

# Advocate

A SECURITIES FRAUD AND CORPORATE  
GOVERNANCE QUARTERLY

## IN RE CENDANT: THE DAWNING OF A NEW AGE

by Jeffrey N. Leibell and Ryan D. Poliakoff

In November of 1997, Waste Management, Inc. admitted to what appeared to be the largest financial fraud that the corporate world had ever seen. Over the course of six years, Waste Management had publicly filed materially false financial information, overstating its income in each year between 1992 and the third quarter of 1997 by greater than \$100 million, for a total fraudulent overstatement of over \$1.3 billion. Private plaintiffs sued to recover what was estimated to be billions of dollars in overall damages. Those plaintiffs alleged deliberate fraud at the highest levels of the Company. In fact, they alleged the Company had maintained two sets of books. The eventual settlement? \$220 million — a relatively meager portion of the total damages. At the time, however, this was widely considered an excellent result because of the sheer dollars involved. Significantly, institutional investors did not lead that case and the plaintiffs were mostly small shareholders. In other words, this was, in reality, lawyer driven litigation.

Fast forward only five months to April 15, 1998 — just several months after the effective date of the merger between CUC International, Inc. and HFS, Inc., to form Cendant Corporation. On that date, Cendant announced that a massive fraud had been committed by CUC. This sent Cendant's share price plummeting almost 47%, and its market capitalization dropped by \$14 billion. Damages have been estimated at about \$7 billion. This time, however, Cendant and CUC's auditor, Ernst & Young LLP, settled for \$3.2 billion in cash — over 42% of the estimated compensable damages. Further, Cendant agreed to a host of unprecedented corporate governance changes to ensure that a similar fraud could never again occur, unlike

*The Cendant litigation: how motivated and duty-driven public pension funds, in their first effort at taking the leadership of a securities fraud class action, achieved the largest securities fraud settlement in American history.*

Waste Management. This exceptional result is directly related to *institutional investor control over the prosecution of the case.*

What follows is the story of the Cendant litigation, and how three motivated and duty-driven public pension funds — the California Public Employees' Retirement System ("CalPERS"), the New York State Common Retirement Fund (the "Common Retirement Fund") and the New York City Pension Funds — in their first effort at taking the leadership of a securities fraud class action — achieved the largest securities fraud settlement in American history.

Cendant was formed in 1997, through the merger of CUC International, Inc. and HFS, Inc. CUC was a consumer marketing giant, specializing in such products as the Entertainment Discount Card. HFS was a franchising specialist, owning the rights to such famous names as Avis Car Rental and Howard Johnson. The merger of the two companies promised to create an earnings juggernaut. It, therefore, came as a complete shock to the investment community when, on April 15, 1998, Cendant announced

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## Inside Look

We began the new millennium with the publication of our first *Institutional Investor Advocate Bulletin*. The *Bulletin*, which will be published as the need arises, addresses emerging issues in the securities class action arena that have the potential to immediately affect institutional investors in a very significant way. Our first *Bulletin* focused on the deceptive means being employed by the plaintiffs' bar to solicit institutional investors to participate in securities litigation as lead plaintiffs in securities class actions. The *Bulletin* article, *Mass Solicitations Dupe Institutional Investors*, written by firm partners Max W. Berger and Robert S. Gans, points out that one does not need to take any kind of affirmative action to participate as a class member in securities class actions and suggests the steps institutional investors should follow to avoid being duped. If you have not received your issue of the *Bulletin* or would like additional copies, please contact us by telephone or e-mail.

Our first quarterly issue of 2000 celebrates the story of how three highly motivated and duty-driven public pension funds — CalPERS, the New York State Common Retirement Fund, and

the New York City Pension Funds — in their first effort at taking the leadership of a securities fraud class action — achieved the largest and most significant securities fraud settlement in American history. Written by Jeffrey N. Leibell and Ryan D. Poliakoff, *In re Cendant: The Dawning of a New Age* explores the high drama both in and out of the courtroom in the \$2.8 billion cash settlement with Cendant Corporation, together with extensive corporate governance changes, as well as the landmark \$335 million settlement with Ernst & Young.

