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Lead Counsel for Purchasers and Acquirers of All Cendant Corporation and CUC International, Inc. Publicly Traded Securities Except PRIDES

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

In re:	Master File No. 98-1664 (WHW)
CENDANT CORPORATION LITIGATION	
	JURY TRIAL DEMANDED

AMENDED AND CONSOLIDATED CLASS ACTION COMPLAINT ON BEHALF OF PURCHASERS AND ACQUIRERS OF ALL CENDANT CORPORATION AND CUC INTERNATIONAL, INC. PUBLICLY TRADED SECURITIES EXCEPT PRIDES

Plaintiffs, individually and on behalf of all others similarly situated, by their attorneys, allege the following upon knowledge, with respect to their own acts, and upon other facts obtained through an extensive investigation conducted by their counsel, which included, among other things, reviews of public filings with the United States Securities and Exchange Commission ("SEC") by Cendant Corporation ("Cendant" or the "Company"), its predecessors and certain of the individual defendants; press releases; publicly available trading information; articles in the general press, the financial press, on wire services and in trade publications in the accounting field; and publicly available information concerning certain of the defendants.

NATURE OF THE ACTION

1. Lead Plaintiffs, the California Public Employees' Retirement System, the New York State Common Retirement Fund and the New York City Pension Funds, bring this action on behalf of all persons and entities, as defined in paragraph 25 below, who suffered damage as a result of defendants' violations of the federal securities laws. On April 15, 1998, Cendant stunned the financial community when it began to disclose the truth about its operations and financial results; specifically, that it would restate previously reported financial results for 1997, including reducing 1997 net income by $100 million to $115 million, because of unspecified accounting irregularities related to certain business segments of CUC, International Inc. ("CUC"), the predecessor company that combined with HFS Incorporated ("HFS") on December 17, 1997 to form Cendant. Cendant's initial disclosure of accounting irregularities, though, failed to disclose the true nature and extent of the massive financial wrongdoing that had permeated CUC and Cendant.

2. On July 14, 1998, Cendant announced that it would restate CUC's previously reported financial results -- not just for 1997, as originally disclosed -- but for 1996 and 1995, and all quarters of those years. Cendant also revised its prior disclosure, revealing that it would reduce 1997 net income by $0.22 to $0.28 per share, or *double* the amount reported on April 15. Further, Cendant

revealed that a "widespread and systemic" fraud had occurred at CUC that included improperly recognizing fictitious revenues, falsely coding services sold to customers and fraudulently manipulating merger reserves.

3. On August 28, 1998, the last day of the Class Period, as defined in paragraph 12 below, Cendant filed with the SEC a report prepared by an independent law firm and an independent public accountant, who had been retained by the audit committee of Cendant's Board of Directors to investigate CUC's improper financial reporting practices. This report, which was adopted by the Cendant Board of Directors, detailed, for the first time, the "pervasive" fraud that had corrupted 17 of CUC's 22 operating units and had caused CUC's operating income to be inflated by approximately $500 million during the Class Period, representing more than one-third of CUC's total reported operating income. CUC's and Cendant's fraudulent accounting practices were "carefully planned" to assure that CUC met or exceeded analysts' expectations. The fraudulent scheme included hundreds of unsupported journal entries knowingly made in order to create -- out of whole cloth -- hundreds of millions of dollars of revenue and income. The magnitude of the financial fraud at CUC and Cendant was confirmed when Cendant filed its restated financial statements with the SEC on September 29, 1998, which disclosed that, during the Class Period, Cendant had overstated income from continuing operations before income taxes by approximately $297.2 million, or 24%, and overstated earnings per share by $0.61, or 130%.

4. During the Class Period, CUC and Cendant issued a series of materially false and misleading statements in three false annual reports on Form 10-K; in eleven false quarterly reports on Form 10-Q; in a false registration statement and joint proxy statement/prospectus, registering 504 million shares of CUC common stock as part of the merger between CUC and HFS (the

"Merger"); and in numerous false press releases and other documents, in which defendants, among other things, announced their fraudulently manipulated quarterly and annual financial results. CUC and Cendant used their artificially inflated stock to fund acquisitions and operations, and the individual defendants profited as well. During the Class Period, defendants, as detailed below, sold, in the aggregate, almost 8.2 million shares of Cendant common stock reaping proceeds of over $287 million. Almost 60% of those shares were sold after the Merger, with over 55% of defendants' insider sales executed in the three months immediately preceding the April 15, 1998 initial disclosure of fraudulent financial information.

5. HFS, for its part, urged its stockholders to approve the Merger, through which the HFS shareholders would receive shares of CUC common stock in exchange for their HFS common stock. However, HFS did not perform the required substantive financial due diligence necessary to form the basis for that recommendation. In fact, HFS completed the Merger even though it was entirely shut out by CUC. As a result, HFS was incapable of conducting the required substantive financial due diligence, despite the terms of the merger agreement between CUC and HFS, which provided for full access to company books and records, and despite the confidentiality agreement entered into in connection with the Merger, which was designed to enable HFS to perform required substantive financial due diligence. Henry Silverman, Cendant's Chairman and Chief Executive Officer, has subsequently admitted that HFS's due diligence was "based almost entirely on public information audited by Ernst & Young, CUC's auditor."

6. Notwithstanding CUC's and Cendant's pervasive financial fraud, Ernst &Young, CUC's independent public accountant, issued unqualified audit opinions on CUC's annual reports for 1995, 1996 and 1997 certifying, among other things, that it had audited such financial statements

in accordance with Generally Accepted Auditing Standards ("GAAS"), and that, in its opinion, those financial statements presented CUC's financial position fairly and in conformity with Generally Accepted Accounting Principles ("GAAP"). Similarly, Ernst & Young issued seven unqualified review reports during the class period, which were included in CUC's quarterly reports on Form 10-Q. Ernst & Young's audit and review procedures were professionally deficient. Ernst & Young failed to adhere to GAAS and review standards established by the American Institute of Certified Public Accountants (the "AICPA"), and, therefore, lacked any reasonable basis for its unqualified reports.

7. The disclosure of the fraud at CUC and Cendant had a dramatic effect on the market price of Cendant's common stock. On the day following the Company's initial disclosure after the market closed on April 15, 1998, the per share price of Cendant's common stock plummeted 47% from $35 5/8 to $19 1/16 per share, causing Cendant's market capitalization to drop by $14.2 billion, to $16.2 billion on New York Stock Exchange record trading of approximately 108.5 million shares. Following Cendant's July 14, 1998 announcement, the stock price dropped to $15 11/16 per share, causing the Company's market capitalization to drop by another $2.8 billion. After Cendant's final August 28, 1998 revelation, the share price of the Company's common stock fell to $11 5/8, causing Cendant's market capitalization to drop another $3.5 billion to $9.9 billion, for a total drop, as a result of the massive fraud, of $20.5 billion, or 67%.

JURISDICTION AND VENUE

8. The claims asserted herein arise under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k, 77l(a)(2) and 77o; and under Sections 10(b),

14(a), 20(a) and 20A of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§ 78j(b), 78n, 78t(a), 78t-1, and Rules 10b-5, 17 C.F.R. § 240.10b-5, and 14a-9, 17 C.F.R. § 240.14a-9, promulgated thereunder by the SEC.

9. This Court has jurisdiction pursuant to Section 22 of the Securities Act, 15 U.S.C. § 77v; Section 27 of the Exchange Act, 15 U.S.C. § 78aa; and 28 U.S.C. §§ 1331 and 1337.

10. Venue is proper in this District pursuant to Section 22 of the Securities Act, Section 27 of the Exchange Act, and 28 U.S.C. §1391(b). Many of the acts and transactions giving rise to the violations of law complained of herein occurred in this District. In addition, defendant Cendant maintains its principal office in this District, at 6 Sylvan Way, Parsippany, New Jersey 07054.

11. In connection with the acts, conduct and other wrongs complained of herein, defendants, directly or indirectly, used the means and instrumentalities of interstate commerce, the United States mails, and the facilities of a national securities market.

THE PARTIES

Plaintiffs

12. The following Lead Plaintiffs purchased or acquired the securities of Cendant or of its predecessor, CUC, during the period beginning May 31, 1995 through and including August 28, 1998 (the "Class Period") and suffered damages as a result of the violations of the federal securities laws alleged herein:

a. Plaintiff CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM ("CalPERS") is organized pursuant to Title 2, Division 5, Part 3 of the California Government Code. CalPERS is the largest public pension system in the nation, holding more than $141.9 billion in assets as of April 30, 1998. It provides retirement and health benefits to more than 1 million state and local public employees, retirees and their families, from more than 2,400 employers. CalPERS is governed by a Board of Administration, which has sole investment authority and fiduciary responsibility for the management of CalPERS's assets under Article XVI, Section 17 of the California Constitution. CalPERS purchased or acquired over 3.7 million shares of CUC and Cendant common stock during the Class Period for over $107 million, including approximately 546,000 shares of HFS common stock exchanged for over 1.3 million shares of CUC common stock in connection with the Merger.

b. Plaintiff NEW YORK STATE COMMON RETIREMENT FUND (the "NYSCRF"), as established by Article 9 of the New York Retirement and Social Security Law, holds and invests the assets of the New York State and Local Employees' Retirement System and the New York State and Local Police and Fire Retirement System. The NYSCRF, the second largest public pension fund in the nation, has approximately 280,000 retiree and 580,000 active members and, as of March 31, 1998, held approximately $105 billion in assets. H. Carl McCall, the Comptroller of the State of New York, is the sole trustee of the NYSCRF and has sole investment and fiduciary responsibility for management of NYSCRF's assets. The NYSCRF purchased or acquired over 3.7 million shares of CUC and Cendant common stock during the Class Period for over $103.9 million, including over 730,000 shares of HFS common stock exchanged for over 1.7 million shares of CUC common stock in connection with the Merger.

c. The New York City Pension Funds (the "NYCPF") consist of the actuarial pension systems of New York City, including the New York City Employees' Retirement System, the Police and Fire Department Pension Funds, the Teachers and Board of Education Retirement Systems and four variable supplements funds. As of March 31, 1998, the NYCPF held over $102 billion in assets. As of June 30, 1996, the NYCPF had approximately 234,000 retiree and 311,000 active members. Pursuant to Title 13 of the Administrative Code, the Boards of Trustees of the NYCPF have delegated to the Comptroller of the City of New York investment responsibility for management of NYCPF's assets. Collectively, the NYCPF plaintiffs specified in paragraphs (I)-(vi) below purchased or acquired approximately 4.3 million shares of CUC and Cendant common stock during the Class Period for over $131.9 million, including approximately 779,000 shares of HFS common stock exchanged for over 1.8 million shares of CUC common stock in connection with the Merger.

i. Plaintiff NEW YORK CITY TEACHERS' RETIREMENT SYSTEM (the "NYCTRS") maintains two retirement programs, the Qualified Pension Plan (the "QPP") and the Tax-Deferred Annuity Program (the "TDA"). The QPP, established pursuant to Section 13-502 of the Administrative Code of the City of New York, provides pension benefits to persons with regular appointments to the pedagogical staff of the New York City Board of Education. The TDA, established pursuant to Internal Revenue Code Section 403(b), provides a means of deferring income tax payments on voluntary tax-deferred contributions. As of March 31, 1998, the NYCTRS held approximately $39.5 billion in assets. As of June 30, 1996, the

NYCTRS had approximately 50,000 retiree and 77,000 active members. The NYCTRS purchased or acquired approximately 692,000 shares of CUC and Cendant common stock during the Class Period for over $21.7 million, including approximately 192,000 shares of HFS common stock exchanged for over 461,000 shares of CUC common stock in connection with the Merger.

ii. Plaintiff NEW YORK CITY FIRE DEPARTMENT PENSION FUND (the "NYCFDPF") provides pension benefits for full-time uniformed employees of the New York City Fire Department. As of March 31, 1998, the NYCFDPF held over $5.6 billion in assets. As of June 30, 1996, the NYCFDPF had approximately 16,000 retiree and 12,000 active members. The NYCFDPF purchased or acquired over 507,000 shares of CUC and Cendant common stock during the Class Period for over $15.3 million, including over 46,000 shares of HFS common stock exchanged for over 111,000 shares of CUC common stock in connection with the Merger.

iii. Plaintiff NEW YORK CITY POLICE DEPARTMENT PENSION FUND (the "NYCPDPF"), created pursuant to Local Law 2 of 1940, provides pension benefits for full-time uniformed employees of the New York City Police Department. As of March 31, 1998, the NYCPDPF held over $15.2 billion in assets. As of June 30, 1996, the NYCPDPF had approximately 35,000 retiree and 37,000 active members. The NYCPDPF purchased or acquired over 1.1 million shares of CUC and Cendant common stock during the Class Period for over $36.4 million, including over 139,000 shares of HFS common stock exchanged for over 334,000 shares of CUC common stock in connection with the Merger.

iv. Plaintiff NEW YORK CITY BOARD OF EDUCATION RETIREMENT SYSTEM (the "NYCBERS") provides pension benefits to, among others, non-pedagogical employees of the New York City Board of Education. As of March 31, 1998, the NYCBERS held approximately $1.6 billion in assets. As of June 30, 1996, the NYCBERS had approximately 8,000 retiree and 21,000 active members. The NYCBERS purchased or acquired approximately 116,000 shares of CUC and Cendant common stock during the Class Period for over $3.4 million, including approximately 6,000 shares of HFS common stock exchanged for over 13,000 shares of CUC common stock in connection with the Merger.

v. Plaintiff NEW YORK CITY EMPLOYEES' RETIREMENT SYSTEM ("NYCERS"), established under Section 12-102 of the Administrative Code of the City of New York, provides benefits to all New York City employees who are not eligible to participate in the NYCFDPF, the NYCPDPF, the NYCTRS or the NYCBERS. As of March 31, 1998, NYCERS held over $37.4 billion in assets. As of June 30, 1996, NYCERS had approximately 125,000 retiree and 164,000 active members. NYCERS purchased or acquired over 1.6 million shares of CUC and Cendant common stock during the Class Period for over $50.9 million, including approximately 357,000 shares of HFS common stock exchanged for over 857,000 shares of CUC common stock in connection with the Merger.

vi. Plaintiffs NEW YORK CITY POLICE OFFICERS' VARIABLE SUPPLEMENTS FUND (the "NYCPOVSF"), NEW YORK CITY POLICE SUPERIOR OFFICERS' VARIABLE SUPPLEMENTS FUND (the "NYCPSOVSF"), NEW YORK CITY FIREFIGHTERS' VARIABLE SUPPLEMENTS FUND (the "NYCFFVSF") AND NEW YORK CITY FIRE OFFICERS' VARIABLE SUPPLEMENTS FUND (the "NYCFOVSF") were enacted, pursuant to enabling State legislation, to provide certain retirees of the New York City Police Department and the New York City Fire Department with fixed supplemental benefits from variable supplements funds. As of March 31, 1998, the NYCPOVSF held over $1 billion in assets, the NYCPSOVSF held over $1.2 billion in assets, the NYCFFVSF held approximately $536 million in assets, and the NYCFOVSF held over $282 million in assets. The NYCPOVSF, the NYCPSOVSF, the NYCFFVSF and the NYCFOVSF collectively purchased or acquired approximately 151,000 shares of CUC and Cendant common stock during the Class Period for over $4 million, including over 39,000 shares of HFS common stock collectively exchanged for over 94,000 shares of CUC common stock in connection with the Merger.

