

Third Circuit Affirms Record \$3.2 Billion Settlement of Securities Class Action Lawsuit against Cendant Corporation and Auditor Ernst & Young

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The United States Court of Appeals for the Third Circuit recently affirmed the approval of the largest settlement of a securities class action case in history, but criticized the district court's decision to hold an auction to select lead counsel and remanded the case with instructions for the judge to significantly reduce the \$262 million in attorneys fees awarded to plaintiff's lead counsel. *In re Cendant Corporation Securities Litigation*, 2001 WL 980469 (3d Cir. Aug. 28, 2001).

Under the terms of the settlement, Cendant Corporation and its former auditor, Ernst & Young, agreed to pay a combined total of nearly \$3.2 billion to settle allegations that the company and its predecessor corporation, CUC International, engaged in a massive accounting fraud to artificially inflate its stock price. Writing for the Court, Chief Circuit Judge Edward Becker explained that approval of the settlement was warranted because the majority of the nine Girsh factors employed by the Third Circuit to determine the fairness, reasonableness and adequacy of class action settlements weighed strongly in favor of approval, whereas only a few of the factors weighed against it.

In addition to approval of the \$3.2 billion settlement, the decision is also notable for several other reasons. First, the Third Circuit held that the district court erred in conducting an auction to select lead counsel, as auctions are typically "inconsistent" with the Private Securities Litigation Reform Act of 1995 ("PSLRA"). Judge Becker observed that when Congress enacted the PSLRA, the selection of lead counsel was entrusted, at least initially, to lead plaintiff in the case. "[T]he power to select and retain lead counsel," Becker noted, "belongs, at least in the first instance, to the lead plaintiff, and the court's role is confined to deciding whether to approve that choice." Therefore, according to the Third Circuit, auctions generally should not be used to select lead counsel in securities litigation cases because such a process "involves the court rather than the lead plaintiff choosing lead counsel and determining the financial terms of its retention." Although Judge Becker acknowledged that there might be some cases where the PSLRA would allow the use of an auction process, "this [case] was not one of them." However, since lead plaintiff's choice of counsel ultimately secured the lead counsel position by matching the lowest reasonable bid submitted in the auction, the Third Circuit held that

the error was harmless.

In addition, the Third Circuit also remanded the case to the district court with instructions to significantly reduce the \$262 million in attorneys' fees awarded to lead counsel. The Court held that because lead counsel had previously negotiated a retainer agreement with lead plaintiff, lead counsel was at most entitled to the \$187 million in fees set forth in the agreement, or \$76 million less than the fees awarded by the district court. Noting, however, that even \$187 million in fees was a "staggering" amount and arguably compensated counsel at an "astonishing" hourly rate, the Third Circuit specifically directed the district court to examine the "reasonableness" of the fees in light of the relative simplicity of establishing Cendant's liability and the fact settlement was reached very early in the case. The Circuit Court then instructed the district judge to reduce the \$187 million award if he determined that such a fee was "clearly excessive" under the circumstances.