In addition to our regular columns, I direct your attention to an especially significant *Informed Sources*, which answers the question of whether an institutional investor can still become lead plaintiff after the 60 day statutory period has lapsed. We feel that this topic is so important that we will explore it in greater detail in future issues.

As always, we welcome comments from our readers by calling 800-380-8496 or by E-mailing us at [blbg@blbglaw.com](mailto:blbg@blbglaw.com). We also invite you to visit to our newly designed web site at [www.blbglaw.com](http://www.blbglaw.com).



one was hit harder than institutional investors. It is estimated that over 80% of Cendant's stock was owned by various institutions at the time of the fraud. In fact, the vast majority of available stock in most "large cap" public corporations is owned by institutional investors. Despite their obvious financial interest, institutional investors had not actively participated in securities class actions; on the contrary, securities fraud lawsuits had historically been brought by individual investors who often held as little as a single share of stock.

Congress passed the Reform Act to encourage institutional investors, such as public pension funds, to take control of such securities class actions. (For a more detailed discussion of the Reform Act, please see *Institutional Investors as Lead Plaintiffs: Is There a New and Changing Landscape?*, in Volume 1, First Quarter, 1999 of the *Institutional Investor Advocate*.) At first, the Reform Act appeared to generate little interest among institutional investors. Institutions had not traditionally participated in securities class action lawsuits, and did not see how becoming plaintiffs could affect their bottom line: investor profits. But institutions were making behind the scenes preparations to enter the securities class action arena. When Cendant announced that CUC had misstated its earnings by hundreds of millions of dollars, it was enough for the three largest public pension funds in America to sit up and take notice.

After the initial lawsuits against Cendant were filed, fifteen separate plaintiffs or so-called plaintiff "groups" sought appointment as lead plaintiff. Among those lead plaintiff applicants was the group comprised of CalPERS, the Common Retirement Fund and the New York City Pension Funds. Collectively, they purchased about 12 million shares of Cendant stock and had lost nearly \$90 million due to Cendant's fraud; these losses were significantly larger than the

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that the Company's new management team had uncovered "accounting irregularities" in CUC's pre-merger bookkeeping. Cendant disclosed that it would restate previously reported 1997 financial results; specifically, 1997 net income would be reduced by \$100 to 115 million. By July 14, 1998, Cendant announced that it would restate CUC's and Cendant's financial results for 1995, 1996 and 1997, and all quarters of those years. At that time, Cendant admitted that a massive fraud had occurred at

CUC that included improperly recognizing fictitious revenues, falsely coding services sold to customers, and fraudulently manipulating merger reserves. Finally, on August 28, 1998, Cendant filed a report with the SEC that detailed the fraud that had been perpetrated by CUC. Over three years, CUC's operating income had been inflated by approximately \$500 million, and earnings per share by \$0.61.

Investors were, understandably, enraged. What had looked like a safe investment in a stable growth company, turned overnight into a loss nightmare. And no

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losses of all other lead plaintiff applicants combined. The Court recognized the Reform Act's congressional mandate. By order filed September 8, 1998, these three pension funds were appointed as Lead Plaintiffs in the consolidated Cendant class action. The Lead Plaintiff appointment was only the first step in a longer battle, however.

Prior to seeking lead plaintiff status, the three pension funds had selected two law firms, Bernstein Litowitz Berger & Grossmann LLP and Barrack Rodos & Bacine, as their counsel in the lawsuit. With respect to the appointment of lead counsel for the class, the Reform Act expressly provides that: "[t]he most adequate plaintiff shall, subject to the

approval of the court, select and retain counsel to represent the class." Rather than approve Lead Plaintiffs' choice of counsel, in the first instance, the Court instituted a competitive bidding process by which any attorney, whether or not in the case, was free to submit a fee bid with the Court determining the lowest *qualified* bid from among those submitted. Lead Plaintiffs were, therefore, faced with the possibility that their choice of counsel would not be respected by the court. This was a substantial issue, as Lead Plaintiffs had already gone through an exhaustive process to select their counsel. Under the terms of the auction process, however, if chosen counsel did not submit the bid determined by the Court to be the lowest qualified bid, then Lead Plaintiffs' chosen counsel would be allowed by the Court to match the bid. If chosen counsel refused to match the selected bid, the Court would select the counsel who had submitted the bid. As it turned out, Lead Plaintiffs' chosen counsel were appointed by the Court to be Lead Counsel to the Class. Any issues that might have arisen regarding a litigant's right to choose their own counsel were, thus, averted.

