MERGER ANTITRUST LAW

LAW 1469
Georgetown University Law Center
Fall 2025

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Reading Guidance

Class 7 (September 16): Hertz/Avis Budget/Dollar Thrifty (Unit 3)

In this class, we will examine how Hertz and Dollar Thrifty allocated the antitrust risk in the 2010 merger agreement. We also will briefly examine the bidding war with Avis following the announcement of the 2010 Hertz/Dollar Thrifty deal, the FTC review of both proposed deals, Hertz's success in the bidding war, the settlement Hertz reached with the FTC to avoid litigation and permit the deal to close, and the aftermath following the closing.

Antitrust risk. Before turning to the case study, we need to examine the concept of antitrust risk in a transaction. Much of this course will focus on the knowledge and tools merger antitrust counsel need to anticipate and deal with the antitrust risk associated with a pending merger or acquisition. *Lawyers give advice; clients make decisions*. The goal of a lawyer at the beginning of a deal is to get the client into a position to make informed decisions about how to proceed (if at all) in light of the transaction's antitrust risk.[1] A big problem for practitioners, and hence for clients, is how to develop and then convey a meaningful sense of this risk to the client. Overall, I find that antitrust lawyers do a terrible job on this.

The class notes provide a way to think systematically about antitrust risk (slides 2-8). I find the best way, by far, to think about antitrust risk is in three nested buckets: (1) inquiry risk, (2) substantive risk, and (3) remedies risk. This three-bucket approach is a very natural way for business people to think about antitrust risk. While I will address these risks in the context of a merger, they apply to any situation where antitrust risk—or indeed any type of legal risk—is present.

1. *Inquiry risk* is the risk that the transaction's merits will be seriously examined. Antitrust questions do not materialize out of thin air. Someone has to have both the *incentive* and the *institutional means* of raising the question and requiring the merging parties to defend their transaction. Inquiry risk can be easily analyzed by looking at the incentives and the institutional means of the various actors interested in the transaction (primarily the federal enforcement agencies, the state attorneys general, competitors, customers, and

[1] There are four principal tasks for merger antitrust lawyers: (1) they anticipate antitrust obstacles presigning that may impede the closing of the deal, preliminarily assess the strength of the substantive defenses and the likelihood they will be able to overcome the obstacles on the merits, anticipate the need and dimension of any foreseeable consent decree, and use the results of this analysis to inform the principal's negotiation of the purchase price and the antitrust risk-shifting provisions of the merger agreement; (2) they defend the deal on the merits in the agency merger review; (3) to the extent that defense is not successful but the merging parties (usually only the buyer is necessary) is willing to fix the problems through a consent decree, they negotiate the consent decree with the investigating agency (if the agency is willing); and (4) if a mutually acceptable consent decree cannot be negotiated and the merging parties want to put the investigating agency to its proof, they defend the transaction on the merits in litigation.

occasionally suppliers) to raise an antitrust question about the deal in a forum that requires an answer.

2. *Substantive risk* is the risk that the transaction violates the antitrust laws. Substantive risk arises if and only if there is an inquiry. The analysis of substantive risk requires an identification of the possible theories of antitrust liability and defenses that could apply to the transaction and then a dispassionate evaluation of those theories in light of the evidence to which the parties have access (including their own documents) or can develop (notably expert evidence), as well as a judgment about the evidence that the investigating agency may develop from third parties that is not available to the merging parties (at least absent discovery in the course of litigation).

3. *Remedies risk* reflects the consequences of a conclusion that the transaction violates the antitrust laws. Remedies risk is analyzed in terms of the types and probabilities of the possible relief that might result from a finding of a violation. This includes the range of possible "fixes," most particularly consent decrees requiring the divestiture of some of the businesses or assets of the merging parties to a third party.[2] As we have already discussed, the idea of a "fix" is to enable an independent third party to "step into the shoes" of the divesting firm, preserve the premerger level of competition and so negate the agency's antitrust concern. Assessing remedies risk requires an evaluation of the minimally reasonable fix (and likely a range of other more onerous fixes), the likelihood of the acceptance of a particular fix by the relevant decision-maker (the investigating agency or the court), and the associated costs of the fix to the merged firm.[3] The evaluation of the remedies risk must also take into account the possibility that there is no fix acceptable to the enforcement agency to cure the antitrust problem, so the available outcomes are only to litigate the merits or terminate the transaction.

In practice, these risks are interrelated and often assessed in tandem. A party negotiating a merger agreement will consider all three when shaping efforts covenants, remedy commitments, and termination rights.

