BARRACK BULLETIN

THE INSTITUTIONAL INVESTOR'S GUIDE TO SECURITIES CLASS ACTION LITIGATION

Volume 2, Spring 2001 Barrack, Rodos & Bacine

Selection of Class Counsel: Our Perspective

On January 30, 2001, Chief Judge Edward R. Becker of the United States Court of Appeals for the Third Circuit announced the formation of a Task Force on Selection of Class Counsel. The stated goal of the 2001 Task Force is to analyze methods currently used by federal judges to select class counsel and to evaluate competitive bidding as an appropriate method for making that selection. The 2001 Task Force solicited comments from interested parties and has held hearings throughout the spring of 2001. The Task Force has indicated that it plans to publish a draft report in October 2001, and a final report sometime after the Third Circuit Judicial Conference on November 13, 2001.

This is not the first time the Third Circuit has tackled the issue of counsel fees in class cases. In the mid 1980's, it established a Task Force to investigate and make recommendations with respect to how counsel fees should be awarded. The 1985 Task Force recommended that counsel fees should be set as a percentage of the recovery to the class; district courts should attempt to establish fees at the outset of a case; and courts and counsel should adhere to the fee structures set in advance when awarding fees.

On February 16, 2001, Barrack, Rodos & Bacine was asked to submit written comments to the 2001 Task Force and our senior partner, Leonard Barrack, was asked to testify before the Task Force. The following is a summary of our written comments submitted in advance of Mr. Barrack's testimony on June 1, 2001.

Barrack, Rodos & Bacine ("BRB") is a litigation firm with twenty five years of experience in major complex class action litigation in courts throughout the United States involving, *inter alia*, violations of the federal securities laws. BRB is unique among firms with similar practices in that it has extensive experience in both prosecuting and defending such actions. BRB has participated in class cases when various methods were utilized by courts to select class counsel. BRB's comments concern the manner by which courts may and should, in the circumstances of different cases, exercise their discretion in carrying out their obligation under Rule 23 of the Federal Rules of Civil Procedure – the rule governing the prosecution of class actions – to protect absent class members in the selection of, and awarding fees and expenses to, class counsel.

After the 1985 Task Force Report was issued, district court judges – with the endorsement of the appellate bench – began to award fees based on the percentage method. The question remained as to whether percentage fees should be established at the beginning or at the conclusion of common fund cases. The 1985 Task Force recommended establishing a percentage-based fee structure at the outset of a case as an effective way to ensure that the interests of class counsel are more closely aligned throughout the litigation with the interests of the Class. A minority of courts followed this recommendation and established percentage fee structures at the outset of class cases.

The *Manual for Complex Litigation* (3d ed. 1995) endorsed this practice, noting that "disputes will be reduced if the court advises the parties at the outset of the litigation what method will be used for calculating fees and, if using the percentage method, the range of likely

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percentages. This decision will have a substantial effect on incentives in the litigation." *Manual*, ¶¶ 4.21, 4.231 at 194-95, 199. (emphasis added).

The Third Circuit itself expressly recommended that district courts consider setting fees in advance in common fund cases, commenting that "district courts can avoid many of the complications associated with fee awards by setting fee guidelines and ground rules early in the litigation process." *Gunter v. Ridgewood Energy Corp.*, 223 F.3d 190, 201-02 n.6 (3d Cir. 2000).

In 1990, Judge Vaughn Walker, a United States District Judge for the Northern District of California, began the experiment of conducting auctions for the selection of counsel and the establishment of the fee structure under which counsel for plaintiffs would prosecute class actions. *See In re Oracle Securities Litigation*, 131 F.R.D. 688 and 132 F.R.D. 538 (N.D. Cal. 1990). The object of an auction "is to give the lawyer what he would have gotten in the way of a fee in an arm's length negotiation, had one been feasible.... To simulate the market where a direct market determination is infeasible." *In re Amino Acid Lysine Antitrust Litigation*, 918 F.Supp. 1190, 1194 (N.D.Ill. 1996).

Thus, we believe that by providing the Lead Plaintiff's chosen counsel with a right to "match" the bid that the court determines is the lowest qualified bid the court will satisfy its obligations under the PSLRA. Providing an ability to match ensures in most cases, that courts will not perform 'shotgun marriages' of lead plaintiffs with counsel not of their choosing.