13. By Order dated September 8, 1998, the Court appointed CalPERS, the NYSCRF and the NYCPF as Lead Plaintiffs. Collectively, Lead Plaintiffs manage over $340 billion in assets and represent approximately 2,405,000 active members, retirees and their families. Lead Plaintiffs purchased or acquired approximately 11.8 million shares of CUC and Cendant common stock during the Class Period for over $343 million, including approximately 2,055,000 shares of HFS common

stock exchanged for over 4.9 million shares of CUC common stock in connection with the Merger. A schedule of Lead Plaintiffs' purchases and acquisitions of CUC and Cendant common stock is annexed hereto as Schedule A.

14. The persons and entities listed on Schedule B annexed hereto are additional plaintiffs in this action. During the Class Period, each one purchased or acquired the securities of Cendant or CUC as specified on Schedule B, and suffered damages as a result of the violations of the federal securities laws alleged herein.

Defendants

Cendant

15. Defendant Cendant purports to be one of the foremost consumer and business services companies in the world. Cendant is a Delaware corporation that was formed through the Merger, which became effective on December 17, 1997. CUC was the surviving entity and simultaneously was renamed Cendant Corporation. Cendant provides all of the services formerly provided by CUC and HFS, including technology-driven membership-based consumer services, travel services and real estate services. Before the Merger, CUC conducted membership activities through its Comp-U-Card division ("Comp-U-Card") and, as of December 1997, through approximately twenty wholly-owned subsidiaries located throughout the United States and Europe. After the Merger, CUC became Cendant Membership Services ("CMS"), a wholly-owned subsidiary of Cendant. The financial statements of CMS for the year ended December 31, 1997 were audited by defendant Ernst & Young LLP. Those financial statements were consolidated into Cendant's consolidated financial statements, and were included in Cendant's Form 10-K for the year ended December 31, 1997. Prior to the Merger, CUC reported on a January 31 fiscal year end, with quarters ending April 30, July 31

and October 31. Following the Merger, Cendant reported, and continues to report, on a calendar year basis.

The CUC Individual Defendants

16. The following defendants were officers of CUC prior to the Merger:

a. Walter Forbes. Defendant Walter A. Forbes ("Walter Forbes") was the Chairman of Cendant's Board of Directors and the Chairman of its Executive Committee from the Merger until his resignation on July 28, 1998. Walter Forbes had been Chairman of CUC since 1983, its Chief Executive Officer since 1976, and its President from 1982 to May 1991. Walter Forbes' compensation at Cendant for the year ended December 31, 1997 was $1.6 million; at CUC, Walter Forbes' compensation was $1.5 million for each of the fiscal years ended January 31, 1997 and 1996. In 1997, solely as a result of the consummation of the Merger, Walter Forbes received $7.5 million for full settlement of the previously-adopted CUC Executive Retirement Plan (the "SERP"). Also as a result of the Merger, Walter Forbes' employment contract with the Company was amended and restated to provide that Walter Forbes would become Chief Executive Officer of Cendant as of January 1, 2000, and receive severance benefits in excess of $37.5 million if he did not then become Chief Executive Officer or does not hold that position until January 1, 2002. During the Class Period, Walter Forbes sold over 1.2 million shares of CUC and Cendant common stock for proceeds of over $38.5 million. When Walter Forbes was forced to resign from the Board effective July 28, 1998, he and the Company executed a separation agreement providing for, *inter alia*, compensation to him in excess of $47.5 million.

b. Shelton. Defendant E. Kirk Shelton ("Shelton") was Vice Chairman and a Director of Cendant from the Merger until he resigned on April 9, 1998. Prior to the Merger, Shelton had been President of CUC since May 1991, Chief Operating Officer since 1988, and Executive Vice President from 1984 to May 1991. Shelton was a director of CUC from 1995 through the Merger. Throughout his employment with CUC and Cendant, Shelton reported directly to defendant Walter Forbes. Shelton's compensation at Cendant for the year ended December 31, 1997 was $1 million; at CUC, Shelton's compensation for the fiscal years ended January 31, 1997 and 1996 was $960,000 and $900,000, respectively. In 1997, solely as a result of the consummation of the Merger, Shelton received $7.4 million for full settlement of the SERP. Also as a result of the Merger, the Company entered into a new employment agreement with Shelton that provided for severance benefits in excess of $20 million in the event that Shelton was not assigned duties after January 1, 2000 commensurate with his pre-Merger duties at CUC. During the Class Period, Shelton sold over 702,000 shares of CUC and Cendant common stock for proceeds of over $23 million. On April 9, 1998, the Company announced Shelton's resignation; Shelton's employment with the Company was terminated for cause on August 27, 1998.

c. McLeod. Defendant Christopher K. McLeod ("McLeod") was Vice Chairman and a director of Cendant from the Merger until he resigned on October 12, 1998. Prior to the Merger, McLeod was Executive Vice President of CUC since 1986, a member of the Office of the President since 1988; Chief Executive Officer of CUC Software since January 1997; and President of Comp-U-Card from 1988 to August 1995. McLeod also was a director of CUC from 1995 onward. McLeod reported directly to defendant Walter Forbes.

McLeod's compensation at Cendant for the year ended December 31, 1997 was $1 million; at CUC, McLeod's compensation for the fiscal years ended January 31, 1997 and 1996, was $960,000 and $900,000, respectively. In 1997, solely as a result of the consummation of the Merger, McLeod received $7.4 million for full settlement of the SERP. Also as a result of the Merger, the Company entered into a new employment agreement with McLeod that provided for severance benefits in excess of $5 million if McLeod was not assigned duties after January 1, 2000 commensurate with his pre-Merger duties at CUC. During the Class Period, McLeod sold over 457,000 shares of CUC and Cendant common stock for proceeds of over $15.9 million.

d. Corigliano. Defendant Cosmo Corigliano ("Corigliano") was Chief Financial Officer of CMS from the Merger until his employment was terminated by Cendant on April 16, 1998. Prior to the Merger, Corigliano was CUC's Senior Vice President since 1991, its Chief Financial Officer since February 1, 1995, and its Controller from 1984 through January 1995. As CUC's Chief Financial Officer, Corigliano reported directly to defendant Shelton. Before coming to CUC, Corigliano had been employed by defendant Ernst & Young in its Stamford, Connecticut office. Corigliano's compensation at Cendant for the year ended December 31, 1997 was $316,000; at CUC, Corigliano's compensation for the fiscal years ended January 31, 1997 and 1996 was $269,000 and $190,000, respectively. In 1997, solely as a result of the consummation of the Merger, Corigliano received $3.6 million for full settlement of the SERP. Also as a result of the Merger, the Company entered into a new employment agreement with Corigliano that provided severance benefits if Corigliano was not assigned duties after January 1, 2000 commensurate with his pre-Merger duties at CUC. During the Class Period, Corigliano sold approximately 35,000 shares of CUC and Cendant common stock for proceeds of approximately $822,000. On April 9, 1998, the Company announced Corigliano's resignation; Corigliano's employment with the Company was terminated for cause as of April 16, 1998.

e. Pember. Defendant Anne M. Pember ("Pember") was Senior Vice President and Controller of CUC from June 1997 through the Merger, and thereafter became Senior Vice President and Controller of CMS. Pember had been CUC's Corporate Controller and Controller of Comp-U-Card since April 1995. Pember was employed by defendant Ernst & Young in its Stamford, Connecticut office from 1981-83.

17. Each of the defendants named in the preceding paragraph reviewed or was aware of the false and misleading statements alleged herein, and were in a position to control or influence their contents or otherwise cause corrective or accurate disclosures to have been made. These defendants engaged in the common course of conduct complained of herein during the Class Period.

18. The following defendants, together with defendants Walter Forbes, Shelton and McLeod, were members of CUC's Board of Directors prior to the Merger, signed the Registration Statement, as defined in paragraph 33 below, and were named therein, with their consent, as about to become directors of Cendant upon the consummation of the Merger:

a. Perfit. Defendant Burton C. Perfit ("Perfit") was a director of CUC since 1982 and was Chairman of CUC's Audit Committee from at least 1987 until the Merger. After the Merger, Perfit continued as a director. The Audit Committee was charged with the responsibility of recommending to the Board independent auditors to conduct the annual audit of CUC's financial statements, reviewing with such independent auditing firm the overall scope and results of the annual audit, and reviewing and approving the performance by the auditors, and was required to meet periodically with the independent auditors and representatives of management (including defendant Corigliano, the CUC's Chief Financial Officer) to review accounting activities, financial controls and reporting. During the Class Period, Perfit sold approximately 29,000 shares of CUC and Cendant common stock for proceeds of approximately $846,000. On July 28, 1998, the Company announced Perfit's resignation from the Board.

b. <u>Donnelley</u>. Defendant T. Barnes Donnelley ("Donnelley") was a director of CUC from 1977 until the Merger and was a member of CUC's Audit Committee from at least 1987 through the Merger. After the Merger, Donnelley continued as a director. During the Class Period, Donnelley sold over 337,000 shares of CUC and Cendant common stock for proceeds of approximately $9.6 million. On July 28, 1998, the Company announced Donnelley's resignation from the Board.

c. <u>Greyser</u>. Defendant Stephen A. Greyser ("Greyser") was a director of CUC from 1984 until the Merger and was a member of CUC's Audit Committee from at least 1990 until the Merger. After the Merger, Greyser continued as a director. He also serves as a director of Edelman Worldwide, Opinion Research Corporation and the investment/brokerage firm Gruntal & Co. L.L.C. On July 28, 1998, the Company announced Greyser's resignation from the Board.

d. <u>Williams</u>. Defendant Kenneth A. Williams ("Williams") was a Vice Chairman, a director and a member of the Office of the President of CUC since July 1996 when CUC acquired Sierra-On-Line, Inc. ("Sierra"). Williams also is the Chief Executive

Officer of Sierra. Prior to joining CUC, Williams was the Chairman of the Board and Chief Executive Officer of Sierra. During the Class Period, Williams sold 635,000 shares of CUC and Cendant common stock for proceeds of approximately $20.7 million.

e. Burnap. Defendant Bartlett Burnap ("Burnap") was a director of CUC since 1976. Burnap was Chairman of CUC's Board of Directors between 1976 and 1983. During the Class Period, Burnap sold approximately 889,000 shares of CUC and Cendant common stock for proceeds of approximately $33.5 million. On July 28, 1998, the Company announced Burnap's resignation from the Board.

f. Rittereiser. Defendant Robert P. Rittereiser ("Rittereiser") has been a director of CUC since 1982 and is Chairman and Chief Executive Officer of Gruntal Financial L.L.C., an investment services firm based in New York City. He has been Chairman of Yorkville Associates Corp., a private investment and financial concern, since its formation in April 1989. Rittereiser served as a Trustee of the DBL Liquidating Trust from April 1992 through April 1996, and served as a director in 1990, as Chairman in November 1992, and as President and Chief Executive Officer from March 1993 until February 1995, of Nationar, a New York banking services company. He is a Director of Ferrofluidics Corporation, Interchange Financial Services Corp. and Wallace Computer Services, Inc.

g. Rumbough. Defendant Stanley M. Rumbough, Jr. ("Rumbough") was a director of CUC since 1976 and is a director of International Flavors and Fragrances, Inc. During the Class Period, Rumbough sold approximately 201,000 shares of CUC and Cendant common stock for proceeds of over $6.6 million. On July 28, 1998, the Company announced Rumbough's resignation from the Board.

19. During the Class Period, the defendants referred to in paragraphs 16 and 18 above (the "CUC Individual Defendants") sold over 4.4 million shares of CUC and Cendant common stock for proceeds of over $149.5 million. A schedule including such sales is annexed hereto as Schedule C.

