Cendant Auction

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In December 1997 a typical corporate event occurred. One corporation, HFS merged into another, CUC and the result was renamed Cendant. Cendant Corporation is known to most of us not as Cendant but as the owner of such diverse activities and services as the Ramada Inn chain, Avis Rent-A-Car, the Real Estate Enterprises of Century 21 and Caldwell Banker, ERA, Days Inn and other various travelers and shoppers services. And as one might expect, such an enterprise had been favorably received on Wall Street and Cendant's stock was one of the most favorably appreciated by the market until April 15, 1998 when Cendant publicly announced that the financial reports of CUC for the year 1997 were incorrect. And cautioned that other years might have false information. In other words, the books had been cooked. And as you would expect, stock which was trading in the neighborhood about $35 ⅝ plummeted 47% directly to about $19. And as you also would expect, complaints were filed against the corporation by shareholders of not only Cendant but former shareholders of HFS and CUC - as well as those persons who held derivative securities known as Prides issued by Cendant. And all those claims came to rest in New Jersey because Cendant has its principal place of business there, in my home state. Those complaints, those claims, alleged violations of the 33 and 34

Securities Act Section 11, 12 10(b) Rule 10(b) and all other good things that you're supposed to abide by if you are in the stock issuing business. As luck would have it, and it was nothing but luck, the luck of the wheel, that case was assigned to me and the other cases which flowed from other jurisdictions because of their commonality. I realize there are a lot of you who are much more expert on this than I was at the time because frankly, this was my first securities and exchange case and it has turned out to be my most interesting case since I've been a Federal Judge. I'm going, today, to try to share with you my view of it, however inexperienced it may be. I don't pretend to be the last word on this matter but I think possibly this may be of help to get my impressions from a novitiate. All right, as I said, the main complaint was filed. Thereafter the other ones came in from other jurisdictions and the question came as you would expect, who would be lead plaintiff. At that time, we had at least fifteen moving parties in response to the PSLRA, seek that denomination. We had individual investors who sought the matter of lead plaintiff and we had pension funds from around the country who wanted to be lead dog. There was a triumvirate of the California state pension fund, New York state pension fund, and New York City's version that alleged $89 million dollars in loses, an amount substantially greater than the next group which was a partnership between Ohio's pension fund and the city of

Philadelphia's teachers fund. Now I can appreciate that later cases have indicated that a greater examination of who should be lead plaintiff might be more appropriate than was done in my case. In my case it appeared readily to me that there was inherent commonality of interest in the proposed triumvirate of California, New York State and New York City because all represented large state or municipal organizations with obvious trustee or fiduciary obligations to many government employees: each would be assumed to have an interest in maintaining the integrity of retirement funds for such employees. It is true that they had had no previous relationship, and that they had come together for that purpose. But I frankly still see nothing wrong with it. It was relatively easy to determine who should be general lead plaintiff and I did consider the triumvirate as the one presumed to have the greatest financial interest without any successful rebuttal of that presumption. But it did appear, as voiced by an objector, that that triumvirate had over $300 million dollars invested in Merrill Lynch. And that was significant because Merrill Lynch had been the underwriter of the Prides securities. And would of necessity be a defendant in any matter brought by the Prides holders. With regard to Prides the apparent losses of the triumvirate were about $6 million dollars. So they had $300 million dollars invested in Merrill Lynch and only $6 million dollars approximately lost in the Prides debacle.

It was obvious to me that there was a conflict, an apparent conflict of interest which was seized upon by another investor for the right to represent Prides as the plaintiff, and I agreed. Therefore, we had two sets of lead plaintiffs. Lead plaintiffs for the general investors and lead plaintiffs for the Prides investors. But something else remained to be done and that was a determination of lead counsel. And as I discussed with some of you a couple years ago when I was here, my clerks and I thought, in view of the aims of the private litigation act and also having got wind of what Vaughn Walker had done in the Oracle matter, we thought that it'd be a good idea to consider the idea of an auction to determine who would be lead counsel. As a matter of fact, I spoke a couple of times on the phone with Vaughn. Fortunately, that year I had not only two very bright clerks, but each was a dabbler in the market and conversant and aware of market forces, I having been an art collector of <u>small</u> means was used to going around the auction houses of New York City, and am well aware and well acquainted with the auction process as practiced by New York houses such as Sotheby's and Christies which unfortunately have got them in some bad trouble recently. So we thought about the concept of an auction. Because ours was the first under the PSRLA I told them that to deal with the overall objective of insuring that we could get reasonable fees but at the same time honoring the direction that lead plaintiff

should have the right to select counsel subject to the court's approval, we would engraft a right of first refusal into the process. That is to say, anyone who was interested in being lead counsel, including original counsel of lead plaintiffs, would have to bid to a grid that I furnished. Upon submission of the bids, I would review the qualifications of each bidder, such as the bidder's litigation record, its reputation, the ability to pursue the cost of litigation as well as the bids. After I did this, the lowest qualified bidders for the general class and the Prides class were not the original counsel to either Lead plaintiff. Original counsel, could agree to the terms of the lowest qualified bidder, and become, if qualified, lead counsel. I announced the bids and the winners to a closed session of the plaintiff firms which had submitted bids. Each bidder pledged confidentiality to maintain the adversarial integrity of the bids. I did not want the defendants to know what the bids and the grid were for obvious reasons - It could damage plaintiffs' ability to negotiate the best bargain. From the copy of the unsealed bid opinion which you have, let's look at the bids.

