

Delaware Court of Chancery Denies Request to Enjoin Dollar Thrifty/Hertz Merger - Court Will Not Second-Guess a Board's Reasonable Process in Negotiating a Merger

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The Delaware Court of Chancery recently refused to enjoin the proposed merger between rental car companies Dollar Thrifty and Hertz, notwithstanding the possibility (or insinuation) of a superior deal with Avis. The decision in *In re Dollar Thrifty S'Holder Litig.*, C.A. No. 5458-VCS (Del. Ch. Sept. 8, 2010) demonstrates the Court of Chancery's unwillingness to enjoin a transaction when a board carefully negotiates and structures a corporate sale and follows a rigorous and deliberative process.

In 2007 and 2008, Dollar Thrifty engaged in merger negotiations with both Hertz and Avis. At the time, Dollar Thrifty was experiencing financial troubles. These negotiations did not result in any deal being reached.

Under the leadership of its new CEO, Dollar Thrifty performed what the court called "a skillful economic u-turn." Dollar Thrifty re-opened merger discussions with Hertz. After months of negotiation and deliberations by the Dollar Thrifty board, Dollar Thrifty agreed to be acquired for \$41 per share (comprising \$32.80 per share in cash, a \$200 million special dividend to be paid in the event of the merger, and 0.6366 of Hertz stock for each share of Dollar Thrifty stock). This represented a 5.5 percent premium over Dollar Thrifty's then-current market price.

The merger agreement also provided for a \$44.6 million termination and reverse termination fee (with an additional reimbursement of up to \$5 million in expenses) payable under certain circumstances, and required Hertz to make significant divestitures if necessary to obtain antitrust approval.

Avis had on prior occasions expressed an interest in acquiring Dollar Thrifty. Upon the announcement of the Hertz deal, Avis announced its intention to make a substantially higher offer of a combination of cash and stock equal to \$46.50 per share.

However, as the Court of Chancery later concluded, the Avis offer (and prior suggestions of an offer) lacked the certainty of the agreement with Hertz.

Certain stockholder plaintiffs filed suit seeking an injunction preventing the stockholder vote required to approve the merger with Hertz. The stockholder plaintiffs attacked the market premium to be paid by Hertz as insufficient, but "the plaintiffs concentrated their fire" on the Dollar Thrifty board's decision to sign the Hertz merger agreement without a pre-signing market check.

The Court of Chancery denied the injunction, reaffirming the court's precedent that so long as the board undertook a reasonable process, directors were free to select their chosen path to maximize shareholder value, even if an alternative path is available that could possibly yield a higher price.

No Pre-signing Market Check was Required

The court rejected the plaintiffs' argument that the Dollar Thrifty board should have conducted a pre-signing auction prior to entering into the Hertz merger agreement. The court held that the Dollar Thrifty board's decision to deal solely with Hertz was warranted under the circumstances.

The court credited the board's concerns that an auction could upset and distract employees and diminution of their productivity; that Avis may have lacked the resources to consummate a deal while Hertz appeared to have adequate resources; that a deal with Avis was subject to greater antitrust risk as compared with a deal with Hertz because Avis (unlike Hertz) had not agreed to pay a reverse termination fee in the event that antitrust approval could not be attained, and Avis had not agreed to the same level of divestitures Hertz was willing to make if necessary to attain antitrust approval; and that if the deal were shopped, there was a risk that Hertz would walk away.

The 5.5 Percent Premium was Sufficient

Additionally, the Court of Chancery noted that the Dollar Thrifty board had an informed view of the company's prospects and its fundamental value; accordingly, the court concluded that the 5.5 percent market premium was sufficient.

The court expressly rejected the plaintiffs' argument that the Dollar Thrifty board would have better performed its fiduciary duties if it had sold the company in early 2009 for approximately \$3.50 per share (but with a 298 percent premium) instead of agreeing to a sale now for \$41 per share (with only a 5.5 percent premium). The court reminded that Delaware "law does not require a well-motivated board to simply sell the company whenever a high market premium is available (such as selling at a distress sale) 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." The court explained that a board is "entitled to use its reasonable judgment in determining whether it [is] a good time to sell and at what price."

The 3.9 Percent Break-Up Fee was Reasonable

The Court of Chancery upheld the merger agreement's 3.9 percent termination fee and other deal protection provisions, finding that they were not preclusive as they left any serious bidder with the opportunity to buy the company if the suitor agreed to pay a price that included the modest compensation to Hertz.

Stockholder Free Choice and the Board's Diligence

The court also noted that Avis remained free to make a superior offer to Dollar Thrifty stockholders and that stockholders were free to reject the Hertz merger terms if Avis were to do so.

Application of the Revlon Standards

This decision confirms that a merger process being reviewed under Delaware law that has been undertaken by independent directors who follow a diligent process will not be lightly overturned by the courts.

The court observed as follows:

At bottom *Revlon* is a test of reasonableness; directors are generally free to select the path to value maximization, so long as they choose a reasonable route to get there.

Specifically, this form of enhanced judicial scrutiny involves two "key features":

(a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and

(b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.

Thus, the court concluded as follows in denying the requested injunctive relief: "When 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."

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