The HFS Individual Defendants

20. The following defendants, except defendant Scott Forbes, were directors of HFS prior to the Merger and were named in the Registration Statement, as defined in paragraph 33 below, with their consent, as about to become directors of Cendant upon consummation of the Merger:

a. Silverman. Defendant Henry R. Silverman ("Silverman") has been President, Chief Executive Officer and a Director of Cendant since the Merger. He became Chairman of Cendant's Board of Directors and Chairman of the Board's Executive Committee on July 28, 1998 upon the resignation of defendant Walter Forbes. Silverman also is an officer and director of a number of the Company's subsidiaries. Silverman was the Chairman of the Board, Chairman of the Executive Committee and Chief Executive Officer of HFS from May 1990 until the effective date of the Merger. Silverman's compensation for the years ended December 31, 1997, 1996 and 1995, was $3.9 million, $3.8 million, and $1.4 million, respectively. Prior to starting HFS in 1990, Silverman headed the leveraged buyout fund at the Blackstone Group, a New York-based investment banking firm. As a result of the Merger, Silverman received options to acquire approximately 14.4 million shares of Cendant common stock. Also as a result of the Merger, Silverman's employment contract with HFS was amended and restated to provide that Silverman would be employed as Chief Executive Officer of Cendant through December 31, 1999 and become Chairman of Cendant's Board and of the Board's Executive Committee on January 1, 2000. The contract also provided severance benefits in excess of $37.5 million if Silverman's employment is terminated prior to January 1, 2002. On September 23, 1998, the Company's Board approved an equity incentive program for senior management as a result of which 17.2 million of Silverman's options were repriced substantially downward. On February 5 and 6, 1998, Silverman sold 1.7 million shares of Cendant common stock -- his entire holdings in the Company -- which were acquired at low prices through the exercise of stock options, for proceeds of over $61.4 million.

b. Snodgrass. Defendant John D. Snodgrass ("Snodgrass") has been Vice Chairman and a Director of Cendant since the Merger. Snodgrass was President, Chief Operating Officer and a Director of HFS from February 1992 until the Merger, and was Vice Chairman of HFS from September 1996 until the Merger. From November 1994 through January 1996, Snodgrass served as Vice Chairman of the Board of Chartwell Leisure Inc., a subsidiary of the Company. Since the Merger until the end of the Class Period, Snodgrass sold over 1.6 million shares of Cendant common stock, for proceeds of over $63.2 million; approximately 1.1 million of those shares were sold on March 17, and April 6 and 7, 1998 for proceeds of over $44.2.

c. Monaco. Defendant Michael P. Monaco ("Monaco") has been Vice Chairman, Chief Financial Officer and a Director of Cendant since the Merger. Monaco also serves as an officer and director of a number of the Company's subsidiaries. Monaco was Vice Chairman and Chief Financial Officer of HFS from October 1996 until the Merger. Monaco's compensation for the year ended December 31, 1997, and for the period October

1996 through December 31, 1996, was $800,000 and $106,000, respectively. As a result of the Merger, Monaco's employment contract with HFS was amended and restated to provide that Monaco would be employed as Vice Chairman and Chief Financial Officer of Cendant, and also provides severance benefits if his employment is terminated prior to January 1, 2001.

d. Buckman. Defendant James E. Buckman ("Buckman") has been Senior Executive Vice President, General Counsel and a Director of Cendant since December 17, 1997. Buckman was the Senior Executive Vice President, General Counsel and Assistant Secretary of HFS from May 1997 until the Merger, a Director of HFS from June 1994 until the Merger, and was Executive Vice President, General Counsel and Assistant Secretary of HFS from February 1992 through May 1997. Buckman also serves as an officer and director of several of the Company's subsidiaries. Buckman's compensation for the years ended December 31, 1997, 1996 and 1995 was $800,000, $633,000 and $506,000, respectively. As a result of the Merger, Buckman's employment contract with HFS was amended and restated to provide that Buckman would be employed as Senior Executive Vice President and General Counsel of Cendant, and provide severance benefits if his employment is terminated prior to January 1, 2001. On February 6, 1998, Buckman sold 300,000 shares of Cendant common stock, for proceeds of over $10.8 million.

e. Scott Forbes. Defendant Scott E. Forbes ("Scott Forbes") (no relation to defendant Walter Forbes) has been Executive Vice President and Chief Accounting Officer of Cendant since April 15, 1998, after serving as Senior Vice President-Finance of the

Company from December 17, 1997 to April 15, 1998. Scott Forbes was Senior Vice President-Finance of HFS from August 24, 1993 until the Merger.

f. Holmes. Defendant Steven P. Holmes ("Holmes") has been a director of Cendant since the Merger. He was Vice Chairman of HFS from September 1996, was a director of HFS since June 1994, and from July 1990 through September 1996, served as Executive Vice President, Treasurer and Chief Financial Officer of HFS. Holmes is a director of Avis Rent-A-Car, Inc., Chartwell and Avis Europe PLC, subsidiaries of the Company.

g. Kunisch. Defendant Robert D. Kunisch ("Kunisch") has been a director of Cendant since the Merger. He had been Vice Chairman of HFS since April 1997, having previously been Chairman of the Board (since 1989), Chief Executive Officer (since 1988) and President (since 1984) of PHH Corporation, a subsidiary of the Company. He is a member of the board directors of CSX Corporation, Mercantile Bankshares Corporation and GenCorp, Inc.

h. Coleman. Defendant Leonard S. Coleman ("Coleman") has been a director of Cendant since the Merger. He was a director of HFS prior to the Merger. Coleman is a director of Beneficial Corporation, Owens Corning, the Omnicom Group and New Jersey Resources.

i. DeHaan. Defendant Christel DeHaan ("DeHaan") was a director of Cendant since the Merger until she resigned from Cendant's Board in January 1998, purportedly for personal reasons.

j. Edelman. Defendant Martin L. Edelman ("Edelman") has been a director of Cendant since the Merger. He was a director of HFS since November 1993, and serves as President and a director of Chartwell. Edelman is a partner of Chartwell Hotels Associates and serves as a director of Avis Rent-A-Car, Inc. and of Capital Trust. On March 13, 1998, Edelman sold 60,000 shares of Cendant common stock for proceeds of over $2.4 million.

k. Mulroney. Defendant Brian Mulroney ("Mulroney"), has been a director of Cendant since the Merger. He was a director of HFS since April 1997. Mulroney is a member of several corporate boards of directors, including Archer Daniels Midland Company Inc., Barrick Gold Corporation and Petrofina, S.A.

l. Nederlander. Defendant Robert E. Nederlander ("Nederlander") has been a director of Cendant since the Merger. He was a director of HFS since July 1995. Since November 1981, Nederlander has been President and Director of the Nederlander Organization, Inc., owner and operator of one of the world's largest chains of theaters. Nederlander has been Chairman of the Board of Riddell Sports Inc. since April 1988, and was that company's Chief Executive Officer from 1988 through April 1, 1993.

m. Pittman. Defendant Robert W. Pittman ("Pittman") has been a director of Cendant since the Merger. He was a director of HFS since July 1994. From September 1995 through October 1996, Pittman was the Chief Executive Officer and Managing Partner of HFS's wholly owned subsidiary, Century 21 Real Estate Corporation.

n. Rosenwald. Defendant E. John Rosenwald, Jr. ("Rosenwald") has been a director of Cendant since the Merger. He was a director of HFS since September 1996. Since 1988, Rosenwald has been Vice Chairman of The Bear Stearns Companies Inc., a subsidiary of which issued the "fairness opinion" to HFS's Board in connection with the Merger. He serves as a director of Hasbro, Inc.

o. Schutzman. Defendant Leonard Schutzman ("Schutzman") has been a director of Cendant since the Merger. He was a director of HFS since August 1993. Schutzman is currently Chairman of the Board and Chief Executive Officer of Triad Capital Corporation of New York, a small business investment company.

p. Smith. Defendant Robert F. Smith ("Smith") has been a director of Cendant since the Merger. He was a director of HFS since February 1993. From November 1994 until August 1996, Smith also served as a director of Chartwell.

21. Each of the defendants named in the preceding paragraph (collectively, the "HFS Individual Defendants") reviewed or was aware of the false and misleading Registration Statement and the Joint Proxy Statement/Prospectus at or about the time they were issued or circulated, and was in a position to control or influence their contents or otherwise cause corrective or accurate disclosures to have been made. HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes also reviewed or were aware of the other false and misleading SEC filings, including the Form 10-K for the year ended December 31, 1997, of the false and misleading press releases, and other statements complained of herein at or about the time they were issued or circulated, beginning on August 28, 1997, and were in a position to control or influence their contents or otherwise cause corrective or accurate disclosures to have been made. Since the Merger until the end of the Class Period, the HFS Individual Defendants sold over 3.6 million shares of Cendant common stock for proceeds of approximately $138 million. All individual defendants

collectively sold over 8.1 million shares of CUC and Cendant common stock during the Class Period for proceeds of over $287.5 million. A schedule of such sales is annexed hereto as Schedule C.

Ernst & Young LLP

22. Defendant Ernst & Young LLP ("E&Y") is a "Big 5" public accounting firm with offices throughout the United States. E&Y was retained as CUC's independent public accountant prior to the time CUC became a public entity in 1983, and continually served as CUC's auditor from then until the Merger. E&Y also conducted timely reviews of CUC's quarterly financial statements during the Class Period. After the Merger, E&Y audited the financial statements of CMS for the year ended December 31, 1997. E&Y issued unqualified audit reports on CUC's financial statements for the fiscal years ended January 31, 1996 and 1997 included in CUC's Form 10-K for those years, and on CMS's annual financial statements for 1997, which were consolidated into Cendant's financial statements included in Form 10-K for that year. In those unqualified audit reports, E&Y certified (i) that it had audited CUC's and CMS's financial statements in accordance with GAAS; (ii) that it had planned and performed those audits "to obtain reasonable assurance about whether the financial statements are free of material misstatement"; (iii) that, in its opinion, CUC's and CMS's financial statements "present fairly, in all material respects, the financial position" of CUC or CMS "in conformity with [GAAP]"; and (iv) that its audits provided a "reasonable basis" for its opinions.

23. In quarterly reports to CUC, E&Y also warranted that had it reviewed CUC's financial results for each such quarterly period "in accordance with the standards established by the [AICPA]", and that, based on its reviews, it was "not aware of any material modifications that should be made to the consolidated financial statements . . . for them to be in conformity with [GAAP]."

E&Y's quarterly reports were included in CUC's Forms 10-Q filed with the SEC for CUC's first three quarters of 1995, CUC's first three quarters of 1996, and CUC's first quarter of 1997.

24. The Registration Statement, as defined in paragraph 33 below, included as Exhibit 23.1 E&Y's "Consent of Independent Auditors," dated August 27, 1997. Here, E&Y consented to the reference to E&Y under the caption "Experts" in the Joint Proxy Statement/Prospectus, and to the incorporation by reference of E&Y's unqualified report, dated March 10, 1997, with respect to the consolidated financial statements of CUC for 1995 and 1996, as included in CUC's 1996 10-K. Accordingly, as set forth under the caption "Experts" in the Registration Statement, those financial statements were included "in reliance upon" E&Y's unqualified audit report, "given upon the authority of [E&Y] as experts in accounting and auditing." E&Y's unqualified audit reports also were included, with E&Y's consent, in the Other SEC Filings, as defined in paragraph 66 below.

CLASS ALLEGATIONS

25. Plaintiffs bring this action on their own behalf and as a class action pursuant to Rule 23(a) and Rule 23(b)(3) of the Federal Rules of Civil Procedure on behalf of a class (the "Class") consisting of: All persons and entities who purchased or otherwise acquired publicly traded securities (other than PRIDES) either of Cendant or CUC during the period beginning May 31, 1995 through and including August 28, 1998 and who were injured thereby, including all persons or entities who exchanged shares of HFS common stock for shares of CUC stock pursuant to the Registration Statement, as defined in paragraph 33 below. Excluded from the Class are: (i) defendants; (ii) members of the family of each individual defendant; (iii) any entity in which any

defendant has a controlling interest; (iv) officers and directors of Cendant and its subsidiaries and affiliates; and (iv) the legal representatives, heirs, successors or assigns of any such excluded party.

26. Throughout the Class Period, shares of CUC common stock and Cendant common stock were actively traded on the New York Stock Exchange, which is an efficient market. The members of the Class, as purchasers on that market and acquirers pursuant to the Registration Statement and the Joint Proxy Statement/Prospectus, as defined in paragraph 33 below, are so numerous that joinder of all members is impracticable. While the exact number of Class members may only be determined by appropriate discovery, plaintiffs believe that class members number in the thousands. Approximately 440 million shares of CUC common stock were issued to holders of HFS common stock pursuant to the Registration Statement. As of March 20, 1998, approximately 843 million shares of Cendant common stock were outstanding.

27. Lead Plaintiffs' claims are typical of the claims of the members of the Class. Plaintiffs and all other members of the Class acquired their CUC common stock pursuant to the Registration Statement and the Joint Proxy Statement/Prospectus, and purchased their CUC and Cendant publicly traded securities on the open market and sustained damages as a result of defendants' wrongful conduct complained of herein.

28. Lead Plaintiffs will fairly and adequately protect the interests of the other members of the Class and have retained counsel competent and experienced in class and securities litigation.

29. A class action is superior to other available methods for the fair and efficient adjudication of this controversy. Because the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it virtually impossible for class members individually to seek redress for the wrongful conduct alleged herein.

30. Common questions of law and fact exist as to all members of the Class and predominate over any questions affecting solely individual members of the Class. Among the questions of law and fact common to the Class are:

a. Whether the federal securities laws were violated by defendants' acts as alleged herein;

b. Whether the Registration Statement and the Joint Proxy Statement/Prospectus, as defined in paragraph 33 below, contained material misstatements or omitted to state material information;

c. Whether CUC's and Cendant's financial results during the Class Period were materially misstated;

d. Whether E&Y's unqualified reports issued on CUC's and CMS's financial statements during the Class Period materially misstated that E&Y's audits thereon were conducted in accordance with GAAS;

e. Whether E&Y's unqualified review reports issued on CUC's interim financial statements during the Class Period materially misstated that E&Y's reviews thereon were conducted in accordance with standards established by the AICPA;

f. Whether the market prices of CUC and Cendant publicly traded securities during the Class Period were artificially inflated due to the material omissions and misrepresentations complained of herein; and

g. Whether the members of the Class have sustained damages and, if so, the appropriate measure thereof.

31. Plaintiffs know of no difficulty that will be encountered in the management of this action that would preclude its maintenance as a class action.

32. The names and addresses of the record owners of CUC and Cendant common stock purchased or acquired during the Class Period are available from the Company's transfer agent(s). Notice may be provided to such record owners via first class mail using techniques and a form of notice similar to those customarily used in class actions.