While district courts have the discretion to select class counsel pursuant to an auction, and to utilize the auction process to establish the fee structure for class counsel in advance, we believe that such auctions should be undertaken only in very rare cases in which the court can: (a) reasonably anticipate that numerous, competent law firms will seek appointment as class counsel; (b) reasonably evaluate the likelihood of a recovery for the class; and (c) reasonably foresee a very substantial recovery. In the normal class action, where such evaluations at the outset are difficult at best, auction bids based on fee proposals do not provide a court with a sound basis to select counsel who will best serve the interests of the class.

However, even when auctions are utilized for the selection of class counsel and establishing a fee structure in advance, courts must be sensitive to the need, first and foremost, to select counsel who is competent and qualified to represent the class, and not simply choose counsel who has submitted the lowest bid. In complex class actions, courts must ensure that counsel for the class possesses the skills and expertise necessary to litigate against the high caliber counsel generally retained by defendants in these types of cases.

Moreover, in cases brought pursuant to the Private Securities Litigation Reform Act of 1995 (the "PSLRA") courts must reconcile the use of auctions with the counsel selection provisions of the Act. In enacting the PSLRA, Congress appeared to create three tiers of judicial oversight of securities law class actions. The three tiers are: (1) appointment of lead plaintiff; (2) selection and retention of class counsel; and (3) setting attorney's fees.

1. With respect to appointment of lead plaintiff, Congress specifically provided a presumption in favor of appointing as lead plaintiff the entity with the largest financial interest in the relief sought in the case. This is a powerful presumption that can be rebutted only by *proof* that the presumptive lead plaintiff cannot adequately represent the interests of the Class under traditional Rule 23 class action jurisprudence.

2. With respect to selection of class counsel, Congress provided that the lead plaintiff shall, subject to the approval of the court, select and retain counsel to represent the class. The Report of the Conference Committee states, however, that the Committee "does not intend to disturb the court's discretion under exist-

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Leonard Barrack
Senior Partner, Barrack, Rodos & Bacine

Chicago Teachers Take the Lead In Securities Suit Against Ford

Edward M. Gergosian, Esquire
Partner, Barrack, Rodos & Bacine

On August 9, 2000, Ford Motor Company and Bridgestone/Firestone announced a joint recall of more than 6.5 million Bridgestone ATX tires installed in Ford's popular Explorer sport utility vehicle and the replacement of all ATX tires on all unsold Explorers in Ford's inventory. The recall was an acknowledgement of the ATX tires' propensity for sudden failure due to tread separation, which, it has been repeatedly alleged, often caused the Ford Explorer to roll over. The Explorer is one of Ford's most important products, accounting for as much as 25% of the company's reported profits during the 1990's. The recall and subsequent disclosures revealed the severe problems with Explorers equipped with ATX tires and suggested that Ford had long known of the defective nature of the tires. Perhaps most significantly, between 1998 and 2000, Ford received thousands of claims for and complaints about ATX tire failures that caused over 2,200 rollover accidents, 400 serious injuries and 174 fatalities.

In addition to the public relations debacle, the ATX/Explorer recall is a financial disaster for Ford. The Company has expended hundreds of millions of dollars to fund the recall and replacement program and has had to halt production of certain vehicles to free up tires for the program. Ford's coveted record of 17 consecutive quarters of increasing operating earnings was squelched by the debacle, as Ford reported third quarter 2000 earnings per share that was less than 60% of its earnings in the prior year's quarter. These startling revelations and admissions resulted in a sharp decline in Ford's stock, wiping out over $11 billion of market capitalization, and inflicting great damage on purchasers of Ford stock during the period between March 1998 and August 2000, as the market price of Ford's stock declined more than 20%, from $29-7/8 on August 8, 2000 to as low as $23-13/16 on August 31, 2000.