Once Lead Plaintiffs and Lead Counsel had been appointed, it was finally time to prosecute the Action. The sheer size of the lawsuit made it unlikely that Cendant and the other defendants would give up without a substantial fight. Lead

Plaintiffs began their prosecution by filing an Amended Complaint, which set forth the allegations against all defendants in extraordinary detail, and simultaneously moved the Court to certify the Class and for partial summary judgment on certain of the Class' claims against the Company. Cendant, in an effort to avoid litigating the motion for partial summary judgment, voluntarily provided documents to Lead Plaintiffs, who agreed to set aside their motion in order to gain access to these documents. Under the Reform Act's automatic discovery stay,

*The sheer size of the lawsuit made it unlikely that Cendant and the other defendants would give up without a substantial fight.*

these documents would not have been made available to Lead Plaintiffs until after the other defendants' motions to dismiss were decided — which could have been months down the road.

Largely as a result of Lead Plaintiffs' status as public pension funds, the Court refused to allow any of the defendants to undertake class discovery, finding that all the information necessary to

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## BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP

Bernstein Litowitz Berger & Grossmann LLP prosecutes class and private actions, nationwide, on behalf of institutions and individuals. Founded in 1983, the firm's practice concentrates in the litigation of securities fraud; corporate governance; antitrust; employment discrimination; and consumer fraud actions. The firm also handles, on behalf of major institutional clients and lenders, more general complex commercial litigation. The firm's client base in securities fraud and corporate governance litigation includes large public pension funds and other institutional investors.

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## Eye On The Issues

LEGISLATIVE/REGULATORY UPDATES  
AND RECENT DECISIONS OF INTEREST

By Steven B. Singer

**SEC Takes Aim at How Companies Report Revenue.** The Securities and Exchange Commission, saying it was worried that some companies book revenue — and thus profits — before they should be able to do so, issued guidance that could lead to some companies being more conservative in reporting revenue.

The staff accounting bulletin was intended to clarify and interpret existing rules, not to make new ones. But in some cases it may force accounting charges by companies that had relied on interpretations that the SEC rejects.

Among the practices covered are “channel stuffing,” in which companies sell large amounts of goods to distributors, thereby getting quick profits, and “bill and hold” transactions, in which revenue is recognized even though a product has not been shipped and no payment is required for a long time. *The New York Times*, December 18, 1999.

**Public Pension Fund Appointed Lead Plaintiff in Prominent Securities Case.** Continuing the trend of public pension funds seeking and being appointed lead plaintiff in significant securities class actions, the New York State Common Retirement System was recently appointed lead plaintiff in the securities fraud litigation against McKesson HBOC Inc. On December 23, 1999, U.S. District Judge Ronald M. Whyte of the Northern District of California selected the New York State System to be lead plaintiff after finding that its potential losses exceeded those of any other individual investor. In selecting the New York State System, the court emphatically rejected the attempts by numerous plaintiffs’ lawyers to aggregate groups consisting of hundreds of small investors in an attempt to contrive the largest financial interest in the case. More than dozen applications to become lead plaintiff were filed after McKesson HBOC stock plummeted by nearly 50 percent in April 1999, following the disclosure that HBOC, the nation’s largest supplier of patient monitoring systems, had overstated its revenues by hundreds of millions of dollars. *New York Law Journal*, December 30, 1999.