FACTS

I. The Creation of Cendant

33. Cendant was formed through the Merger of CUC and HFS on December 17, 1997, in which approximately 440 million shares of CUC common stock were issued to holders of common stock of HFS. The Merger was accomplished pursuant to a Registration Statement filed with the SEC on or about August 28, 1997 (the "Registration Statement"), and a Joint Proxy Statement and Prospectus (the "Joint Proxy Statement/ Prospectus") dated August 28, 1997 that was distributed to shareholders of CUC and HFS on or about August 29, 1997. Pursuant to the terms of the Merger, holders of HFS common stock received 2.4031 shares of CUC stock for each share of HFS stock (the "Exchange Ratio"). Over 183 million shares of HFS common stock were exchanged for approximately 440 million shares of CUC common stock, which valued the Merger at approximately $14.1 billion. Holders of CUC common stock did not exchange their stock as part of the Merger, although their approval and approval by HFS stockholders, was required to consummate the Merger. CUC remained as the surviving company following the Merger; its name was changed to Cendant. The Registration Statement was signed by defendants Walter Forbes, Shelton, McLeod, Corigliano, Perfit, Donnelley, Greyser, Burnap, Rittereiser, Rumbough and Williams.

34. The Merger was announced on May 27, 1997, when CUC and HFS issued a joint press release and filed with the SEC the Agreement and Plan of Merger (the "Merger Agreement"). The Merger Agreement was attached as Appendix A to the Joint Proxy Statement/Prospectus and formed a part of the Registration Statement. On August 28, 1997, CUC filed the Registration

Statement with the SEC, which included the Joint Proxy Statement/Prospectus, and HFS filed a Definitive Proxy Statement with the SEC, which also included the Joint Proxy Statement/Prospectus. On August 29, 1997, CUC and HFS each sent those documents to their respective stockholders of record.

35. CUC described itself in the Joint Proxy Statement/Prospectus as

> a leading technology-driven, membership-based consumer services company, providing approximately 69 million members with access to a variety of goods and services worldwide. These memberships include such components as shopping, travel, auto, dining, home improvement, lifestyle, vacation exchange, credit card and checking account enhancement packages, financial products and discount programs. . . . CUC's membership activities are conducted principally through its Comp-U-Card division and CUC's wholly-owned subsidiaries, FISI*Madison Financial Corporation [("FISI")], Benefit Consultants, Inc. [("BCI")], Interval International Inc., Entertainment Publications, Inc. [("EPub")] and SafeCard Services, Inc. [("SafeCard")].

CUC's membership activities, which were conducted through Comp-U-Card and approximately twenty wholly-owned subsidiaries prior to the Merger, are now conducted by CMS.

36. HFS described itself in the Joint Proxy Statement/Prospectus as

> one of the foremost global services providers. HFS provides services to consumers through intermediaries in the travel and real estate industries. In the travel industry, HFS, through its subsidiaries, franchises hotels primarily in the mid-priced and economy markets. It is the world's largest hotel franchisor, operating the Days Inn™, Ramada™ (in the United States), Howard Johnson™, Super 8™, Travelodge™ (in North America), Villager Lodge™, Knights Inn™ and Wingate Inn™ franchise systems. Additionally, HFS owns the Avis worldwide vehicle rental systems, which is operated through its franchisees and is the second-largest car rental system in the world (based on total revenues and volume of rental transactions).

The Joint Proxy Statement/Prospectus further detailed HFS's ownership, through its subsidiaries, of residential real estate brokerage offices, and its position as "the largest provider of corporate relocation services in the United States."

37. Throughout the Class Period, CUC (and Cendant) reported a string of record financial results and increasing profits, always meeting or exceeding analysts' expectations. CUC (and Cendant) was characterized as a strong, successful and growing company. As a result, the market price of CUC's and then Cendant's common stock rose steadily from approximately $16 5/16 per share on May 31, 1995, the first day of the Class Period, to more than $41 per share in March 1998. On April 15, 1998, the date of Cendant's first partial disclosure (after the close of the market) of its and CUC's financial wrongdoing, the per share market price closed at $35 5/8.

38. CUC and Cendant used its steadily rising stock price to finance operations and acquisitions. In fact, the Company had expanded its leadership position in all of its operating segments through acquisitions. During 1995 and 1996, CUC acquired six companies, valued at approximately $2.6 billion by issuing approximately 172 million shares of common stock. CUC accounted for these acquisitions using the pooling of interests method. In 1997, CUC made the following additional acquisitions:

a. During February 1997, CUC issued 3 million shares of its common stock to acquire substantially all of the assets and specific liabilities of NUMA Corporation ("NUMA"), a publisher of personalized heritage publications and marketer and seller of personalized merchandise. Those shares had a market value of approximately $72 million.

b. On October 3, 1997, CUC issued 14.2 million shares of common stock in exchange for all of the outstanding common stock of Hebdo Mag International Inc. ("Hebdo Mag"), a publisher and distributor of classified advertising information. Those shares had a market value of approximately $434 million.

c. On December 17, 1997, CUC issued 440 million shares in exchange for all of the outstanding common stock of HFS. Those shares were valued at approximately $14.1 billion.

This practice continued in 1998 with, for example, Cendant's failed proposed acquisition of American Bankers Insurance Group Inc. ("American Bankers") for $67 per share in cash and Cendant common stock, which would have resulted in a total purchase price of over $3 billion. At the time of the initial disclosures of CUC's and Cendant's financial wrongdoing, as alleged herein, Cendant also had pending acquisitions of Providian Insurance and National Parking Corporation. As described in paragraph 66 below, during the Class Period, CUC and Cendant filed with the SEC at least twenty registration statements (not including amendments) to register approximately 630 million shares of common stock and over $7 billion of other securities.

39. In the Section entitled "Background of the Merger," the Joint Proxy Statement/Prospectus stated that, in January 1997, defendants Silverman and Walter Forbes held preliminary discussions regarding strategic opportunities for the two companies. The preliminary discussions were described as having terminated in February 1997, but Walter Forbes reportedly contacted Silverman again in April 1997 to discuss a possible combination of HFS and CUC. In mid-April, Silverman and defendant Monaco met with Walter Forbes and defendant Shelton to discuss the matter and agreed that a "merger of equals" structure "might represent a desirable approach to achieve the strategic business combination."

40. As further described in the Joint Proxy Statement/Prospectus: (a) on May 9, 1997, the two companies "entered into a confidentiality agreement (the 'Confidentiality Agreement'), pursuant to which they agreed to exchange non-public information, subject to certain customary

terms and conditions"; (b) on May 16, 1997, "members of the senior management of both companies, together with their respective advisors held a meeting to discuss the CUC and HFS business and to afford each company an opportunity for due diligence with respect to the other company"; (c) following this meeting "and continuing through May 27, 1997, the senior management, legal counsel and financial advisors of each of CUC and HFS continued their discussions and due diligence with respect to the other company"; (d) on May 22, 1997, "at a meeting held telephonically, HFS's senior management and advisors updated the HFS Board on the status of the due diligence review, and the negotiations with, CUC and discussed the terms of the proposed merger"; (e) on May 26, 1997, "the HFS and CUC management teams and their respective legal counsel and financial advisors continued to discuss various issues relating to the proposed merger"; and (f) on May 27, 1997, each of the Boards of HFS and CUC met with their respective financial advisors and legal counsel to review the proposed merger and the terms of the proposed merger agreements, and the Boards of HFS and CUC each determined that the Merger was "fair to and in the best interests of" their respective companies and stockholders and "resolved to recommend that their respective stockholders vote in favor of approving and adopting the Merger Agreement."

41. In the Merger Agreement, CUC represented and warranted as follows:

> SECTION 3.2. Representations and Warranties of CUC. . . .
>
> * * *
>
> (e) SEC Documents; Undisclosed Liabilities. CUC has filed all required registration statements, prospectuses, reports, schedules, forms, statements and other documents (including exhibits and all other information incorporated therein) with the SEC since December 31, 1994 (the "CUC SEC Documents"). As of their respective dates, the CUC SEC Documents complied in all material respects with the

requirements of the Securities Act or the Exchange Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such CUC SEC Documents, and none of the CUC SEC Documents when filed contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The financial statements of CUC included in the CUC SEC Documents comply as to form, as of their respective dates of filing with the SEC, in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with GAAP (except, in the case of unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present the consolidated financial position of CUC and its consolidated subsidiaries as of the dates thereof and the consolidated results of their operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal year-end audit adjustments and except that, in the case of financial statements included therein which were later restated to account for one or more business combinations accounted for as poolings-of-interest, such original financial statements do not reflect such restatements). . . .

(f) Information Supplied. None of the information supplied or to be supplied by CUC specifically for inclusion or incorporation by reference in (i) the Form S-4 will, at the time the Form S-4 becomes effective under the Securities Act, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein not misleading or (ii) the Joint Proxy Statement will, at the date it is first mailed to CUC's stockholders or at the time of the CUC Stockholders Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The Form S-4 and the Joint Proxy Statement will comply as to form in all material respects with the requirements of the Securities Act and the Exchange Act and the rules and regulations thereunder . . .

(g) Absence of Certain Changes or Events. . . . [S]ince January 31, 1997, CUC and its subsidiaries have conducted their business only in the ordinary course or as disclosed in any CUC SEC Document filed since such date and prior to the date hereof, and there has not been (i) any material adverse change in CUC, . . . (v) except insofar as may have been disclosed in CUC SEC Documents filed and publicly available prior to the date of this Agreement . . . or required by a change in GAAP, any change in accounting methods, principles or practices by CUC materially affecting its assets, liabilities or business, . . . or (vii) any action taken by CUC or any of the CUC subsidiaries during the period from January 31, 1997 through the date of

> this Agreement that, if taken during the period from the date of this Agreement through the Effective Time would constitute a breach of Section 4.1(b).
>
> * * *
>
> SECTION 4.1. Conduct of Business. . . .
>
> * * *
>
> (b) Conduct of Business by CUC. . . . [D]uring the period from the date of this Agreement to the Effective Time, CUC shall, and shall cause its subsidiaries to, carry on their respective businesses in the ordinary course consistent with past practices and in compliance in all material respects with all laws and regulations . . .
>
> * * *
>
> SECTION 6.3. Conditions to Obligations of HFS. The obligation of HFS to effect the Merger is further subject to satisfaction or waiver of the following conditions:
>
> (a) Representations and Warranties. The representations and warranties of CUC set forth herein shall be true and correct both when made and at and as of the Closing Date, as if made at and as of such time . . .

Similar representations and warranties were made by HFS.

42. The Merger Agreement also provided that Cendant's Board would consist of 30 directors, half selected by CUC and half selected by HFS. Silverman was designated to serve as President and Chief Executive Officer of the Company, and Walter Forbes to serve as Chairman of the Board. Pursuant to the Merger Agreement, on January 1, 2000, Forbes would become President and Chief Executive Officer and Silverman Chairman of the Board. The Merger was approved by shareholders of CUC and HFS at Special Meetings held on October 1, 1997, and was consummated on December 17, 1997.

II. CUC and Cendant Perpetrated a Massive Company-Wide Fraud

A. Cendant's Disclosures of the Massive Fraud

43. After the close of the market on April 15, 1998, the Company stunned investors by issuing a press release, carried over *Business Wire*, announcing that it would restate its previously reported financial results for 1997 and that it might restate financial results for certain other periods, because of unspecified accounting irregularities related to business segments of CUC. The Company stated that it would reduce reported net income for 1997, before restructuring and unusual charges, by $100 million to $115 million, which would reduce previously reported earnings per share of $0.07 by $0.11 to $0.13, thus creating a loss for 1997. Cendant also stated that the Company's Audit Committee had retained the law firm of Willkie Farr & Gallagher ("WF&G") as special legal counsel to investigate the accounting irregularities and that WF&G had retained the accounting firm of Arthur Andersen LLP ("AA") to perform an independent investigation. Cendant's auditor, Deloitte & Touche, LLP ("D&T"), was retained to audit the Company's restated financial statements. Because of this, the Company warned that, "[i]n accordance with [Statement on Auditing Standards] No. 1, the Company's previously issued financial statements and auditors' reports should not be relied upon. Revised financial statements and auditors' reports will be issued upon completion of the investigations." Although Cendant disclosed the existence of some financial wrongdoing, those disclosures, as later revealed, were materially incomplete and misleading.

44. The Company's April 15, 1998 press release attempted to minimize the scope of the problem. Cendant referred to the wrongdoing as being "*limited* to certain former CUC businesses, which accounted for *less than one third* of Cendant's net income in 1997" (emphasis added).

Defendant Silverman stated: "We're outraged by the actions of a *small number* of former CUC employees who betrayed the trust that was placed in them by the Company and our fellow shareholders" (emphasis added). That press release also stated that it remained committed to the completion of its previously announced acquisitions of American Bankers and other companies.

45. According to an article in the April 16, 1998 edition of *The Wall Street Journal*, the irregularities were tied to the profit recognized from each of the 66.5 million members worldwide of the membership segment's discount travel, shopping and entertainment clubs. An April 17, 1998 article in *The Wall Street Journal* reported that the irregularities were related to the manner in which CUC and Cendant matched its membership revenue and expenses, and quoted defendant Silverman as assuring investors that HFS "did all the due diligence that one does when one buys a public company." *Bloomberg Business News* then reported on April 20, 1998, that such irregularities occurred in Cendant's Alliance Marketing division -- the division responsible for enlisting new members.

46. After Cendant's initial partial disclosure, the Company made several statements in which it reaffirmed its commitment to complete the American Bankers acquisition. Those press releases were issued on April 17, 1998 ("we would expect the ABI transaction to be completed late summer . . . By that time, we expect the accounting issues to be behind us"); April 27, 1998 ("We have reaffirmed our commitment to completing all pending acquisitions"); May 7, 1998 (extending tender offer); May 8, 1998 (assumes completion of American Bankers transaction); May 29, 1998 (new credit facilities will enable closing of transaction); and July 2, 1998 (further extending cash tender offer). These statements, like the Company's earlier ones, were misleading in that they falsely described a healthy Cendant, not a company suffering from pervasive financial wrongdoing.

47. In an April 20, 1998 press release in which Cendant announced that it had named a new executive vice president and chief financial officer of the Company's Alliance Marketing Division, the division to which Cendant claimed the accounting wrongdoing was confined, Silverman stated that "[t]he Alliance Marketing business is healthy, strong and profitable. We look forward to giving investors a better understanding of that business so that our April 15 announcement can be understood within a fuller context." In an April 27, 1998 letter to shareholders, Walter Forbes and Silverman stated that "Cendant is strong, highly liquid, and extremely profitable. The vast majority of Cendant's operating businesses and earnings are unaffected" by the financial wrongdoing. These statements were false.