In response to Ford's disclosures in August 2000, and a securities fraud class action filed against the Company in September 2000, the Public School Teachers' Pension and Retirement Fund of Chicago ("Chicago Teachers Fund"), asked Barrack, Rodos & Bacine ("BRB") to evaluate the Fund's losses and the fraud action's allegations. Chicago Teachers Fund is the administrator of a single-employer defined benefit public employee retirement system established by the Illinois legislature to provide retirement, survivor, and disability benefits for certain certified teachers and employees of the Chicago public schools. The Chicago Teachers Fund manages approximately $10 billion in assets. The Fund membership consists of approximately 16,000 retirees and beneficiaries currently receiving benefits; 22,000 currently vested members not yet receiving benefits; and 12,000 nonvested members.

"The Chicago Teachers Fund seeks to improve the recovery to the class and to substantially enhance the caliber and quality of reporting and disclosure by public companies."

- Michael Nehf, Executive Director

Lawyers from BRB evaluated the Fund's losses and the allegations in the pending action, provided written and oral briefing and subsequently met with Chicago Teachers Fund representatives. The Fund's Board voted to seek appointment as lead plaintiff in *Ford* based on the belief that its institutional leadership will add value for the class. In addition, the Fund's Board voted to seek court approval of its selection of BRB as lead counsel for the class.

In November 2000, after this thorough investigation, Chicago Teachers Fund filed a detailed complaint alleging that Ford's public statements between March 1998 and August 2000 concerning the Ford Explorer and the safety of its products violated the federal securities laws. The complaint alleged that before the announcement of the recall, Ford failed to disclose its growing awareness of the problems with and defects in the Ford Explorers equipped with ATX radial tires nor did it account for or disclose the prospective cost of the ATX-equipped Explorer product failures and associated remedial costs, thereby materially misstating Ford's financial results and condition. At the same time, Chicago Teachers Fund moved to be appointed lead plaintiff in this securities class action. Michael Nehf, the Executive Director of the Chicago Teachers Fund, explains the reasons for becoming involved: *"The Chicago Teachers Fund seeks to improve the recovery to the class and to substantially enhance the caliber and quality of reporting and disclosure by public companies."*

On February 5, 2001, Judge Avern Cohn of the United States District Court for the Eastern District of Michigan appointed Chicago Teachers Fund as lead

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Delaware Court Appoints Group of Institutional Investors To Lead Class Action Against DaimlerChrysler AG

Jeffrey W. Golan, Esquire
Partner, Barrack, Rodos & Bacine

DaimlerChrysler AG, which was formed in November 1998 by the merger of Chrysler Corporation and Daimler-Benz AG, found itself in the litigation hot seat last fall, after the company's CEO admitted that Daimler had lied to Chrysler shareholders and management in order to do the deal. The negotiations leading up to the marriage of the companies were characterized at the time by Daimler's consistent representations that its transaction with Chrysler was a "merger of equals" with Chrysler's corporate structure constituting a 50% component of the new company. Based upon these representations, 97% of Chrysler shareholders voted to approve the merger. Under the terms of the acquisition, each share of Chrysler stock was exchanged for 0.6235 of a share of DaimlerChrylser stock, giving Chrysler shareholders ownership of approximately 42% of the new company's common stock. Chrysler executives accepted this exchange, the equivalent of only a 28% premium over Chrysler's trading price rather than the 40% premium originally anticipated by Chrysler management, based upon assurances from Daimler that the merger would be on an equal footing.

"If I had gone and said Chrysler would be a division, everybody on their side would have said, "'There is no way we'll do a deal.' But it's precisely what I wanted to do."

- Jürgen Schrempp, DaimlerChrysler's CEO

Over the next two years, the former Daimler executives who took the lead positions within DaimlerChrysler acted to reduce Chrysler's position in the new company to the point where Chrysler became a mere stand-alone operating division of DaimlerChrysler. In an interview published in the October 30, 2000 edition of The Financial Times, Jürgen Schrempp, DaimlerChrysler's CEO and the architect of the merger, acknowledged that the acquisition of Chrysler as an operating division of Daimler had been planned from mid-January 1998, when Schrempp initially proposed a "merger of equals" to Chrysler's CEO, Robert Eaton. The Financial Times article quoted Schrempp: "the structure we have now with Chrysler (as a standalone division) was always the structure I wanted. We had to go a roundabout way but it had to be done for psychological reasons. If I had gone and said Chrysler would be a division, everybody on their side would have said, 'There is no way we'll do a deal.' But it's precisely what I wanted to do."

