hertz unless there was both a no vote and the acceptance of another more valuable transaction contract within a year."

Conclusion

Vice Chancellor Strine's opinion in *Dollar Thrifty* provides a valuable and detailed insight into the evaluative process employed by the Delaware courts when performing a *Revlon* analysis. The attitude of Delaware courts is best summed up in the Vice Chancellor's statement that "[w]hen directors who are well motivated, have displayed no entrenchment motivation over several years, and who diligently involve themselves in the deal process choose a course of action, this court should be reluctant to second-guess their actions as unreasonable." The decision also demonstrates, however, just how fact-based the Court's analysis will be, signifying that cookie-cutter approaches are not sufficient. Despite this reality, the decision certainly should serve as a helpful guide to boards and their legal and financial advisors when considering and structuring change of control transactions.

Post Script

There have been a number of interesting twists and turns in the Dollar Thrifty saga since the signing of the merger agreement with Hertz. These developments testify to the wisdom of the Vice Chancellor's decision: not only was Avis not discouraged from seeking a transaction with Dollar Thrifty, but it actually significantly improved its offer, and the deal protections in the Hertz merger agreement did not deter Dollar Thrifty shareholders from opposing the Hertz transaction when it came up for a vote.

On May 3rd, shortly after Dollar Thrifty announced its merger agreement with Hertz, the CEO of Avis sent Thompson a letter expressing surprise at the announcement and signaling interest in acquiring Dollar Thrifty. Dollar Thrifty's board concluded that Avis's interest could reasonably be expected to result in a superior offer and, consistent with the Hertz merger agreement, entered into a confidentiality agreement with Avis the next day.

Some months later, on July 28th, Avis finally made an offer of \$46.50 per share with a mix of cash and stock. Although Avis offered to divest assets generating up to \$325 million in revenue if necessary to obtain antitrust clearance, this offer contained no reverse termination fee. On August 3rd, Thompson communicated to Avis that its offer was not “superior” to Hertz’s, largely because the lack of a reverse termination fee and antitrust concerns led the board to conclude that a deal with Avis could not “reasonably be expected to be consummated on a timely basis.”

Nevertheless, on September 12th, Hertz sweetened the terms of its deal, increasing the merger price to \$50.97 per share (representing a total price of \$1.46 billion) and retaining the reverse termination fee of \$44.6 million. In response, on September 23rd, Avis bumped its bid to \$52.71 per share, but again declined to add a reverse termination fee. Then, just prior to the September 30th Dollar Thrifty stockholder vote on the transaction, Avis for the first time supplemented its \$1.53 billion offer with a \$20 million reverse termination fee. In the face of these improved terms from Avis, the Dollar Thrifty stockholders rejected the Hertz transaction, and the CEO of Hertz made good on his prior threat to walk away from the deal. Discussions between Dollar Thrifty and Avis continue.

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