48. On May 5, 1998, the Company issued a press release announcing its earnings for the quarter ended March 31, 1998, including $368.5 million in income from continuing operations, and earnings per share of $0.27. Cendant stated that "[m]ore than eighty percent of the Company's net income for the first quarter of 1998 came from Cendant business units not impacted by the potential [CUC] accounting irregularities." In a later-issued May 5, 1998 press release, Cendant stated that its earlier announced quarterly results "were compiled in accordance with what Cendant believes are appropriate accounting practices, and reflect the elimination of any potential historical accounting irregularities under investigation by the Audit Committee." These statements were materially false and misleading.

49. On the morning of July 14, 1998, in a press release carried over *Business Wire*, Cendant announced that the Company's previously reported restatement of 1997 financial results was materially understated, and then estimated that the 1997 restatement would reduce net income by $0.22 to $0.28 per share, or *double* the amount reported on April 15. Cendant also announced

that it would restate CUC's previously reported financial results for 1995 and 1996 and all quarters in both of those years. Cendant disclosed that the reasons for the restatements included irregular charges against merger reserves, false coding of services sold to customers, delayed recognition of membership cancellations and quarterly recording of fictitious revenue (which occurred in all quarters in the Class Period).

50. On July 28, 1998, Cendant announced that Walter Forbes had resigned his position as Chairman of the Board of Directors, and that eight other Cendant directors who had been directors of CUC also had resigned.

51. On August 13, 1998, Cendant announced its results for the quarter ended June 30, 1998, including $347.2 million in income from continuing operations, and earnings per share of $0.24. The Company announced that its investigation into accounting irregularities had concluded, and that a complete report would be released later in August 1998.

52. Then, on August 27, 1998, in a press release carried over *PR Newswire*, Cendant announced that the Report to the Audit Committee of the Board of Directors of Cendant Corporation, dated August 24, 1998 (the "Report"), in which Cendant described details about the massive and pervasive financial fraud at the Company and its restatement of financial statements for 1995, 1996 and 1997, had been issued by WF&G and AA and had been adopted by Cendant's Board. The Company stated that it would file the Report on Form 8-K, and that the Report would be sent to the SEC and to the office of the U.S. Attorney for the District of New Jersey, who were investigating the accounting and reporting irregularities at the Company. Defendant Silverman stated that "[t]his report brings to a close a difficult period for Cendant employees and shareholders alike."

53. On August 28, 1998, Cendant filed with the SEC on Form 8-K (the "August 28, 1998 8-K"), which attached the Report. As set forth in detail below, the Report -- *for the first time* -- expressly confirmed that CUC's acts of financial malfeasance "were pervasive," affecting 17 of CUC's 22 operating units. The Report disclosed that CUC's reported operating income was artificially increased during the Class Period by approximately $500 million as a result of adjusting journal entries that were unsupported and not permitted under GAAP. Indeed, the Report revealed that CUC created hundreds of millions of dollars of fictitious revenue by processing hundreds of unsupported journal entries and that it materially increased its reported cash, accounts receivable and deferred revenue balances. Also, improper entries were made on a quarterly basis: in 1995, 1996 and 1997, quarterly operating income was fraudulently increased by $31 million, $87 million and $176 million, respectively.

54. In the Report, Cendant -- *for the first time* -- disclosed that CUC's false financial reporting was "a carefully planned exercise," as most of the hundreds of unsupported journal entries were made after the ends of years or quarters and backdated to prior months. Merger reserves were transferred through intercompany accounts to and among various subsidiaries and then reversed into those subsidiaries' net income. In a repeat of its 1989 improper membership acquisition cost accounting practice, described in paragraph 89 below, CUC also improperly recorded revenues on an accelerated basis in relation to its recognition of the expenses associated with those revenues. This was accomplished, in large part, by arbitrarily re-labeling revenues from certain products at Comp-U-Card, where revenues and expenses were recognized over time, to other Comp-U-Card products where revenues were recognized immediately while related expenses continued to be deferred. CUC's membership cancellation reserve was, also, used improperly during the Class

Period, despite being substantially understated, to increase income through unsupported and backdated journal entries.

B. Cendant's Restatements of Previously Issued Financial Statements

55. On September 29, 1998, Cendant filed with the SEC its Form 10-K/A for the year ended December 31, 1997 (the "10-K/A") to restate its previously issued financial statements as a result of the accounting irregularities and financial fraud. In the 10-K/A, Cendant admitted that, during the Class Period, it had overstated income from continuing operations before income taxes by approximately $297.2 million, or 24%, and earnings per share by $0.61, or 130%. In Footnote 3 to the consolidated financial statements included in the 10-K/A, Cendant disclosed the amounts by which its calendar years (Cendant now reports on a calendar year-end) 1995, 1996 and 1997 financial statements, which reflect the two companies on a pooled basis, had been materially inflated:

Year Ended December 31, 1995 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement (Understatement)
Net Revenues	$2,992.1	$3,026.7	$ (34.6)
Income From Continuing Operations Before Income Taxes	$ 503.3	$ 388.4	$ 114.9
Earnings Per Share	$ 0.45	$ 0.30	$ 0.15

Year Ended December 31, 1996 Restatement (In Millions, Except Per Share Amounts)	As Reported	As Restated	Overstatement
Net Revenues	$3,908.8	$3,748.6	$160.2
Income From Continuing Operations Before Income Taxes	$ 713.7	$ 579.2	$134.5
Earnings Per Share	$ 0.56	$ 0.41	$ 0.15

Year Ended December 31, 1997 Restatement (In Millions, Except Per Share Amounts)	As Reported	As Restated	Overstatement
Net Revenues	$5,314.7	$4,882.2	$432.5
Income From Continuing Operations Before Income Taxes	$ 294.7	$ 246.9	$ 47.8
Earnings Per Share	$ 0.07	$ (0.24)	$ 0.31

56. CUC and E&Y represented that CUC's 1995 and 1996 annual financial statements, which were incorporated in the Registration Statement and the Joint Proxy Statement/Prospectus, were presented in conformity with GAAP. They were not. In fact, those financial statements were materially false and misleading. CUC's income from continuing operations before income taxes for 1995, previously reported as approximately $276.2 million, was overstated by approximately $114.9 million, or 95%; CUC's income from continuing operations before income taxes for 1996, previously reported as approximately $235.3 million, was overstated by approximately $134.5 million, or 95%. CUC's earnings per share for those years were overstated by approximately $0.24 and approximately $0.19, or 140% and 105%, respectively. As reported on July 15, 1998 by

Dow Jones Online News, defendant Silverman stated that "[w]e merged with a company and 50% to 60% of the earnings were without substance."

57. The misrepresentations of the 1995 and 1996 financial statements were especially material to the Registration Statement and the Joint Proxy Statement Prospectus. In both of those SEC filings, the Merger was described by CUC and HFS as a "merger of equals." That was not the case. This representation by the CUC Individual Defendants and the HFS Individual Defendants, made to convince the shareholders of their respective companies to approve the Merger, was materially false and misleading.

58. Cendant also restated CUC's previously reported quarterly financial statements for each quarter in the years ended December 31, 1995, 1996 and 1997. The 10-K/A disclosed restated amounts for each quarter in 1996 and 1997:

First Quarter 1996 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$ 821.4	$ 755.6	$ 65.8
Income From Continuing Operations Before Income Taxes	$ 96.0	$ 55.2	$ 40.8
Earnings Per Share From Continuing Operations Before Cumulative Effect of Accounting Change	$ 0.14	$ 0.08	$ 0.06

Second Quarter 1996 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$ 935.7	$ 882.0	$ 53.7
Income From Continuing Operations Before Income Taxes	$ 101.0	$ 66.9	$ 34.1
Earnings Per Share From Continuing Operations	$ 0.14	$ 0.12	$ 0.02

Third Quarter 1996 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement (Understatement)
Net Revenues	$1,042.9	$1,086.0	$ (43.1)
Income From Continuing Operations Before Income Taxes	$ 68.5	$ 82.1	$ (13.6)
Earnings Per Share From Continuing Operations	$ 0.09	$ 0.09	$ 0.00

Fourth Quarter 1996 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$1,108.8	$1,025.0	$ 83.8
Income From Continuing Operations Before Income Taxes	$ 158.1	$ 125.8	$ 32.3
Earnings Per Share From Continuing Operations	$ 0.20	$ 0.13	$ 0.07

First Quarter 1997 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$1,158.2	$1,091.0	$ 67.2
Income From Continuing Operations Before Income Taxes	$ 166.0	$ 116.6	$ 49.4
Earnings Per Share From Continuing Operations Before Cumulative Effect of Accounting Change	$ 0.21	$ 0.14	$ 0.07

Second Quarter 1997 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$1,300.5	$1,127.5	$173.0
(Loss) From Continuing Operations Before Income Taxes	$ (13.4)	$ (84.0)	$ 70.6
(Loss) Per Share From Continuing Operations	$ (0.02)	$ (0.09)	$ 0.07

Third Quarter 1997 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$1,431.3	$1,310.5	$102.8
Income From Continuing Operations Before Income Taxes	$ 248.3	$ 202.6	$ 45.7
Earnings Per Share From Continuing Operations	$ 0.31	$ 0.25	$ 0.06

Fourth Quarter 1997 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement (Understatement)
Net Revenues	$1,424.7	$1,335.2	$ 89.5
(Loss) From Continuing Operations Before Income Taxes	$ (345.5)	$ (180.5)	$ (165.0)
(Loss) Per Share From Continuing Operations Before Extraordinary Gain	$ (0.42)	$ (0.22)	$ (0.20)

59. On or about October 13, 1998, Cendant filed with the SEC Forms 10-Q/A for the first and second quarter of 1998. These amended filings set forth the following restatements:

First Quarter 1998 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$1,436.6	$1,288.1	$148.5
Income From Continuing Operations Before Income Taxes	$ 368.5	$ 279.0	$ 89.5
Earnings Per Share	$ 0.27	$ 0.22	$ 0.05

Second Quarter 1998 Restatement
(In Millions, Except Per Share Amounts)

	As Reported	As Restated	Overstatement
Net Revenues	$1,306.3	$1,277.9	$ 28.4
Income From Continuing Operations Before Income Taxes	$ 347.2	$ 262.1	$ 85.1
Earnings Per Share	$ 0.24	$ 0.18	$ 0.06

60. Under GAAP, restatement of previously issued financial statements is the most serious step, reserved only for situations in which no lesser remedy is available. Indeed, under Statement of Financial Accounting Standard No. 16, *Prior Period Adjustments*, and Accounting Principles Board Opinion No. 20, *Accounting Changes*, restatements are only permitted -- and are required -- for *material accounting errors or irregularities that existed at the time the financial statements were prepared*. The Company publicly admitted that it was restating 1995, 1996 and 1997 financial statements because of "accounting irregularities." "Irregularities" is a term of art under GAAS, which "

> refers to *intentional* misstatements or omissions of amounts or disclosures in financial statements. Irregularities include fraudulent financial reporting undertaken to render financial statements misleading, sometimes called *management fraud* . . .

AU § 316.03 (1997). Thus, Cendant has conceded that its financial results were intentionally misstated throughout the Class Period.

61. In addition, defendant Monaco was quoted in the Company's July 14, 1998 press release as saying, "We have now received evidence that for at least the last three years the financial results of the former CUC reflected a continuing program of false entries which misrepresented the financial performance and condition of that company." Monaco continued: "These accounting practices were widespread and systemic and affected the accounting records of all the major business units of CUC." Indeed, the Report characterized the irregularities as "pervasive," and stated that "the purpose of many of the irregularities was at least to conform CUC's publicly-reported results to Wall Street's earnings expectations." Thus, all of Cendant's and CUC's 1995, 1996 and 1997 financial statements issued during the Class Period were knowingly materially false and misleading,

as were all of the publicly disseminated documents in which those financial statements (or financial information derived therefrom) were described, included or incorporated by reference.

C. Cendant's April 15, 1998 to August 28, 1998 Disclosures Caused the Largest Loss in Market Capitalization in History

62. Immediately prior to the first partial public disclosure of the financial wrongdoing alleged herein, Cendant had a market capitalization of approximately \$30.4 billion. On April 16, 1998, the day after the Company's first partial disclosure, the per share price of Cendant's common stock dropped from \$35 5/8 to \$19 1/16 on New York Stock Exchange record trading of approximately 108.5 million shares, resulting in a drop to Cendant's market capitalization of \$14.2 billion, or 47%. On July 14, 1998, the date of Cendant's next partial disclosure, the per share price of Cendant's common stock dropped to \$15 11/16, causing the Company's market capitalization to drop to \$13.4 billion, or by another \$2.8 billion, for a total drop as of that date of \$17 billion, or 56%. On August 31, 1998, the first trading day after the Company's detailed disclosure of its financial wrongdoing, the per share price of Cendant's common stock dropped to \$11 11/16, causing Cendant's market capitalization to drop another \$3.5 billion to \$9.9 billion, for a total drop, as a result of the financial wrongdoing, of \$20.5 billion, or 67%.

III. Defendants' Materially False and Misleading Statements During the Class Period

63. As a result of the foregoing and of HFS's failure to disclose that it had not performed required substantive financial due diligence, CUC, Cendant, HFS and certain individual defendants, as described herein, made a multitude of materially false and misleading statements or omitted to state material information during the Class Period, as set forth in annual and quarterly reports filed

with the SEC, the Registration Statement and the Joint Proxy Statement/Prospectus, other registration statements filed with the SEC, and press releases.

64. CUC and Cendant filed with the SEC and disseminated to the public the following annual and quarterly reports, each of which included materially false and misleading financial statements:

a. The 1995, 1996 and 1997 Forms 10-K, which were filed with the SEC on or about April 25, 1996, May 1, 1997 and March 31, 1998, respectively.

b. The Forms 10-Q for the first three quarters of 1995, which were filed with the SEC on or about June 14, 1995, September 5, 1995 and December 11, 1995, respectively.

c. The Forms 10-Q for the first three quarters of 1996, which were filed with the SEC on or about June 14, 1996, September 16, 1996 and December 13, 1996, respectively.

d. The Forms 10-Q for the first three quarters of 1997, which were filed with the SEC on or about June 16, 1997, September 15, 1997 and December 13, 1997, respectively.