On November 28, 2000, in the wake of these shocking admissions, Chrysler's largest shareholder, Tracinda Corporation, filed a complaint in the United States District Court for the District of Delaware against the company and its new management for fraud and violations of the federal securities laws in connection with the merger. This non-class action complaint was quickly followed by the filing of 23 class actions. The complaints alleged that Schrempp's statement constituted an admission that the "merger of equals" representations surrounding the merger were false when made; and that those misrepresentations induced Chrysler shareholders to approve the merger and caused financial damage to Chrysler investors.

On January 29, 2001, a number of institutions and individuals moved for appointment as lead plaintiff in the class action suits. Barrack, Rodos & Bacine represented three institutions -- the Denver Employees Retirement Plan ("DERP"), Policemen's Annuity and Benefit Fund of Chicago ("PABF") and Municipal Employees Annuity and Benefit Fund of Chicago ("MEABF") -- in a joint motion for appointment as lead plaintiffs. Our client in other matters, the Florida State Board of Administration ("FSBA"), also moved for lead plaintiff appointment. Each of these institutional investors suffered very significant losses, stemming either from their ownership of Chrysler stock on September 20, 1998, the date of the Merger vote, and exchange of Chrysler stock for DaimlerChrysler stock in the November 17, 1998, Merger or from purchases of DaimlerChrysler stock on the open market after the Merger.

By the time of the Court hearing on February 23, the four institutional investors who filed lead plaintiff motions – the FSBA, DERP, PABF and MEABF – agreed that it would be best to work together on the case, and requested that the Court appoint the group as lead plaintiffs. Based upon these circumstances, the Court appointed the four funds as lead plaintiffs.

After conducting an extensive investigation, we and our co-lead counsel filed a 58-page First Amended

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DaimlerChrysler

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Consolidated Class Action Complaint on April 9, 2001, on behalf of a Class consisting of all persons and entities (other than defendants) that purchased DaimlerChrysler stock during the period from November 13, 1998 through November 17, 2000, including all persons and entities that exchanged Chrysler stock for DaimlerChrysler stock in the Merger or purchased it on the open market. The complaints assert claims based on the prospectus for the merger as well as a series of false and misleading statements about Chrysler's sales during the period from November 13, 1998 through November 17, 2000.

We asserted claims against DaimlerChrysler, Daimler-Benz, Schrempp, and other DaimlerChrysler executives involved with the merger negotiations for violations of both the Securities Act of 1933 and the Securities Exchange Act of 1934. Defendants moved to dismiss the Complaint on May 9, 2001. We will be filing our responding brief by June 13, and all briefing on the motions will be concluded by early July. We expect that the court will rule on the motions to dismiss later this summer. Fund representatives are welcome to contact us for a copy of the Complaint or any other information about this case that we can provide. ❖

Chicago Teachers

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plaintiff, finding that it possessed the qualifications and experience to supervise the prosecution of the case. The court also approved the Fund's selection of BRB as lead counsel. On March 16, 2001, Chicago Teachers Fund filed its Consolidated Complaint on behalf of the class in the *Ford* action. The class consists of those persons who purchased Ford common stock between March 31, 1998 and August 31, 2000. We anticipate that defendants will soon move to dismiss the complaint, and that the court will hold a hearing on that motion later this summer. Any fund seeking more information concerning the case should feel free to contact us for a copy of the Complaint or any additional information about this case.❖

Does "5-in-3" Rule Apply to Institutions? SEC Says No

Jeffrey A. Barrack, Esquire
Barrack, Rodos & Bacine

The Private Securities Litigation Reform Act of 1995 ("PSLRA") was enacted by Congress as a response to what it perceived as "lawyer-driven" litigation that employed "professional plaintiffs" who had only a nominal interest in the companies they were suing. The so-called "five-in-three" rule, which generally limits persons from serving more than five times in a three year period as a lead plaintiff, was one of the means through which Congress sought to eliminate the perceived problem of "professional plaintiffs" and to promote the leadership of securities class actions by investors with significant interests in such cases. Congress viewed this as a way to curtail abusive litigation and ensure that meritorious cases would be aggressively litigated for the benefit of all class members.