Now after the lowest qualified bid was determined and announced to those contenders in September of 1998, within two weeks original counsel for the lead plaintiffs in the general and in the Prides case indicated their desire to accept the lowest bid terms and I obviously permitted that. Thereafter I met with

lead counsel, lead plaintiffs and defendants in the main case. And around the conference table I suggested that it might be appropriate for them to have the benefit of a year to try to resolve the matter. I felt that the basic liability was probably established already by the public announcements of Cendant - although there were complicated matters as to apportionment of the damages and the determination of damages among the various defendants, particularly individuals. Consequently, I felt as though keeping in mind the thrust of the private litigation statute, that it would be appropriate if we could satisfy or compensate the injured shareholders as soon as reasonably possible and also prevent Cendant from becoming terminal by trying to remove the cloud of litigation over its corporate head as soon as possible. I thought probably that a year might do it. So, the parties and I agreed to the format wherein they would meet with me every four or five weeks for a status conference. In the interim, regular motion practice would be pursued with the commitment by me to make decisions as soon as possible and not to keep the various parties hanging as to what might be the court's opinion in some motion matter. Fortunately for everyone, everyone kept his and their part of the bargain. I decided motions regularly. Most of the time I decided them from the papers generally, although I reserved final expression until we had oral argument, just in case oral argument persuaded me

otherwise or caused me to modify my view. Most times after I had heard oral argument I read the opinion from the bench and everyone knew what had happened that day. They also religiously kept in touch with me from the stand point of status conferences. As example, the lead counsel came to me shortly after the beginning of the litigation year and sounded me out with regard to their desire to, by auction, as it turned out, to engage the services of financial experts to assist them. As it turned out, they got Lazard Freres as their expert. So that's the way it went for a year. Defense counsel also met with my separately. My deciding the motions, my regular meeting with the the parties in conference, occasionally by telephonic conference, and lo and behold, toward the end of December of 1999 I was informed that the matter had been resolved. As it turned out, I won my nickel bet which I originally bet Lead counsel that the case would be settled by then. Now as to the terms of the settlement, oh, by the way, I failed to mention, in the interim, shortly thereafter litigation began, lead counsel for the Prides filed a summary judgment motion and also an injunctive motion to require Cendant to post $300 million dollars in escrow for the expected judgment of the Prides holders. And frankly, I'll share this with you, I really think the defense was somewhat startled and caught unprepared for that frontal assault so soon in the litigation and they looked at me as with the pained eyes of deer, caught in the

headlights - I told them as far I was concerned, I would permit the Lead counsel to make such a motion. So as you can expect, he settled his case early on for full com-pensation of the Prides holders, $341 million although that compensation took the form of paper for paper. His securities didn't ripen until 2001 and the settlement was the exchange of new securities for the old which would ripen into Cendant stock in 2001. So it turned out that everything went well with regard to that matter, and I was very pleased. But getting back to the main case, it was told to me in December and later with regard to the motions for approval that Cendant had agreed to settle for $2.87 billion dollars and that Ernst and Young, the defendant accounting firm, had agreed to settle for $335 million dollars. There are other details of the settlement which we can flesh out now but basically that was the proposed settlement. The requested fees of counsel came in at 8.275% percent according to the accepted bid, which aroused the eyebrows of some persons. Most importantly the New York City pension fund, which had earlier joined with the other pension funds to become lead plaintiffs, was and still is upset and is taking the appeal route. With regard to some other individual plaintiffs they too are seeking the appeal route for the review of that award. The settlement itself is subject to attack by investors who believe I erroneously disallowed their opting out of the class as well as - arguing that the settlement should have

been for more. So we will have to see what the Circuit does with regard to that. But in the meantime, I would strongly urge all of you, if you have similar matters to consider the efficacy of the auction process with determination of lead counsel where you believe, you can get a representative number of bidders to engage in market or adversarial competition so that the lowest qualified fees or bid can be determined. Notice I keep saying qualified, unfortunately some Florida District Court has misread my opinion in the sense that it believes I had merely an exercise in determining what was the lowest fee. It was not just an exercise in determining what was the lowest fee. The initial step is for the court as I did in this matter to review the qualifications of all bidders and I insisted that original counsel for would be lead plaintiffs bid as well. And after I determined what bidders were qualified, then I determined the lowest bid for such services. So I want to stress to you that it is a qualitative analysis, it is not merely a quantitative analysis as apparently the Florida judge misunderstood.

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