65. The Registration Statement and the Joint Proxy Statement/Prospectus were filed with the SEC and sent to shareholders of CUC and HFS on or about August 28, 1997. CUC registered approximately 504 million shares of its common stock in connection with the Merger.

66. CUC and Cendant filed with the SEC and disseminated the following registration statements on Forms S-3 and S-4 (the "Other SEC Filings") during the Class Period:

a. CUC filed Forms S-4 on December 7, 1995 (registering 7.5 million shares of CUC common stock); June 21, 1996 (registering 30 million shares and 25.6 million shares of CUC common stock); June 28, 1996 (registering 17.2 million shares of CUC common stock); and December 24, 1996, amended January 2, 1997 (registering 3.5 million shares of

CUC common stock). Cendant filed a Form S-4 on February 20, 1998 (registering 2.2 million shares of $3.125 cumulative preferred stock).

b. CUC filed Forms S-3 on July 28, 1995, amended September 6, 1995 (registering 3.8 million shares of CUC common stock); October 6, 1995, amended November 11, 1995 and December 8, 1995 (registering 1.5 million shares of CUC common stock); August 29, 1996, amended September 17, 1996 (registering 120,000 shares of CUC common stock); October 7, 1996, amended October 9, 1996 (registering 12.7 million shares of CUC common stock); December 5, 1996 (registering 1.2 million shares of CUC common stock); December 6, 1996 (registering 742,000 shares of CUC common stock); January 24, 1997 (registering 5.6 million shares of CUC common stock); March 10, 1997 (registering 18 million shares of CUC common stock and $550 million 3% convertible subordinated notes); and May 12, 1997 (registering 569,000 shares of CUC common stock). Cendant filed Forms S-3 on January 29, 1998, amended on February 6, 17 and 20, 1998 (registering $4 billion of debt securities, preferred stock, common stock purchase contracts and other securities (including 26 million PRIDES)); and on April 3, 1998, (registering $3 billion of debt securities; preferred stock, common stock purchase contracts and other securities).

67. CUC and Cendant issued press releases in which CUC and Cendant announced each of their quarterly and annual earnings during the Class Period. These press releases (referred to collectively hereafter as the "Press Releases"), were publicly disseminated to the market over *Business Wire* and other wire services, and were dated May 31, 1995 (first quarter 1995); August 29, 1995 (second quarter 1995 and six months ended July 31, 1995); November 29, 1995 (third quarter 1995 and nine months ended October 31, 1995); March 19 and 20, 1996 (quarter ended January 31,

1996 and fiscal year 1995); May 22 and 23, 1996 (first quarter 1996); September 4, 1996 (second quarter 1996 and six months ended July 31, 1996); December 2, 1996 (third quarter 1996 and nine months ended October 31, 1996); March 11, 1997 (quarter ended January 31, 1997 and fiscal year 1996); May 29, 1997 and June 2, 1997 (first quarter 1997); September 5, 1997 (second quarter 1997 and six months ended July 31, 1997); December 2 and 9, 1997 (third quarter 1997 and nine months ended October 31, 1997); December 18, 1997 (the closing of the Merger); February 4, 1998 (fiscal year 1997); April 15, 1998 (initial partial disclosure of the fraud); April 17 and 27, 1998, May 7 and 8, 1998, and June 2, 1998 (reaffirming commitment to complete the American Bankers acquisition); and April 20, 1998 and May 5, 1998 (confining the massive fraud).

68. The SEC filings and the Press Releases referred to in paragraphs 64-67 above included or incorporated by reference Cendant and CUC financial statements (or financial information derived therefrom) that were not prepared in conformity with GAAP, and contained other assertions that were materially false and misleading.

A. <u>CUC's and Cendant's Violations of GAAP</u>

69. At all relevant times during the Class Period, Cendant and CUC represented that their financial statements when issued were prepared in conformity with GAAP, which are recognized by the accounting profession and the SEC as the uniform rules, conventions and procedures necessary to define accepted accounting practice at a particular time. As set forth in Statement of Financial Accounting Concepts ("SFAC") No. 1, *Objectives of Financial Reporting by Business Enterprises*, one of the fundamental objectives of financial reporting is that it provide accurate and

reliable information concerning an entity's financial performance during the period being presented. Paragraph 42 of SFAC No. 1 states as follows:

> Financial reporting should provide information about an enterprise's financial performance during a period. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance.

As provided in SEC Rule 4-01(a) of Regulation S-X, "[f]inancial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate." 17 C.F.R. § 210.4-01(a)(1).

70. Management is responsible for preparing financial statements that conform with GAAP. The AICPA Professional Standards provide:

> The financial statements are management's responsibility. . . . Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, record, process, summarize, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. . . . Thus, the fair presentation of financial statements in conformity with generally accepted accounting principles is an implicit and integral part of management's responsibility.

AU § 110.03 (1998). In connection with the audits of CUC's 1995 and 1996 financial statements and the audit of the financial statements of CMS for 1997, CUC and CMS management made written representations to E&Y in which CUC and CMS management acknowledged their responsibility for the fair presentation in those financial statements of CUC's and CMS's financial position, results of operations, and cash flows in conformity with GAAP. AU § 333.06. These representation letters were signed by defendants Walter Forbes, Shelton, Corigliano and Pember. Similar written management representations were provided by CUC management for each of E&Y's reviews of CUC's interim financial statements during 1995, 1996 and 1997. AU § 722.13(g).

1. <u>Cendant's and CUC's Annual Financial Statements</u>

a. <u>Cendant's and CUC's Manipulation of Merger Reserves Violated GAAP</u>

71. Whether using the pooling of interests method or the purchase method, the accounting for merger reserves in a business combination is governed by Accounting Principles Board Opinion No. 16, *Business Combinations* ("APB 16").

> [A]ll expenses related to effecting a business combination accounted for by the pooling of interests method should be deducted in determining the net income of the resulting combined corporation for the period in which the expenses are incurred. Those expenses include, for example, registration fees, costs of furnishing information to stockholders, fees of finders and consultants, salaries and other expenses related to services of employees, and costs and losses of combining operations of the previously separate companies and instituting efficiencies.

APB 16, ¶ 58. In a business combination accounted for by the purchase method,

> [o]ther liabilities and commitments, including unfavorable leases, contracts, and commitments and plant closing expense incident to the acquisition, at present values of amounts to be paid determined at appropriate current interest rates

should be recorded in the period in which the acquisition is completed. *Id.* ¶ 88i. Accordingly, under both accounting methods, a reserve should be created consisting of the anticipated future costs of effecting the business combination. Under the pooling method, there would be a charge to income in the period the business combination was consummated; under the purchase method, goodwill would be increased. As merger-related costs are incurred in future periods, the reserves are charged so that the net income of those future periods is not affected by those expenses.

72. Cendant and CUC violated GAAP in their accounting for business combinations. Cendant and CUC improperly recorded merger reserves in amounts far in excess of costs necessary to complete business combinations, included costs that were not merger-related, and wrote off merger reserves, either by increasing revenue or by decreasing expenses that were not related to the business combinations. The amounts of improper merger reserve reversals were $10.7 million in 1995, $58.9 million in 1996, and $115.2 million in 1997. In addition, Cendant improperly used the Company's merger reserves in 1997 to write off non-merger-related operating and other expenses for 1997 and future periods in the amount of approximately $134.2 million. Specifically, CUC and Cendant improperly manipulated merger reserves in violation of GAAP as follows:

<u>1997 Merger Reserve Reversals - $115.2 Million</u>

a. In January 1998, Cendant improperly used $19.6 million of the merger reserve (the "Ideon Reserve") established in connection with CUC's 1996 acquisition of Ideon Group, Inc. ("Ideon"), together with $20.7 million of the merger reserve (the "Cendant Reserve") established in connection with the Merger, to fraudulently increase Cendant's 1997 income by $40.3 million through a series of individual unsupported post-closing journal entries. Certain of those "post-closing" journal entries were used to improperly increase revenue; other entries were used to improperly reduce expenses that were totally unrelated to the specific mergers. Defendant Pember directed this manipulation of merger reserves, even though that accounting treatment is not permitted under GAAP.

b. Cendant improperly used $43 million of the Ideon Reserve to fraudulently increase Cendant's 1997 income. CMS first spread the reserve, through CMS's corporate intercompany accounts, to CMS's NUMA, National Card Control, Inc. ("NCCI"), and North

American Outdoor Group, Inc. ("NAOG") subsidiaries through many unsupported intercompany journal entries. Although this purportedly was a merger reserve, the controllers at those subsidiaries were unaware of any merger-related expenses incurred by them; indeed, those subsidiaries had no overlapping business with Ideon. Then, another series of unsupported intercompany "topside" adjustments -- *i.e.*, adjustments made at the corporate level rather than at the subsidiary or divisional level -- were made to improperly record $15.1 million of that amount into income. Further, the remaining $27.9 million of the transferred Ideon Reserve was improperly taken into income through additional unsupported topside journal entries to increase revenue at NUMA, NAOG and NCCI. This violation of GAAP also was directed by defendant Pember.

c. At the time the $15.1 million of the Ideon Reserve was improperly taken into income through intercompany transactions, another $17 million of the Cendant Reserve was spread to the BCI, NUMA, Welcome Wagon and WorldEx subsidiaries through another series of unsupported post-closing intercompany journal entries. The memorandum from defendant Pember authorizing those adjustments did not explain the GAAP basis for them, nor could it. Of that $17 million:

i. $10.5 million was transferred to BCI, which then recorded unsupported journal entries to transfer that amount to CUC's FISI subsidiary and to improperly increase FISI's profit-sharing revenue. The $10.5 million of transferred profit-sharing revenue was disagreed with by BCI's controller and assistant controller, Steve Pedersen and Mary Peterson, respectively, each of whom believed that the adjustments bore no relation to reality. The FISI controller, Terry Johnson, believed the amount to be unusually high. In December 1997, for example, FISI's profit-sharing revenue was only approximately $18 million. Johnson could not recall a prior instance in which CUC corporate requested an adjustment to FISI's profit sharing revenue. This violation of GAAP was directed by defendants Corigliano and Pember.

ii. $2.5 million was transferred to Welcome Wagon, after which a topside adjustment was made to improperly increase Welcome Wagon's revenue and to eliminate the intercompany payable. The $2.5 million transfer was deemed odd by Welcome Wagon's controller, Ron Guggenheimer, as well as by Welcome Wagon's staff accountants. The adjustment was believed to be unusual because it was made as a post-closing adjustment, and because Welcome Wagon's 1997 net income was significantly lower than the $2.5 million. This violation of GAAP was directed by defendant Pember.

iii. $3 million was used to improperly increase the revenue of WorldEx through an unsupported topside intercompany adjustment.

iv. $1 million was used to improperly increase the revenue of NUMA through an unsupported topside intercompany adjustment.

d. Cendant improperly used the merger reserve (the "Berkeley Reserve") established in connection with the 1997 acquisition of Berkeley Systems ("Berkeley") by CUC's Sierra to fraudulently increase the 1997 income of Cendant Software ("Software"), a division comprised of Sierra and Davidson & Associates, Inc. ("Davidson"). Through several entries using intercompany accounts on CMS's and Sierra's books, $5.4 million of the remaining Berkeley Reserve was transferred from Sierra through Comp-U-Card to Software (Davidson) and then improperly taken into income by Software by increasing its miscellaneous income. Software's controller, Pam Drake, had no support for the entry and found it "most odd"; the controller for Sierra, Brian Foster, similarly had no support for the transfer. The non-GAAP adjustment was directed by defendant Pember. Defendant McLeod, when reviewing Software's 1997 financial results, recognized that $5.4 million of that division's income was attributable to the merger reversal, but took no action to correct the improper accounting. The proper adjustment should have been to reduce goodwill, because the goodwill was recorded less than a year earlier.

e. Cendant improperly reversed $9.5 million of purchase accounting reserves to fraudulently increase the revenue of CUC's Spark Services, Inc. ("Spark") subsidiary in 1997. The entries were made without a written manual journal entry form or any supporting documentation. Kevin Kearney, controller of Spark, could not explain how this adjustment properly increased revenues; the non-GAAP treatment was directed by defendant Pember. The proper entry would have been to decrease goodwill.

<u>1996 Merger Reserve Reversals - $58.9 Million</u>

f. CUC materially misrepresented its 1996 financial statements by improperly using approximately $51.1 million of the Ideon Reserve to inflate income through increasing revenue and reducing expenses:

i. In February 1997, $35.2 million of the Ideon Reserve was improperly taken into income for 1996 through multiple individual unsupported post-closing journal entries. Approximately $10 million of those improper and unsupported post-closing journal entries was posted to the month of January 1997; accordingly, 1997 results were overstated by that amount, as well.

ii. In February 1997, $7.8 million of the Ideon Reserve was improperly transferred through intercompany accounts to Welcome Wagon and NCCI, and then improperly taken into 1996 income by those subsidiaries. Those adjustments were posted to the month of January 1997; accordingly, 1997 results were overstated by that amount, as well. Welcome Wagon's general ledger accountant, Lisa Plucinski, was uncomfortable with the entry because it increased Welcome Wagon's income despite the fact that Welcome Wagon had a net loss that year. Also, Welcome Wagon had no overlapping operations that would have supported any transfer of the Ideon Reserve to Welcome Wagon. This violation of GAAP was directed by defendant Corigliano.

iii. In January 1997, $7 million of the Ideon Reserve was improperly used to reduce SafeCard's operating expenses for 1996. After that amount was transferred through the intercompany accounts, it was improperly taken into income through a series of unsupported journal entries. At the same time, $5.6 million of accrued expenses were improperly written off directly from SafeCard's books. There was no support for this accounting treatment.

g. Comp-U-Card improperly transferred $1.1 million of the Ideon Reserve to Sierra through an intercompany account purportedly to cover "integration" costs related to CUC's acquisition of Sierra. However, the costs that were offset against this intercompany transfer were not merger-related, but were normal operating costs that should not have been charged against the Ideon Reserve.

h. CUC improperly used $2.2 million of a special merger reserve established in connection with the acquisition of Plextel Communications, Inc. ("Plextel") to offset Comp-U-Card costs in 1996. The reserve was improperly transferred through intercompany accounts to Comp-U-Card, and then used by Comp-U-Card, through post-closing journal entries to the January 1997 financial statements, to reduce its operating expenses. There was no support for those journal entries.