I should note that, for me at least, a lawyer cannot ethically assist a client in proceeding with a transaction or course of conduct where the inquiry risk is essentially zero but the substantive risk is near or at 100%. That is, a lawyer needs something more to advise a client than a high level of confidence that the client will not get caught. That something more is a *colorable argument* that the course of conduct is lawful. A colorable argument does not have to be a winning argument, nor does it have to comport with the judicial antitrust rules then in effect. Although definitions vary, my test in practice is that an argument—including an argument that the judicial rules applying the antitrust statutes should be changed —is colorable if I am comfortable making the

[2] Recall that a typical "fix" in a horizontal merger is the divestiture of a product line or business in the problematic area from one of the two merger companies. For examples, if two supermarket chains are merging and there is an antitrust problem is the Chattanooga supermarket market, then the merging parties can "fix" the problem by agreeing to divest the all of the supermarket stores in Chattanooga owned or operated by one or the other of the other merging parties to an independent third party that will continue to operate them as supermarket stores with the same competitive force as the divestiture seller.

[3] These include the loss of synergies associated with the divested businesses, any discount from going-concern value that the divestiture seller likely will have to accept since merger divestitures are usually made in "fire sale" conditions, and the transactions costs associated with the divestiture sale.

argument to a judge I respect in open court and knowing that the argument will be reported through the various antitrust newsletters and blogs to the antitrust bar at large.[4]

The contractual allocation of these risks—who bears which risk, under what conditions, and with what limitations—is the central focus of today's class.

Antitrust risk allocation. This is a critical and challenging topic in merger antitrust law and worth careful thought. *Remember that the seller does not get its money unless the deal closes.* The merger agreement is where the seller can negotiate for provisions that increase the probability of closing. Conversely, the buyer does not want to be obligated to close a deal that has to be restructured through a consent decree if the restructured deal eliminates so much of the buyer's benefit from the deal that the deal is no longer in the buyer's business interest. Accordingly, the buyer wants to negotiate limitations as to what it may be contractually obligated to do to fix the antitrust problems in the face of a challenge by the investigating agency. The ultimate objective of the buyer here is to escape its closing obligations and walk away from the purchase agreement if the fix demands too much. Negotiating the antitrust-related provisions is one of the most important things an antitrust deal lawyer does.

I have included the complete 2010 Hertz/Dollar Thrifty agreement in the reading materials (pp. 51-141). You need only read the highlighted antitrust-related provisions, but I want you to be able to see the provisions in the context of the entire merger agreement. I suggest you read the agreement on-screen and not print it out.

My suggestion for approaching the merger agreement is to start with the class notes on allocating antitrust risk in merger agreements.

- First, the deck explores some terminology used in merger agreements (slide 10) and then looks at the objectives each of the parties would like to achieve in the merger agreement (slides 11-13). It is important to get a good feel for the objectives of the merging parties—which, not surprisingly, differ considerably between buyer and seller—since they create the tensions in the negotiations.
- Second, after a quick refresher of the possible outcomes of the DOJ/FTC merger review process (slide 15), turn to how the provisions in the merger agreement can further or impede the objectives of each party (slides 16-18).
- Third, take a quick look at the organization of a typical merger agreement (slides 19-24). After (or while) reading these slides, look at the table of contents of the Hertz/Dollar Thrifty agreement (pp. 52-56).
- Fourth, examine the types of specific provisions in a merger agreement that allocate the antitrust risk (slides 25-50). For the ambitious, as you read each of the specific provisions, locate the actual provision(s) in the Hertz/Dollar Thrifty agreement and see what the parties agreed to do in this deal. Alternatively, you can see them individually analyzed in Risk-Shifting Provisions in Hertz/Dollar Thrifty (supplemental class notes).

[4] I should emphasize that this is a personal approach and not a view on what the formal rules of ethics governing lawyers necessarily require. Some attorneys to whom I have spoken who know more about the formal requirements of the ethics rules agree with me when the conduct in question is criminal, but say that my approach is more restrictive than necessary when the unlawful conduct would not be criminal. Others, however, are not so sanguine about the noncriminal scenario.

- Finally, read the summary in the class notes (slides 51-53.

