

WSGR ALERT

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DELAWARE CHANCERY COURT UPHOLDS REASONABLENESS OF BOARD STRATEGY IN MERGER TRANSACTION

On September 8, 2010, the Delaware Court of Chancery rejected an attempt by shareholder plaintiffs to enjoin a proposed merger between Dollar Thrifty and Hertz. While emphasizing that there is no single roadmap for a board to fulfill its *Revlon* duties in considering the sale of a company, the court clearly articulated the key features of judicial review under *Revlon*, and provided guidance as to the actions a board can take to satisfy this standard.¹

Dollar Thrifty engaged in numerous failed merger discussions with both Hertz and Avis in 2007 and 2008 when its business was doing poorly. Then, Dollar Thrifty managed to turn around its business under the leadership of its new CEO. In December 2009, Dollar Thrifty resumed merger discussions with Hertz. The board expressly considered whether to reach out to Avis or other potential buyers, but concluded that Avis was not well positioned to make a bid due to financing concerns and greater antitrust risk compared to Hertz. The board also worried about the strong possibility that Hertz would cease merger discussions if the company went into auction mode and that a failed public auction could damage the company by upsetting employees who had experienced downsizing and increased expectations during the turnaround. Thus, the board decided to engage solely with Hertz but reserved the opportunity to consider a post-signing topping bid.

After months of negotiation, including the rejection of several offers by Hertz, Dollar

Thrifty entered into a merger agreement with Hertz in April 2010. The merger agreement provides for: \$41 per share for Dollar Thrifty shareholders in a cash-stock combination; a \$44.6 million (3.9 percent) termination and reverse termination fee; a promise by Hertz to make certain divestitures if necessary to obtain antitrust approval; and a "fiduciary out" allowing Dollar Thrifty to consider a superior proposal from an unsolicited bidder.

After the merger announcement, Avis sent a letter indicating its interest, followed nearly three months later by an offer to acquire Dollar Thrifty for \$46.50 per share in a cash-stock combination. Avis's offer included a promise to divest assets to obtain antitrust approval at a level lower than Hertz, no financing contingency, and no termination or reverse termination fee. The Dollar Thrifty board could not declare Avis's deal to be "superior" because the deal could not be reasonably expected to be consummated on a timely basis due to lingering antitrust concerns and the lack of a reverse termination payment.

Dollar Thrifty shareholders filed a complaint after Avis sent its letter of interest but before it made its bid. The suit alleged that the Dollar Thrifty board breached its fiduciary duties by agreeing to the merger agreement with Hertz without a pre-signing auction and for a price that yielded only a 5.5 percent premium over the market price.

In rejecting the shareholders' claim, the court explained that "*Revlon* 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 attain the best immediate value. The court identified two key features of judicial review under *Revlon*: first, that the court will review "the decisionmaking process employed by the directors, including the information on which the directors based their decision"; and second, the "reasonableness of the directors' action in light of the circumstances then existing" which requires the directors to prove that "they were adequately informed and acted reasonably."

As part of this process, the court examined whether the board was properly motivated. Where—as here—the record revealed no basis to question the board's good-faith desire to attain the best outcome for shareholders, the court is more likely to defer to the board's judgment about the means to get there.

The court then substantively reviewed the evidence and concluded that the board diligently attended to its duties, including engaging in an appropriate process and acting in an informed manner. The court reached this conclusion based on a number of steps taken by the Dollar Thrifty board, as outlined below. Specifically, the board:

- was closely engaged at all relevant times in making decisions about how to handle the negotiations with Hertz and whether to bring Avis into the process,

¹ See *In re Dollar Thrifty S'holder Litig.*, C.A. No. 5458-VCS (Sept. 8, 2010).

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- having been well informed by management;
 - possessed substantial experience in finance, business, and the industry;
 - had a thorough and well-documented deliberative process;
 - engaged legal and financial advisors early on and considered their advice throughout deliberations;
 - was receptive to serious expressions of interest by any party, despite past failed negotiations;
 - bargained aggressively and was willing to terminate discussions when necessary to extract further concessions;
 - was open to reexamining its actions at all stages (e.g., it walked away from negotiations with Hertz two weeks prior to the signing of the merger agreement to continue as an independent company);
 - considered an offer in light of the company's "fundamental value" (as the court explained, "[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 a board's view, but the market premium is comparatively low, because the board believes the company is being valued quite fully");
 - considered the company's future prospects as a stand-alone entity (e.g., that Dollar Thrifty lacked a long-term growth strategy);
 - ensured the viability of a post-signing market check since no market check had been performed;
 - considered whether deal protections in a merger agreement would deter a serious topping bidder (the court found that the deal protections at issue did not prevent Avis from presenting a competing bid and that generally "deal protections actually encourage an interloper to dig deep and to put on the table a clearly better offer rather than to emerge with pennies more");
 - left sufficient time between the merger signing and stockholder vote for a late-coming bidder to present a topping bid; and
 - considered closing certainty (as the court noted, "[V]alue is not value if it is not ultimately paid").
- While all of these steps may not be applicable in every situation, a board of directors considering selling the company would be well advised to approach its task in a similar fashion.
- The court's analysis and decision are a further endorsement of the strength of the business judgment rule in Delaware, and in particular of the recognition of courts that the informed business decisions of boards, made in good faith, should not be second-guessed. As the court concluded, "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."²
- For any questions or more information on this decision or any related matters, please contact any member of the firm's corporate and securities practice or securities litigation practice.



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² The court's conclusion seems particularly appropriate in light of the fact that, subsequent to this ruling, Hertz raised its offer to \$50 per share in a cash-stock combination.