Along with the "five-in-three" rule, Congress established a presumption that the lead plaintiff applicant with the greatest financial interest in a class action is the "most adequate plaintiff" to lead the litigation. This provision was another means to banish the "professional plaintiffs," defined by the Conference Report for the PSLRA as those "who own a nominal number of shares in a wide array of public companies [and who] permit lawyers readily to file abusive securities class action lawsuits." H.R. Conf. Rep. 104-369, at 32.

But what of institutional investors in this statutory scheme? Congress recognized that the "5-in-3" restriction could easily conflict with the "most adequate plaintiff" presumption when institutional investors with large holdings in many companies seek to lead securities class cases. Indeed, the legislative history of the statute expressly provides that courts should not disqualify such institutional investors who wish to become involved in more than the statutorily-presumed 5 case maximum. "Institutional investors seeking to serve as lead plaintiff *may need to exceed this limitation and do not represent the type of professional plaintiff this legislation seeks to restrict. As a result, the Conference Committee grants courts discretion to avoid the unintended consequence of disqualifying institutional investors from serving more*

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ing law to approve or disapprove the lead plaintiff's choice of counsel when necessary to protect the interests of the plaintiff class."

3. Finally, with respect to setting attorney's fees, Congress provided that total attorney's fees and expenses "awarded *by the court* to counsel for the plaintiff class shall not exceed a reasonable percentage of the amount … paid to the class." On this point, the Conference Committee wrote: "By not fixing the percentage of fees and costs counsel may receive, *the Conference Committee intends to give the court flexibility in determining what is reasonable on a case-by-case basis*."

Professor John C. Coffee, Jr., of the Columbia Law School, recently wrote that there is a necessary distinction to be drawn between a lead plaintiff's selection of counsel – which is entitled to a great deal of deference by a court – and how the court should set counsel's compensation. According to Professor Coffee, because compensation for class counsel comes from the entire class, it must be the court's determination about what constitutes a reasonable fee that controls. We believe that by providing the Lead Plaintiff's chosen counsel with a right to "match" the bid that the court determines is the lowest qualified bid the court will satisfy its obligations under the PSLRA. Providing an ability to match ensures in most cases, that courts will not perform "shotgun marriages" of lead plaintiffs with counsel not of their choosing.

Barrack Rodos & Bacine believes that auctions are not appropriate in most cases. Generally, the class is better by the court assuring itself that the counsel selected by the lead plaintiff is competent and experienced to lead the prosecution of the case.

Further, courts that choose to establish fees in advance through an auction mechanism and counsel who participate in such auction procedures must abandon any time-based analysis of the fee when the court awards the fee at the end of the case. The purpose of an auction is to establish a market-driven fee structure at the outset of the action, pursuant to which counsel will prosecute the case with the sole interest of maximizing the recovery of the class. Allowing any consideration at the end of the case of the number of hours spent by counsel would run counter to the fundamental purpose of establishing a percentage-based fee in advance, and should not be tolerated – either by the district court or any reviewing court.

Two recent cases in which BRB has participated illustrate the good and the bad of the auction process. In *In re Cendant Corp. Securities Litigation*, the court conducted an auction for the selection of class counsel. It set the ground rules in advance, including that the bids would be held in confidence until resolution of the case. There was ample interest and publicity about the bidding process, which took place after a significant amount of information was available publicly about the fraud at Cendant and the market losses suffered by Cendant investors. The court established the fee grid after consultation with counsel and the lead plaintiffs and evaluated the bids based on the competency of counsel and whether the bids would create the proper incentives to optimize the recovery for the class.

In order to reconcile the provisions of the PSLRA designed to encourage institutional investors to take a more active role in securities class action lawsuits with the court's auction procedures, the court allowed the firms retained by the Lead Plaintiffs to agree to abide by the terms of the lowest qualified bid, and appointed those firms as counsel for the class on that basis.

In approving the landmark settlements with defendants in the *Cendant* case, which provided a $3.18 billion recovery for the class -- over four times larger than the next highest securities class recovery in history -- the court determined that based on the result achieved and the auction process pursuant to which co-lead counsel prosecuted the case, it was reasonable and appropriate to award a fee in accordance with the benchmark established through the bidding process.

The district court made detailed findings supporting the appropriateness of the percentage awarded in accordance with the auction process. The result, the court found, was "excellent settlements of uncommon amount achieved by highly skilled counsel with reasonable cost to the class."