**Auditors Miss A Fraud and SEC Tries To Put Them Out of Business.** In a rare move that commentators have stated is “sending shivers through the accounting world,” the SEC is seeking to bar two auditors from Coopers & Lybrand (now

part of PricewaterhouseCoopers) from signing off on audits of public companies. The SEC’s action arises out of a financial fraud that occurred at California Micro Devices Corp. in the early 1990s, where one third of the company’s revenue turned out to be fictitious. To inflate revenues, the company frequently booked bogus sales to fake companies for products that did not exist, and often booked revenue for products shipped when customers had not even ordered the products. Eventually, the company’s top two officers were convicted of securities fraud, and Cal Micro’s chief accountant testified at the trial that Coopers approved many of the fraudulent practices. The SEC instituted administrative proceedings against the two principal Coopers auditors on the engagement, charging that they “conducted the audit in a vacuum, recklessly ignoring unmistakable red flags” evincing fraud. An SEC administrative law judge is set to begin a hearing on the allegations in late February. *The Wall Street Journal*, January 6, 2000

**Accounting Firm Is Said To Violate Rules Routinely.** Most partners of PricewaterhouseCoopers, the world’s largest accounting firm, violated rules requiring that they not have investments in companies audited by their firm, the Securities and Exchange Commission said in a report released in early January. The firm said five partners had been dismissed as a result of the investigation.

The report, compiled by a law firm that studied the accounting firm after previous problems led to SEC action in a few cases, documented a system in which violations were routine, many partners said they were unfamiliar with details of the long-standing rules and little effort was made by the firm to enforce them.

The SEC said that 31 of the 43 partners in the firm’s top leadership had committed at least one violation, as had six of the 11 partners responsible for enforcing the rules requiring that senior employees of accounting firms have no stake in the companies whose financial reports the firm is certifying as independent auditors. Altogether, the investigation found 8,064 violations by partners and employees of the firm.

The SEC expressed grave concerns about the report’s findings. “This report is a sobering reminder that accounting professionals need to renew their commitment to the fundamental principle of auditor independence,” said Lynn E. Turner, the chief accountant of the SEC and a former partner of Coopers and Lybrand, one of the firms that merged in 1998 to form PricewaterhouseCoopers. He said a new study would review the performance of other major accounting firms, adding, “I am concerned about whether the new study will find any differences between the firms.” *The New York Times*, January 7, 2000.

**Selective Disclosure Tackled By SEC Rules Proposal.** The SEC has proposed broad new rules addressing the selective disclosure of non-public information to favored analysts rather than the general public.

Under the proposed rules, a corporation intentionally disclosing material information to analysts must publicly disclose the same information simultaneously. In the event of an accidental or inadvertent disclosure, the corporation must promptly follow up with a public disclosure. "Promptly" means as soon as reasonably practicable, but no later than 24 hours after an unintentional disclosure. The SEC decided to treat intentional and unintentional disclosure differently because it did not wish to punish corporate officers who may have made a mistake.

If an officer does inadvertently disclose material nonpublic information, the SEC requires that prompt public disclosure be made through an SEC filing, a press release or press conference. While disclosure through a company Web site is encouraged, the SEC determined that Web site disclosure would be inadequate to satisfy the public disclosure requirement because a significant number of households do not have Internet access. *CCH Federal Securities Law Reports No. 1905*, January 12, 2000.

**North American Securities Administrators Cite "Bull Market in Fraud" In Calling for Increased Prosecution of Securities Law Violators.** In a speech at the annual enforcement conference of the North American Securities Administrators Association on January 9, 2000, NASAA President Bradley Skolnick called for a summit of state, federal and industry regulators to increase the state level prosecution of securities law violators. Skolnick stressed that he also wanted to see tougher penalties for securities law violators, including increased criminal sentences, and urged state prosecutors to bring "many more" criminal prosecutions against wrongdoers. The speech is part of Skolnick's plans to address what he called a "bull market in fraud." *Securities Regulation & Law Report*, January 17, 2000.

**Companies May Exclude Shareholder Proposals for Stock Dividends from Proxy.** In a recent ruling, the SEC held that a request for stock dividends made pursuant to a shareholder proposal may be excluded from a company's proxy.