The bidding war. After Hertz and Dollar Thrifty signed their 2010 merger agreement, Avis Budget Group launched a "topping" bid (pp. 143-146). You might wonder how Avis Budget could come into the picture with a competing bid after Hertz and Dollar Thrifty had signed a definitive merger agreement approved by each company's board of directors. The answer is that Delaware corporate law—and most public corporations are Delaware corporations (including Hertz Global Holdings and Dollar Thrifty Automotive Group)—holds that ironclad lockups of a company in a merger agreement violate the so-called *Revlon* fiduciary duties of the target company's board of directors. Under *Revlon*, the board of a target company must seek the highest value reasonably available to shareholders, and therefore cannot enter a merger agreement that prevents superior offers from being considered. As a result, merger agreements involving Delaware corporations contain a provision that permits the target company's board to terminate a signed merger agreement in order to accept a superior bid from a third party. This provision is commonly called a "fiduciary out." *Revlon* duties terminate when the shareholders vote to approve the transaction. I have a short note on fiduciary outs in the reading materials (pp. 147-153).

In years past, I have assigned the press releases, letters to shareholders and employees, the occasional investor presentations, transcripts of analyst calls, and excerpts from SEC filings that tell the entire story of the bidding war. This year, I have made those materials optional and moved them out of the required reading materials.[5] Even so, I strongly recommend that you read them. Despite their apparent length, they are quick and easygoing reads. They will give you an excellent feel of how a contested takeover proceeds. If you look at these optional materials, I suggest you read them on-screen. Read them like a novel. Look for how Dollar Thrifty maneuvered to obtain a higher deal price *and* risk-shifting provisions that provided a higher probability of closing. At the same time, watch for how and with what success Hertz and Avis Budget each resisted the Dollar Thrifty demands. Finally, keep in mind that Hertz and Avis Budget knew very little about what the other was doing in the bidding except for these publicly released materials.

The FTC merger review. Next, we turn to the outcome of the FTC merger review. Read the FTC press release and the administrative complaint (pp. 155-162). Make sure you understand the FTC's theory of the case and ask how well you would have predicted the consent decree relief if you had known the basic facts. You may find it helpful to know that most airports collect data on airport rental car operations, so you may assume that you would have known the locations of each airport in which Hertz and Dollar Thrifty overlapped, the names of the other airport rental car competitors, and the revenues or revenue market shares of each of the companies.[6] If your client is one of the merging parties, you would also have known their expansion plans for the future, so that you can do at least one side of the potential competition analysis.

Also, note that the FTC complaint alleges *two* separate and distinct violations. This is standard FTC practice. By contrast, DOJ complaints charge only violations of Section 7 of the Clayton Act. What is going on here?

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[5] *See* Hertz/Avis Budget/Dollar Thrifty: The Bidding War in the Unit 3 supplemental materials.

[6] For some examples of statistics on airport car rental operations, see the monthly reports from the Denver International Airport, the Kansas City International Airport, and the Charleston International Airport.

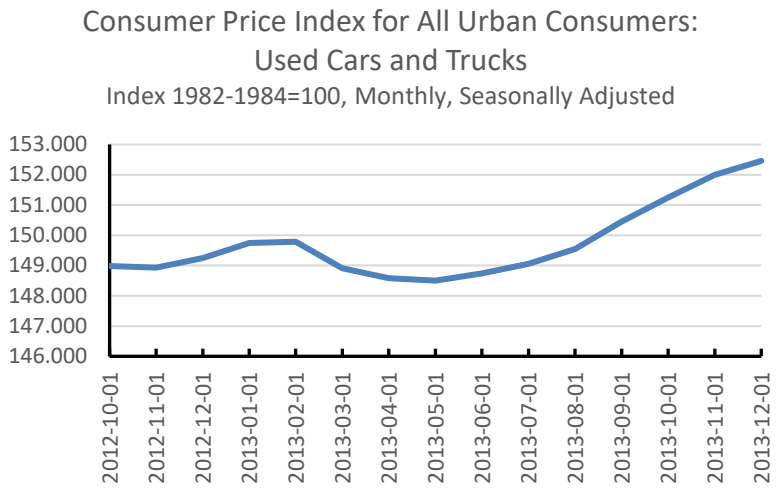
Once the FTC accepted the consent decree subject to public comment on November 15, 2012 (sometimes called *provisional acceptance*), the FTC permitted the Hertz/Dollar Thrifty deal to close without interference.[7] The merging parties consummated the deal five days later (p. 163). As we saw in Unit 5 on antitrust settlements, the FTC rules require that a provisionally accepted consent order be placed on the public record and published in the Federal Register with an invitation for comment on the order. That notice was published on November 26, 2012, and the period for public comments closed on December 17, 2012.[8] Usually, there are no public comments, and the Commission often votes on final acceptance of the order about four to six weeks after the public comment period ends. Here, however, the Commission did not finally accept the consent order (and then in a slightly modified form) until July 10, 2013, seven months later (p. 165). What does this suggest about the provisionally accepted consent order?