In contrast, the pitfalls of selecting counsel and establishing fees through an auction process were demonstrated in *In re Network Associates, Inc. Securities Litigation*. In that case, the district court appointed the City of Philadelphia, through its Board of Retirement and Pensions, as presumptive lead plaintiff, based on its financial interest in the litigation. However, in the appointment order, the court required the City to conduct an auction for selection of counsel based on fee proposals from its own counsel, which included BRB, and other

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firms. If the City decided to select its own counsel as class counsel, the court further required the City to make a second, alternative choice, and to explain the reasons why it chose its counsel again in the event that such counsel's fee proposal was not the lowest. The City objected to these requirements, citing its own regulatory procedures and the PSLRA. The City offered, in the alternative: (1) to negotiate a fee in advance with its chosen counsel, subject to court approval; or (2) to have the court itself undertake an auction where the City's chosen counsel would be allowed to match the lowest qualified bid. When the court rejected these proposed alterations to its previous order, the City withdrew as lead plaintiff rather than agree to a procedure that it believed would require the City to breach its own regulations concerning selection of counsel and would poorly serve the class.

BRB believes that auctions are not appropriate in most cases. Generally, the class is better served by the court assuring itself that the counsel selected by the lead plaintiff is competent and experienced to lead the prosecution of the case. In those rare instances when a court decides to utilize auctions to select counsel and establish fee structures at the outset, the court should reconcile the auction method with the provisions of the PSLRA by allowing the lead plaintiff's chosen counsel to be appointed as class counsel by "matching" the bid selected by the court. Without such a provision, the right of lead plaintiffs to select counsel subject to approval of the court is virtually meaningless. ❖

DID YOU KNOW....

According to an article in the May NAPPA Report:

- ❖ In 2000, $4.4 billion in cash was set aside for payments to class members (including the $3.18 billion Cendant settlement); over $1 billion was recovered for class members in each of the preceding two years.
- ❖ Slightly more than half of the funds responding to a recent NASACT survey believed that fund officials had a legal duty to recover these funds.
- ❖ About 1/3 of the funds responding to the survey reported "no recovery" from class action settlements.
- ❖ It is highly likely that all significant public funds were entitled to a recovery in at least one of the 700+ settlements during this three year period.

LOOK FOR OUR ARTICLE ABOUT CLASS ACTION CLAIMS MANAGEMENT IN THE NEXT ISSUE OF THE BARRACK BULLETIN

5-in-3 Rule

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than
five times in three years." H.R. Conf. Rep. at 35 (emphasis added).

When faced with the dilemma of appointing an institution as lead plaintiff in apparent violation of the "5-in-3" rule, courts have not acted uniformly. Barrack, Rodos & Bacine has consistently argued to courts across the country that the words of the PSLRA and Conference Report leave no doubt that institutional investors were not intended to be subject to the "five-in three" rule's restrictions on professional plaintiffs. Indeed, in the first case to decide the issue, <u>Blaich v. Employee Solutions, Inc.</u>, 1997 WL 842417 at *2 (D. Ariz. 1997), we successfully argued that the "5-in-3" provision of the PSLRA does not apply to institutional investors. <u>See</u> Leonard Barrack, "Role of Institutional Investors," <u>Barrack Bulletin</u>, Volume I, First Quarter, 2000.

The Securities and Exchange Commission ("SEC") has now endorsed our position that the so-called "five-in-three" rule *does not apply to institutional investors*. In a March 26, 2001 letter to Judge Richard A. Lazzara of the United States District Court for the Middle District of Florida, the SEC applauded the Court's decision in <u>Piven v. Sykes Enterprises</u>, Case No. 8:00-cv-212-T-26F (M.D. Fla. Sept. 14, 2000), that found that an institutional investor is not precluded from serving as a lead plaintiff in more than five cases. In <u>Sykes,</u> the court stated that while there has not yet developed a clear consensus among courts when a presumptive most adequate plaintiff may serve as lead plaintiff in more than five cases in three years, the restriction on "professional plaintiffs" is not absolute. The court understood that the "legislative history makes clear that institutional plaintiffs with 'real' interests at stake are preferred in this context." <u>Piven v. Sykes Enterprises</u>, opinion at 14-15.