In an SEC no-action letter dated January 6, 2000, the SEC determined that AT&T Corp. could omit from its proxy materials a shareholder request to provide stock dividends in the value of its current cash dividends. The shareholder submitting the proposal argued that stock dividends were entitled to more favorable income tax treatment because they were not immediately taxable and were subject to only long-term capital gain tax rates (if held for at least one year). The SEC deter-

## *CII Celebrates Fifteenth Anniversary*

The Council of Institutional Investors, the nation's preeminent organization founded to address pension funds' investment needs, celebrated its fifteenth anniversary in January 2000. The CII has proven to be one of the most important forces in investor representation and shareholder rights, and has been instrumental in the field of corporate governance and management accountability.

Bernstein Litowitz Berger & Grossmann LLP congratulates the CII for fifteen years of protecting the rights of investors across the country, and wishes the CII much success in the future.

mined that the proposal may be omitted pursuant to Rule 14a-8(i)(13) of the Securities Exchange Act of 1934, which provides that a proposal may be omitted if it "relates to specific amounts of cash or stock dividends." *Securities Regulation & Law Report*, January 31, 2000.

**Companies' Disclosure Efforts Need to Improve, Say Portfolio Managers.** The Association for Investment Management and Research, a nonprofit organization that includes more than 40,000 investment professionals, issued a report in February which criticized the disclosure efforts of public companies.

According to the AIMR, the biggest problem areas include explaining unusual or nonrecurring charges, disclosing off-balance-sheet assets or liabilities and issuing enough forward-looking information. Commenting on the report, Thomas A. Bowman, the president of AIMR, stated that "the quality of corporate and financial disclosure is a continuing concern to the global investment community." One analyst told AIMR the pressure to meet analysts' earnings expectations is causing chief financial officers to "push the envelope often" on disclosure.

Companies that AIMR cited as doing the best job of disclosure included General Electric Co., Microsoft Corp, Johnson & Johnson, Merck & Co. and Intel Corp. *The Wall Street Journal*, February 8, 2000.

*Steven B. Singer can be reached at [steven@blbglaw.com](mailto:steven@blbglaw.com).*

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determine that Lead Plaintiffs fulfilled the adequacy and commonality requirements of the Federal Rules already was provided in the certifications Lead Plaintiffs filed with the Amended Complaint. Faced with the inability to harass Lead Plaintiffs under the guise of class discovery, all defendants agreed to certify the Class. Then, on July 27, 1999, the court denied various defendants' motions to dismiss the Amended Complaint, holding that it sufficiently plead reckless or intentional conduct on the part of all defendants. With the motions to dismiss defeated, Lead Plaintiffs were now free to pursue discovery. Or so they thought.

Soon after the motions to dismiss were denied, a third-party defendant (one sued by defendant E&Y) moved for a stay of all proceedings against him, pending a criminal investigation by the U.S. government of the fraud allegedly committed by CUC's officers and directors. Cendant, E&Y and various other defendants soon followed suit, claiming

that, if the case were to be stayed against any one defendant, it should be stayed against all of the defendants. Even the government filed a stay motion, claiming that its case against former CUC officers would be prejudiced if discovery were granted in the class action. These stay motions threatened to derail the entire lawsuit. Lead

*Lead Plaintiffs remained in control of the Action through various means, and participated in and approved all significant litigation events.*

Plaintiffs would be denied the ability to prosecute the Action, and, thus, would be at a distinct disadvantage in settlement discussions. After weeks of extensive briefing — including Lead Plaintiffs' assurances that, as public institutions that wanted the perpetrators of the Cendant fraud brought to justice, they would not interfere with the government's investigation — the Court denied all of the stay motions. Finally, the case could proceed unhindered.

While the motions to dismiss and motions to stay were pending, Lead Plaintiffs began what were to be many months of intense settlement discussions with Cendant, and later with E&Y. These were not ordinary settlement negotiations, however. Unlike a small plaintiff in a typical securities class action, Lead Plaintiffs were not interested in a quick fix. Instead, as institutions which had lost

nearly one hundred million dollars, Lead Plaintiffs pushed for a settlement that they believed would properly compensate themselves, as well as the other class members; in other words, a settlement amounting to billions of dollars — unprecedented in securities class actions.