1995 Merger Reserve Reversals - $10.7 Million

i. CUC materially misrepresented its 1995 financial statements by improperly reversing approximately $10.7 million of merger-related reserves into income for 1995.

> i. In February 1996, $6.3 million of merger reserves, which had been established as a result of CUC's 1995 acquisition of two European companies, was transferred from CUC Europe and Credit Card Sentinel through intercompany accounts to CUC and improperly taken into income by CUC. Mark Maybrey, CFO of CUC Europe, was instructed by CUC to establish these reserves, but was never asked to estimate the anticipated costs that may have resulted from either acquisition, even though substantial amounts of the costs included by CUC in those reserves could only have been incurred by CUC Europe. The full amount of those reserves was transferred to CUC and then improperly taken into income, as directed by defendant Corigliano.

ii. In February 1996, \$2.3 million of merger reserves established in connection with the acquisitions of Welcome Wagon and Gifts International was improperly reversed into income through unsupported post-closing journal entries, with \$1 million used directly to increase revenue. The proper entry would have been to decrease goodwill, because the reserve was established less than a year earlier.

iii. Approximately \$2.1 million of merger reserves established in connection with CUC's 1995 acquisition of Essex Corporation ("Essex") was improperly reversed to fraudulently increase income by offsetting operating expenses that were unrelated to the acquisition of Essex. Tom Albright, Essex's Chief Operating Officer, questioned the propriety of the adjustments; indeed, Albright believed that there was no basis for the adjustments. Defendant Corigliano directed these non-GAAP adjustments; defendant Shelton became aware of the reversals in discussions concerning Essex's variances from its budget, but took no action to correct the improper accounting. The credit should have reduced goodwill.

<u>1997 Improper Merger Reserve Utilization - \$134.2 Million</u>

j. Cendant improperly used the Cendant Reserve to write off \$7.2 million of SafeCard assets as of December 31, 1997 that had been impaired long before, and were not related to, the Merger. There was no support for this accounting treatment, which was directed by defendant Pember. The carrying value of those impaired assets should have been charged to SafeCard's 1997 operations.

k. In March 1998, Cendant improperly charged the Cendant Reserve, rather than the Ideon Reserve (which had already been improperly reversed into income), for the

$15 million settlement of a class action (the "Chambers Settlement") against CUC. The Chambers Settlement was unrelated to the Merger. This adjustment was wholly unsupported.

l. Cendant improperly wrote off $39.6 million of assets of CMS's EPub subsidiary against the Cendant Reserve. Sandy Berry, EPub's Controller, questioned whether the assets being written off were actually impaired. Of the $39.6 million written off against this reserve, $16 million was not impaired and should have been depreciated or amortized over future periods. The remaining $24 million of assets, though impaired, was not impaired as a result of the Merger; accordingly, it should have been written off as period costs. This violation of GAAP was directed by defendant Pember.

m. A one-time $30 million payment to CNA in December 1997 in connection with renewal of the contract between CNA and FISI was improperly charged by Cendant to the Cendant Reserve, rather than as a prepaid asset. Defendant Shelton negotiated and signed the new CNA contract, and understood that the CNA relationship was to continue. Defendants Corigliano, Silverman, Monaco and Scott Forbes also knew that the relationship with CNA was continuing but that the payment had been charged against the Cendant Reserve, but took no action to correct the improper accounting. Under Cendant's improper accounting treatment, the payment would have been amortized improperly over a much longer period of time than the three-year life of the new contract.

n. Cendant improperly charged to the Cendant Reserve $3.7 million of accounts receivable that were on the books of Long Term Preferred Care ("LTPC"), a wholly-owned subsidiary of FISI, through intercompany journal entries directed by defendant Pember.

These accounts receivable had been determined to be uncollectible long before the Merger. Accordingly, the charge should have been recorded in LTPC's 1997 operating expenses.

o. Cendant, as directed by defendant Pember, improperly wrote off $17.3 million of goodwill, which had been originally recorded when SafeCard acquired National Leisure Group ("NLG"), against the Cendant Reserve. Much of the write-off was attributed to substantial allocations to NLG for CMS's management and information systems (*i.e.*, 10% of total corporate MIS costs). However, according to James Citro, NLG's Controller, the computer system allocations were improper because NLG had its own computer system and operated on a stand-alone basis. The asset was not impaired and should not have been written off. As a result of Cendant's improper accounting, CMS wrote off an asset, without any charge to its operations, rather than incur a charge to future operations over the useful life of that asset.

p. Cendant improperly wrote off $2.3 million of NLG's computer costs against the Cendant Reserve. According to Citro, the computer system was still in use. As a result, the amount should not have been written off. As a result of CMS's improper accounting, Cendant wrote off an asset, without any charge to its operations, rather than incur a charge to future operations over the useful life of that asset.

q. Cendant posted a number of improper journal entries to record payments made in connection with SafeCard's acquisition of NLG:

i. In February 1998, CMS decided to pay cash instead of stock to NLG's former owners. Under terms of a settlement with NLG's former owners, the value of the shares of common stock due to be paid to the sellers increased by $770,000.

When the total amount was paid, CMS improperly recorded the entire payment as a reduction to the Cendant Reserve. The $770,000 was additional purchase price, and, therefore, should have been recorded as additional goodwill and amortized over future periods. Moreover, the NLG acquisition was unrelated to the Merger.

ii. As a result of NLG's achievement of financial goals targeted in the purchase agreement, Cendant paid the sellers and NLG employees $495,000 each. Cendant improperly charged the Ideon Reserve for those two payments. The $495,000 payment to NLG's sellers was additional purchase price, which should have been recorded as additional goodwill and amortized over future periods. The $495,000 payment to NLG employees did not satisfy a liability to the sellers and, therefore, should have been recorded as compensation expense in 1997.

iii. Cendant also paid bonuses to certain NLG employees who continued their employment. One of those payments, in the amount of $267,000, was made in February 1997 and improperly charged against the Ideon Reserve. This payment should have been recorded as compensation expense in 1997. Another $267,000 bonus payment was made in January 1998 and improperly charged against the Cendant Reserve. This payment, which had nothing to do with the Merger, should have been recorded as compensation expense when incurred.

r. Cendant improperly wrote off $3.2 million of BCI's capitalized software costs against the Cendant Reserve. Approximately $476,000 of those capitalized costs related to computer software that was then in use by BCI, and approximately $2,715,000 related to computer software that BCI was then developing and planning to implement during 1998 or

1999. Pedersen, BCI's Controller, who was aware of the status of BCI's computer software use and development, did not believe that the write-off was appropriate. The improper write-off was directed by defendant Pember. As a result of CMS's improper accounting, Cendant wrote off an asset, without any charge to its operations, rather than incur a charge to future operations over the useful life of that asset.

s. Cendant improperly wrote off against the Cendant Reserve a $1.75 million settlement of a breach of contract claim that was not related to the Merger. Anthony Menchaca, President of Comp-U-Card, did not know of any reason for the settlement to have been charged against the Cendant Reserve. The settlement should have been recorded as a general and administrative expense in the first quarter of 1998.

t. Cendant improperly wrote off $3.75 million of First Data Corporation ("FDC") goodwill against the Cendant Reserve. The $3.75 million was the unamortized balance when FDC lost its contract with American Express, at which time the goodwill became impaired. The impairment was unrelated to the Merger. The write-off should have been treated as an operating expense in the second quarter of 1997.

u. Cendant improperly wrote off approximately $1.4 million of goodwill, contract rights and other assets of Dining Out Tonight Club ("DOTC") against the Cendant Reserve. The assets of DOTC were acquired by CUC Publishing, a subsidiary of CUC, in 1991. By July 1996, DOTC's product line ceased to exist, but the improper write-off was made in 1997, as directed by defendant Pember. The assets should have been charged to CUC's operating income in the second quarter of 1996.

v. Cendant improperly wrote off against the Cendant Reserve a joint venture with Time Warner Cable. This was an interactive cable television shopping program that was test marketed with Time Warner Cable and had been abandoned by CUC in December 1996. Approximately $2.5 million of capitalized costs related to that program were written off in 1997. Nevertheless, Pember directed that those capitalized costs be restored and then written off against the Cendant Reserve. Because the program was abandoned and the asset was unrealizable, no later that December 31, 1996, there was no basis on which to write the asset off against the Cendant Reserve. The $2.5 million should have been written off in the fourth quarter of 1996.

w. Cendant improperly charged approximately $600,000 of defendant Walter Forbes' private plane expenses against the Cendant Reserve. Walter Forbes submitted the expenses in September 1997, and defendant Shelton approved the charges and directed that the expenses be charged to the Cendant Reserve. Based upon the time period during which the plane expenses were incurred, those expenses could not have related to the Merger and, therefore, should have been charged to income in the fourth quarter of 1997.

x. Cendant improperly charged against the Cendant Reserve $2 million in costs to upgrade Comp-U-Card's software system. According to Speaks, the upgraded system is operational and will provide future benefits and, even if the Merger had not occurred, the older system needed to be upgraded. The costs should have been capitalized and depreciated over the estimated useful life of the upgraded system.

y. Cendant improperly charged the Cendant Reserve approximately $460,000 in severance costs. Essex underwent a corporate restructuring in October 1997. Approximately $350,000 of that amount was paid to Gerald Cunningham, Essex's then-president; the remaining amount was to be paid to various individuals who were not notified of their termination until January 1998. Because the $350,000 payment to Cunningham was made pursuant to the corporate restructuring, not the Merger, the charge should not have been made against the Cendant Reserve. This amount should have been charged to Essex's 1997 income statement as a payroll-related charge. The balance of the severance also was related to the restructuring but, because the terminated employees were not notified until 1998, no accrual was required in 1997.

z. Cendant improperly charged against the Cendant Reserve $300,000 of prepaid fees from Robinson, Lerer & Montgomery, a public relations firm. This improper accounting treatment was authorized by defendant Silverman. The fee should not have been charged against the Cendant Reserve. It should have been treated as a prepaid expense and written off as the public relations firm rendered its services.

aa. Cendant improperly used the Cendant Reserve to "plug" a $338,000 retained earnings shortfall for 1997. The shortfall was wholly unrelated to the Merger and, therefore, the Cendant Reserve should not have been used. The charge should have been charged to the 1997 income statement.

bb. Cendant improperly charged the Cendant Reserve $250,000 in fees from E&Y for services rendered in connection with E&Y's regular audit of CMS for 1997. These services were not related to the Merger and, therefore, should have been charged to income, not to the Cendant Reserve.

b. <u>Cendant's and CUC's Revenue Recognition Violated GAAP</u>

73. According to the Financial Accounting Standards Board, revenue recognition requires that the revenue be both realized and earned. SFAC No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, ¶ 83. To be earned, the business enterprise must have accomplished what it must do to be entitled to the revenues. *Id.* ¶ 83b. To be realized, goods or services must have been exchanged for cash or claims to cash. *Id.* ¶ 83a. Revenue is realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured. Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, ch. 1A, ¶ 1. When such an uncertainty as to realizability is present, revenue is not recorded. Expenses directly related to revenues must be recognized in the same period in which the related revenue is recognized. SFAC No. 6, *Elements of Financial Statements*, ¶ 146.

74. Under Cendant's and CUC's stated accounting policy for revenue recognition, membership revenue was recognized ratably over the membership period, net of a membership cancellation reserve, while membership acquisition costs were deferred and charged to operations as membership fees were recorded. This stated policy does not properly account for revenues, like CUC's, that are fully refundable throughout the term of membership. Moreover, Cendant and CUC did not even comply with that stated policy. As a result of CUC's non-GAAP accounting for membership revenues and membership acquisition costs, income was overstated in the 1995, 1996 and 1997 10-Ks by $26.7 million, $22.7 million and $41.4 million, respectively.

75. Cendant's and CUC's stated policy for accounting for membership revenue and membership acquisition costs failed to properly account for the fact that substantially all club

memberships (except those sold through SafeCard) were and remain fully refundable throughout the term of the membership. The stated policy also failed to properly account for the fact that substantial membership solicitation expenses incurred by CUC and Cendant were not refundable to CUC or Cendant in the event the related membership was canceled. In the 10-K/A, Cendant made the following statement regarding the SEC's view, brought about as a result of the SEC's investigation into CUC's and Cendant's financial wrongdoing, of the Company's membership revenue recognition and membership acquisition cost policy:

> [T]he SEC concluded that when membership fees are fully refundable during the entire membership period, membership revenue should be recognized at the end of the membership period upon the expiration of the refund offer. The SEC Staff further concluded that non-refundable costs should be expensed as incurred since such costs are not recoverable if membership fees are refunded.