In its March 2001 letter, the SEC praised <u>Sykes</u> as a "well-reasoned opinion" that "would provide important guidance to litigants and other courts facing the issue." The SEC's endorsement of this position should add great weight to this reading of the PSLRA and will certainly be a further weapon in our arsenal as we continue to assert the right of institutional investors to lead securities class cases. ❖

Quaker Oats Settles Snapple-Related Securities Fraud Lawsuit

M. Richard Komins, Esquire
Partner, Barrack, Rodos & Bacine

After a six year struggle, Barrack, Rodos & Bacine and its co-counsel reached a settlement with The Quaker Oats Company valued at more than $10 million on behalf of a class of investors who purchased Quaker Oats common stock during the period August 4 through November 1, 1994.

The litigation arose out of Quaker Oats' announcement on November 2, 1994 that it was acquiring Snapple Beverage Corp. for $1.7 billion in cash, and that it would borrow up to $2.4 billion to make the acquisition. This announcement caused a sharp decline in Quaker's stock price and resulted in millions of dollars in market loss for Quaker's shareholders. Quaker's decision to take on this additional debt, which would increase its ratio of debt-to-total capitalization to approximately 84 percent, appeared to run contrary to its publicly stated "guideline" -- originally announced in 1993 and repeated during the Class Period -- of maintaining a debt-to-total capitalization in the "upper-60 percent range."

The suit against Quaker and its Chief Executive Officer, originally filed in November 1994 in the United States District Court for the District of New Jersey, alleged that Quaker's statements regarding its debt-to-total capitalization guideline were materially misleading. The plaintiffs claimed that Quaker was not only liable for reiterating its debt-to-total capitalization guideline in September 1994, by which time the negotiations with Snapple were underway, but that it was under a duty to update its earlier statements by August 1994, when it was clear that Quaker no longer intended to follow the guideline and was looking to make a highly leveraged acquisition.

The case was dismissed by the New Jersey district court on the ground that the debt-to-total capitalization guideline statements, as a matter of law, could not have been "material" -- i.e., investors in Quaker stock. Plaintiffs appealed the dismissal to the Court of Appeals for the Third Circuit, which reversed the dismissal and reinstated the case. The Third Circuit disagreed with the lower court's ruling that Quaker's debt-to-total capitalization guideline was not material as a matter of law, noting that "by including the total debt-to-total capitalization ratio guideline in the 1993 Annual Report Quaker may well have created the reasonable understanding among investors that the ratio guideline was a number to which Quaker attached considerable significance." In ground breaking language, the Third Circuit ruled further that *"there can be no doubt that a duty exists to correct prior statements if the prior statements were true when made but misleading if left unrevised."*

After months of discovery, when the case was approaching trial, defendants filed a motion for summary judgment, arguing that the evidence showed that Quaker did not decide to acquire Snapple for all cash until just before the deal was announced, and therefore, defendants did not intend to defraud investors. The district court rejected the defendants' arguments and denied summary judgment, finding that there was sufficient evidence of defendants' intention to increase Quaker's leverage above the "guideline" to allow the case to proceed to trial.

The district court set a trial date of April 9, 2001. As that date approached, settlement discussions intensified and resulted in defendants' agreement to pay $9.9 million in cash to members of the class, as well as to fund up to $500,000 of the costs of sending out notice and administering the settlement. The parties will seek preliminary approval of the proposed settlement on June 7, 2001, and we anticipate that a final approval hearing will be held by late summer 2001. Claim forms are not yet available. If you are a member of the class and do not receive a claim form by the end of June 2001, or if you have questions about the proposed settlement, please contact Leslie Molder, Esquire of Barrack, Rodos & Bacine at (215) 963-0600. ❖

About the Publisher…

Barrack, Rodos & Bacine is a boutique law firm that has been extensively involved in class and derivative actions alleging violations of securities laws for nearly twenty-five years. The firm, with attorneys in offices located in Philadelphia, San Diego, New York, New Jersey and Boston, has been appointed by federal judges throughout the country as lead counsel in over 30 cases since the passage of the PSLRA and represents a number of institutional investors in securities class actions. The Barrack Bulletin is published four times a year.

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