Further, it was important to Lead Plaintiffs, as institutional investors and as continuing Cendant shareholders, that Cendant take measures to prevent fraud from being repeated in the future. In a move unprecedented in securities class action litigation — one that demonstrated that these settlement discussions were not "business as usual" — Lead Plaintiffs demanded that Cendant agree to make meaningful corporate governance changes; for example, Cendant was asked:

- to adopt an institution-approved definition of "independent director";
- to ensure that a majority of the Board of Directors — as well as the entire audit, nominating and compensation committees — be comprised of independent directors;
- to agree that Cendant officers and directors could no longer "re-price" their stock options without the consent of a majority of Cendant's shareholders; and
- to also remove Cendant's staggered board so that all directors would be approved annually.

From the outset, and throughout the negotiations, the defendants were made and remained aware that Lead Plaintiffs were not in a hurry to settle, were not afraid of litigating their motion for partial summary judgment, and would not shy away from a trial on the merits.

In the meantime, Lead Plaintiffs continued to actively prosecute the case. Lead Plaintiffs were well informed about their true chances of winning the lawsuit, and were able to negotiate a fully-informed settlement.



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## *Informed Sources*

INFORMED SOURCES features questions and answers that address issues presented by our readers. If you wish to submit a question, and we encourage you to do so, E-mail us at [blbg@blbglaw.com](mailto:blbg@blbglaw.com), call us at 800-380-8496, or write to us at the firm address.

**Q** *What should an institutional investor do if it believes that a class action has been filed against a particular company prematurely, or that the suit lacks merit?*

**A** The lead plaintiff provisions of the Private Securities Litigation Reform Act ("PSLRA") require that a party seeking to be appointed as lead plaintiff for the class must move "not later than 60 days" after the date on which notice of the filing of a complaint is published. Often times, during the 60 day time period, it is difficult to determine whether a case has any merit. Indeed, many such questionable or marginal cases are filed by the traditional class action law firms immediately upon the announcement of negative news by a company and the corresponding drop in that company's stock price and before any factual detail can

be developed. This situation presents a difficult choice for an institutional investor: whether to wait until the case develops into a meritorious one and risk having the 60 day time period expire or file a motion for lead plaintiff in an action that it believes was filed prematurely.

The lead plaintiff provisions require an institution to consider the good and bad of a particular case. Just as an institution could move within 60 days to serve as lead plaintiff in a case it believes to be meritorious, that same institution should consider moving to be lead plaintiff in a case that it believes to have been filed prematurely. Then, once appointed, it can determine the best course to take on behalf of the class, which might even include voluntarily dismissing a case based upon evidence that the litigation lacks merit.

In most instances, however, an institution might not be willing to seek lead plaintiff status over a litigation believed to have been filed prematurely. In such a case, if the litigation ultimately develops into a meritorious case after the 60 day lead plaintiff time period has expired, an institution still has a limited number of options available to it: (a) convince the court that the pending cases were filed prematurely and the Court's lead plaintiff determination needs to be revisited; (b) pursue an individual action in federal court; and (c) a State public pension fund can bring a class action comprised solely of State public pension funds in state court.

Lead Plaintiffs in *Cendant* were involved in every aspect of the case, and in the settlement negotiations. They were advised about the relative strengths and weaknesses of the case against each defendant and formed their own judgments. They reviewed the damage analyses prepared by the Class' damages expert, as well as damage information provided by *Cendant's* damages expert. Lead Plaintiffs met extensively with their financial consultant, Lazard Frères, and with Lead Counsel. In fact, Lead Plaintiffs were consulted on all strategic settlement decisions prior to settlement meetings with defendants, and were debriefed afterward. As the settlements neared finalization, Lead Plaintiffs were in daily contact with Lead

Counsel, reviewed the memoranda of understanding — approving all terms.