The aftermath. The remaining materials deal with what happened after the Commission approved the consent decree (pp. 167-205). The story is a modern legend in antitrust circles. The FTC's consent order required Hertz to divest Simply Wheelz LLC d/b/a Advantage Rent A Car to a joint venture between Franchise Services of North America (FSNA) (the owner of the U-Save rental car brand) and Macquarie Capital (a private equity investor). As part of the divestiture, Simply Wheelz leased 24,000 vehicles from Hertz. The Hertz master lease agreement required Simply Wheelz to bear the residual value risk of the leased fleet. In practical terms, this meant that at the end of the lease term for a car, Simply Wheelz would pay Hertz the contractually specified residual value of the car. Title to the car then would pass to Simply Wheelz, which would sell the car at auction. Simply Wheelz would make money if the auction price was greater than the contractually set residual value for the car and lose money if the auction price was less than the contractually set residual value.

[7] The Commission's vote approving the complaint and provisionally accepting the proposed settlement order was 4-1, with Commissioner J. Thomas Rosch dissenting. Commissioner Rosch explained: "I voted against acceptance of the consent decree because I found it inadequate to resolve the competitive concerns at several dozen other airports affected by the transaction. I would have instead voted to challenge the transaction because of the significant risk of post-merger coordinated interaction among the remaining competitors." *See* News Release, Fed. Trade Comm'n, FTC Requires Divestitures for Hertz's Proposed $2.3 Billion Acquisition of Dollar Thrifty to Preserve Competition in Airport Car Rental Markets (Nov. 15, 2012).

[8] *See* Fed. Trade Comm'n, Hertz Global Holdings, Inc., Analysis of Agreement Containing Consent Orders To Aid Public Comment, 77 Fed. Reg. 70440 (Nov. 26, 2012).

Rental car companies maintain a new fleet by replacing their cars every six months or so. When Simply Wheelz began auctioning off its older leased fleet vehicles as part of ordinary course fleet management activities, it began to experience significant losses because used car prices were falling. The following chart (which tracks retail prices) is indicative of the dip in wholesale prices:



Source: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: Used Cars and Trucks in U.S. City Average [CUSR0000SETA02], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CUSR0000SETA02, August 13, 2023.

As of October 25, 2013, Simply Wheelz had sold 5,295 vehicles for an average loss of $1,633 per vehicle and a total loss of approximately $8.6 million. On October 9, 2013, Simply Wheelz failed to make a required payment to Hertz under the lease agreement. On November 2, 2013, after negotiations between Simply Wheelz and Hertz to restructure the credit arrangement failed to conclude, Hertz gave notice that it was terminating the Master Lease Agreements and seeking the return of the entire Hertz Leased Fleet.

On November 5, 2013, four months after the Commission approved the consent order in final, Simply Wheelz filed for bankruptcy to freeze the lease agreement.[9] As part of the bankruptcy proceedings, Franchise Services of North America conducted an auction to sell certain of Advantage's assets. The Catalyst Group, Inc. was the winning bidder for 40 locations, leaving Advantage with 28 locations. The bankruptcy court approved the sale. Under Paragraph V of the FTC's consent order, FSNA was also required to obtain prior approval from the FTC before disposing of any assets it acquired as the original divestiture buyer. The FTC approved the sale to the Catalyst Group on January 30, 2014 (pp. 167-190). FSNA then petitioned the Commission to sell 22 of the 28 remaining locations to Hertz (10 locations) and Avis (12 locations), which the Commission granted on May 29, 2014 (pp. 191-203). Subsequently, FNSA petitioned to sell one

[9] *In re* Simply Wheelz d/b/a Advantage Rent-A-Car, No. 13-03332, Chapter 11 (Bankr. S.D. Miss. filed Nov. 5, 2013).

closed Advantage location in San Jose to Sixt Rent-a-Car, LLC, and another closed Advantage location in Portland to Avis Budget Group, which the Commission approved on September 2, 2014.[10]

On June 26, 2017, FSNA filed for Chapter 11 bankruptcy protection in federal bankruptcy court in Mississippi. The company's decision to seek bankruptcy protection was driven by several factors, including liquidity issues associated with expenses incurred in pending litigation by and against its former financial advisor, Macquarie Capital (USA) Inc., and two Macquarie employees who also served as directors of the company, in connection with the acquisition of Simply Wheelz.

The story illustrates how poorly chosen or poorly capitalized divestiture buyers can undermine a consent decree's effectiveness and leave the agency with limited remedies once the transaction has closed.

Enjoy the reading! Email me if you have any questions.

[10] This petition and approval letter are not included in the reading materials.