What resulted, just more than one year after Lead Plaintiffs' appointment, was an unprecedented recovery: over \$3.2 billion in cash from all settling defendants, a variety of corporate governance improvements as outlined above, plus 50% of any net recovery *Cendant* or certain of its current and former officers and directors obtain in related (but separate) litigation against E&Y. That settlement is more than four times larger than the largest previous settlement in the history of securities class actions. The corporate governance improvements were unprecedented in securities litigation; indeed, such relief may not have even been

available under the federal securities laws if Lead Plaintiffs succeeded at trial. Lead Plaintiffs had desired direct payment from certain of the individual defendants (rather than just payment of the substantial insurance proceeds covering their liability). However, Lead Plaintiffs recognized that it was in the Class' best interests to accept the more than \$2.8 billion in cash from *Cendant*, and the assignment of the individuals' recovery against E&Y, together with the corporate governance improvements *Cendant* agreed to, rather than risk it all on the uncertainty of obtaining, at trial, such a sum from *Cendant* or, for that matter, any significant payment from the Individual Defendants.

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As for the E&Y settlement of \$335 million, standing alone it would be the third largest securities settlement in history; it is over four times more than any accounting firm has ever paid to settle a securities class action. With respect to Ernst & Young, Lead Plaintiffs believed that, although the fraud occurred at CUC, under the securities laws, accounting firms must stand as watchdogs on behalf of the investing public. The

*It was important to Lead Plaintiffs, as institutional investors and as continuing Cendant shareholders, that Cendant take measures to prevent fraud from being repeated in the future. They demanded that Cendant agree to make meaningful corporate governance changes.*

Supreme Court said many years ago that accounting firms have a paramount role in ensuring the accuracy of financial reports issued by public companies. Here, a massive financial fraud took place at CUC, which encompassed three annual reports, seven quarterly reports and some 20 registration statements, each of which included or incorporated fraudulent financial statements. Lead Plaintiffs believed that Ernst & Young failed to perform their watchdog function and Cendant shareholders paid the price.

The public reaction to Lead Plaintiffs' achievement was overwhelmingly positive. *The New York Times* reported that

the settlement was "by far the largest ever in a securities class-action suit." The *Times* further recognized that Cendant agreed to the corporate governance changes "at the insistence of the pension funds." Recognizing that the case was "a unique class action waged by large plaintiffs," John Coffee, the noted Columbia Law School Professor, reportedly stated that Lead Plaintiffs "were properly trying in [the] action to not only recover financial losses but to realize their priorities in corporate governance."

Lead Plaintiffs have themselves recognized the importance of their participation in the settlement. Charles P. Valdes, Chairman of the CalPERS Investment Committee, noted that the settlement "demonstrates the important role that pension funds can play as lead plaintiffs in securities actions. Not only have we recovered the losses incurred by all class members, but the company is emerging from the lawsuit stronger and worthy of greater confidence by the financial markets." Adam Barsky, Chairman of the Board of Trustees of the New York City Employees Retirement System and the Teachers Retirement System, agreed that the "landmark settlement was achieved by the model collaboration of some of the nations largest pension funds. . . ." And H. Carl McCall, New York State Comptroller, vowed that the pension funds would "always fight to protect shareholders . . . when they suffer losses because of management fraud or other grossly inappropriate behavior."

The Cendant settlement, indeed, represents "the dawning of a new age" in securities class action litigation. It proves the substantial power that institutional investors wield in the modern securities lawsuit. There has never been a settlement as significant, both in terms of dollars and corporate governance changes. And, looking at the history of the lawsuit, it is clear that the participation of institutional investors contributed significantly to the record results. No

party stands to lose or gain more from securities class actions than institutional investors. The result of the Cendant litigation, proves just how important it is for institutional investors to get involved.

*Jeffrey N. Leibell can be reached at [jnleibell@blbglaw.com](mailto:jnleibell@blbglaw.com).*

*Ryan D. Poliakoff can be reached at [rdp@blbglaw.com](mailto:rdp@blbglaw.com)*

## Contact Us

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[www.blbglaw.com](http://www.blbglaw.com)

**Editor:** Gerald H. Silk

**Editorial Director:** Ava C. Thorin

**Contributing Attorneys:** Jeffrey N. Leibell, Ryan D. Poliakoff and Steven B. Singer

### BERNSTEIN LITOWITZ BERGER & GROSSMANN LLP

1285 Avenue of the Americas  
New York, New York 10019

212-554-1400

800-380-8496

*Fax*

212-554-1444

*E-mail*

[blbg@blbglaw.com](mailto:blbg@blbglaw.com)