76. In any event, Cendant and CUC did not even comply with their own stated policy. Although the policy stated that membership revenue was realized ratably over the membership term, certain of Cendant's and CUC's clubs realized revenue immediately; for example, approximately 21% of total membership revenue in 1997 was derived from such immediate recognition clubs. In addition, Comp-U-Card engaged in various other practices that were inconsistent with CUC's stated policy, that, when taken together, resulted in a mismatching of revenues and expenses and the premature recognition of income throughout the Class Period.

a. Comp-U-Card improperly deferred expenses in programs that recognized revenue immediately. This accounting method violated GAAP, because it resulted in the recognition of expenses over a longer period of time than that used for the recognition of related revenues.

b. CUC improperly reclassified revenue from deferred recognition programs to immediate recognition programs. This process improperly accelerated revenue recognition in violation of the stated policy and GAAP. CUC used its "Projection Model" to summarize its membership revenue and adjust revenue purportedly to be in conformity with GAAP. The Projection Model generated two categories of schedules: one for deferred recognition programs, and another for immediate recognition programs. The Projection Model was programmed to automatically -- and improperly -- reallocate revenues from deferred to immediate recognition programs through a column labeled "Allocation" on Comp-U-Card's immediate recognition Projection Model schedules. For 1997, Comp-U-Card improperly reallocated $58.1 million of revenue, with $47.9 million taking place in the fourth calendar quarter.

c. Cendant's and CUC's Accounting for Membership Cancellations Violated GAAP

77. CUC used its membership cancellation reserve improperly by periodically, and without support, reversing that reserve to fraudulently increase income. Throughout the Class Period, CUC's membership cancellation reserve, which, under GAAP, was required to fairly value membership revenue and membership receivables, was substantially understated. As a result of CUC's improper accounting for membership cancellations, CUC's income for 1995, 1996 and 1997 was overstated by $48 million, $19 million and $12 million, respectively. For example:

a. CUC improperly accounted for membership rejects in transit. Under Comp-U-Card's accounting practice, the credit cards of new members were billed upon the expiration of any trial membership period. If a new member challenged or rejected that charge, Comp-U-Card's bank, through which membership credit card charges and rejections were processed, adjusted the bank's records for Comp-U-Card's cash balance and notified Comp-U-Card of those "rejects-in-transit." At the end of each month, in order for the bank's reported balance to agree with Comp-U-Card's general ledger account, Comp-U-Card's bank reconciliations for that account reflected a reconciling item in the amount of membership rejects-in-transit processed that month by the bank. Basic accounting procedures require that such reconciling items be recorded in Comp-U-Card's general ledger in the accounting period in which the bank processed the rejects. However, beginning prior to the start of the Class Period, CUC developed the practice of improperly not recording those rejects-in-transit for the last three months of CUC's fiscal year, and recording them at the end of the first quarter of the next fiscal year. Accordingly, the rejects-in-transit appeared on accounts receivable and cash reconciliations, resulting in an overstatement of both accounts receivable and cash, from October of a particular fiscal year through March of the following fiscal year. This longstanding non-GAAP policy was common knowledge among Comp-U-Card accounting personnel.

b. CUC improperly understated the membership cancellation reserve. As of January 31, 1995, for example, the outstanding rejects and cancellations were approximately $44 million, which exceeded the reserve of $33 million. The actual amount required in the reserve at that time was $108 million. Throughout the Class Period, CUC used a formula to justify its reserve; that formula, however, was wholly unsupported: To "justify" the formula and the reserve amount, CUC personnel would cherry-pick cancellation rates from Comp-U-Card's cancellation database. The understatement was exacerbated by CUC's non-

GAAP practice, as described immediately above, of failing to record rejects-in-transit for the last three months of the year. By "holding" rejects-in-transit, CUC caused the membership cancellation reserve to appear higher than it actually was. In fact, the membership reserve throughout the Class Period was inadequate. At January 31, 1996 and 1997 and December 31, 1997, there were reconciling items on Comp-U-Card's bank reconciliations for rejects-in-transit of $72 million, $100 million and $137 million, respectively. Those rejects-in-transit by themselves exceeded the reserves reflected on Comp-U-Card's books at January 31, 1996 and 1997 and December 31, 1997 by $35 million, $71 million and $100 million, respectively.

c. CUC made a variety of other unsupported and improper adjusting journal entries to the membership cancellation reserve. Those adjustments were apparent from CUC's general ledger:

i. In 1995 and 1996, CUC, through a series of post-closing journal entries, improperly reduced its membership cancellation reserve and increased income by $18 million and $15 million, respectively.

ii. In 1997, CUC, through a series of journal entries, improperly increased cash and the membership reserve by $111.8 million. The July through September "unbooked" rejects-in-transit were reflected as substantial reconciling items on the monthly bank reconciliations. The bank reconciliation for one account for the month of September, for example, included a $30 million reconciling item for rejects-in-transit.

d. <u>CUC's and Cendant's Other Violations of GAAP</u>

78. In addition to the violations of GAAP described above, Cendant and CUC violated GAAP as follows:

a. **Commissions Payable.** Comp-U-Card improperly understated commissions payable, and recorded improper unsupported post-closing adjusting journal entries at year end to improperly reduce commissions payable and increase various revenue accounts. As a result, Comp-U-Card's commissions payable account was understated at the end of 1995, 1996 and 1997, causing its net income to be overstated, by $14 million, $20 million and $26.3 million, respectively.

i. Comp-U-Card, because it collected membership fees from generic clients on a four-month lag, should always have had on its books a liability for commissions due to clients approximating four months of unpaid commissions on those fees. Instead, it had only one month of commissions payable at the end of 1997, thereby causing Cendant's and CUC's income to be materially overstated.

ii. Comp-U-Card made a series of unsupported and improper post-closing adjusting journal entries to reduce commissions payable and increase revenue. There was no conceptual GAAP basis for such adjustments. Those entries were made at a time when commissions payable already were understated. The reversal of those entries had an income statement impact for 1996 and 1997 of $9.1 million and $2.8 million, respectively. After reversing those improper entries, commissions expense and commissions payable each needed to be increased for 1995, 1996 and 1997 by $8 million, $4.8 million and $10.3 million, respectively.

b. **Sierra Deferred Tax Asset.** When Sierra acquired Berkeley, Berkeley had on its books a deferred tax asset of $2.6 million that was fully reserved. When Sierra recorded Berkeley's opening fair value balance sheet, this amount was properly excluded. CUC directed, through defendant Pember and others, that the balances be reinstated after the Merger. The amount of the reserve was then improperly taken into miscellaneous income without any adjustment made to the now unreserved deferred tax asset. Sierra's personnel did not agree with putting the deferred asset on the books or with reversing the reserve into income.

c. **Write-Off of BCI Profit-Sharing Receivable.** In the last three months of 1995, BCI made a series of 66 unsupported and improper journal entries to write-off $14 million of BCI profit-sharing receivables through an intercompany account. As a result, the receivable was written off, but income was not reduced.

d. **Deferred Marketing Costs.** CUC improperly reduced various miscellaneous expense accounts by $18 million through a series of improper unsupported post-closing journal entries in 1995 that increased CUC's direct marketing costs-in-progress account. Those accounts were wholly unrelated to marketing.

e. **FISI Capitalization of New Business Solicitation Costs.** During 1997, FISI improperly capitalized $2.3 million of new business solicitation expenses to be amortized over seven years, even though it had always been FISI's practice, in accordance with GAAP, to expense such costs as incurred. The amount includes costs of marketing materials and other outside expenses incurred in solicitations, as well as the salaries and other related costs of FISI's employees involved in new business solicitations. The amount of capitalized salaries represented approximately 50% of the 1997 compensation paid to such employees. FISI's president and its controller, Ken Keith and Terry Johnson, respectively, did not agree with this non-GAAP accounting treatment. Keith raised this issue with Shelton, who directed Keith to Silverman, who, Shelton claimed, directed the adjustment.

f. **Topside Adjustments to Hebdo Mag.** At the end of 1997, CUC made an improper unsupported topside adjustment to decrease accounts payable and general and administrative expenses at Hebdo Mag in the amount of $3 million.

2. <u>CUC's Quarterly Financial Statements Violated GAAP</u>

79. CUC's quarterly financial statements for 1995, 1996 and 1997 also were not presented in conformity with GAAP, and thus were materially false and misleading. In total, reported quarterly operating income for 1995, 1996 and 1997 was improperly overstated by $31 million, $87 million and $176 million, respectively. These overstatements were based on the following accounting artifices:

a. At the end of each of those quarters, unsupported topside journal entries were made to the consolidating report to increase revenue and decrease expenses of Comp-U-Card. Those adjustments created a discrepancy each quarter between the results for Comp-U-Card, as reflected in the quarterly consolidating reports, and the actual results, as reported by Comp-U-Card in its reporting packages submitted to CUC corporate.

b. Improper topside adjustments also were made to subsidiaries' revenues and expenses, as presented in the consolidating report, but not in those subsidiaries' general ledgers or reporting packages. Unsupported topside adjustments to Comp-U-Card's balance sheet accounts, as presented in the consolidating report but not in Comp-U-Card's general ledger, were made on a quarterly basis. Cash and accounts receivable were increased by substantial amounts, sometimes by as much as $200 million or more in a quarter.

c. Unsupported topside adjustments were made on a quarterly basis to increase the deferred membership income and accounts receivable accounts of certain CUC subsidiaries, as presented in the consolidating report but not in the general ledgers of those subsidiaries.

B. CUC's 1995 and 1996 10-Ks, Cendant's 1997 10-K, CUC's 1995, 1996 and 1997 10-Qs, and <u>the Press Releases Were Materially False and Misleading</u>

80. As described above, 1995, 1996 and 1997 financial statements issued by CUC and Cendant were not prepared in accordance with GAAP, and, therefore, were materially false and misleading.

81. In addition to the assertions set forth in the financial statements (and selected financial data), those 1995, 1996 and 1997 quarterly and annual reports contained assertions that were materially false and misleading:

a. In "Management's Discussion and Analysis of Financial Condition and Results of Operations" in CUC's 1996 10-K and CUC's 1995, 1996 and 1997 10-Qs, CUC described membership revenues and membership acquisition costs, as follows:

> i. "The Company's overall membership base continues to grow at a rapid rate . . . which is the largest contributing factor to the . . . increase in [membership] revenues . . ."
>
> ii. "As the Company's [membership] services continue to mature, a greater percentage of the total individual membership base is in its

> renewal years. This results in increased profit margins for the Company due to the significant decrease in certain marketing costs incurred on renewing members."
>
> iii. "Marketing costs decreased [remained constant] as a percentage of revenue . . .. This [decrease] is primarily due to improved [maintained] per member acquisition costs and an increase in renewing members. . . . Marketing costs include the amortization of membership acquisition costs . . . ."

As described above, however, CUC's membership revenues and membership acquisition costs were not accounted for in conformity with the above statements and, in fact, were accounted for in a manner that violated GAAP.

b. In Note 1, entitled "Basis of Presentation," to the condensed consolidated financial statements included in the CUC's 1995, 1996 and 1997 10-Qs, CUC expressly represented that:

> The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. . . . In the opinion of management [of CUC International Inc.], all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

As described above, however, those financial statements violated GAAP in many material respects. In fact, as WF&G and AA found respecting the 1995, 1996 and 1997 10-Qs, "efforts were *not* made to assure that all necessary adjustments were made so as to correctly and fairly present CUC's quarterly financial position and results of operations" (emphasis added). Those representations by Cendant and CUC were materially false and misleading.

c. In Note A, entitled "Summary of Significant Accounting Policies" to the consolidated financial statements included in the 1995 and 1996 10-Ks, CUC made the following assertions:

> PRINCIPLES OF CONSOLIDATION
>
> The consolidated financial statements include the accounts of [the Company] . . . All significant intercompany transactions have been eliminated in consolidation.
>
> * * *
>
> DEFERRED MEMBERSHIP INCOME, NET [Membership Acquisition Costs and Deferred Membership Income]
>
> In accordance with the provisions of Statement of Position 93-7, "Reporting on Advertising Costs," membership acquisition costs are deferred and charged to operations as membership fees are recognized. . . . Such costs are amortized on a straight-line basis as revenues are realized over the membership period . . . .
>
> * * *
>
> EXCESS OF COST OVER NET ASSETS ACQUIRED
>
> The excess of cost over net assets acquired is being amortized over 5 to 30 years using the straight-line method. . . . The carrying value of the excess of cost over net assets acquired will be reviewed by management if the facts and circumstances suggest that the value may be impaired. If this review indicates that the carrying amounts will not be recoverable, as determined based on the undiscounted cash flows of the entities acquired over the remaining amortization period, management will reduce the carrying amount by the estimated shortfall of cash flows.

In Note 2, entitled "Summary of Significant Accounting Policies" to the consolidated financial statements included in the 1997 10-K, Cendant made the following assertions:

> PRINCIPLES OF CONSOLIDATION
>
> The accompanying consolidated financial statements include the accounts of [the Company] . . . All material intercompany balances and transactions have been eliminated in consolidation.
>
> * * *
>
> GOODWILL
>
> Goodwill, which represents the excess of cost over fair value of net assets acquired is being amortized on a straight-line basis over the estimated useful lives, ranging from 5 to 40 years. . . .
>
> ASSET IMPAIRMENT
>
> . . . The recoverability of . . . goodwill [is] evaluated on a separate basis for each acquisition . . .
>
> MEMBERSHIP ACQUISITION AND ADVERTISING COSTS
>
> Membership acquisition costs are deferred and charged to operations as membership fees are recognized. . . .
>
> * * *
>
> CORE BUSINESS OPERATIONS AND REVENUE RECOGNITION
>
> . . . Membership fees are . . . recorded as deferred membership income upon acceptance of the membership, net of estimated cancellations. Membership fees are recognized over the average membership period . . .

As described above, however, Cendant's and CUC's membership revenues, membership acquisition costs, and goodwill were not accounted for in conformity with the above statements and, in fact, were accounted for in a manner that violated GAAP. In addition, because many intercompany entries were made to, *inter alia*, improperly write off merger reserves, significant intercompany transactions were not properly accounted for in consolidation. And because Cendant and CUC recorded hundreds of improper unsupported journal entries, the financial statements in the 1995, 1996 and 1997 10-Ks did not "include the accounts and transactions of" CUC or Cendant.

82. As set forth in paragraph 67 above, CUC and Cendant issued the Press Releases in which CUC and Cendant announced each of their quarterly and annual earnings set forth above. As described in paragraphs 69-79 above, those financial results were materially misstated, and, accordingly, were restated. The Press Releases, therefore, also were materially false and misleading. For the same reasons, other statements made in the Press Releases, samples of which are excerpted below, are materially false and misleading:

a. In the May 31, 1995 press release, Walter Forbes stated:

> The first quarter of fiscal year 1996 is off to a strong start. Our membership base now surpasses 36.8 million. During the quarter, we added 3 million net new members. . . The strong membership trends are reflected in our revenue increase of 20%. The continued strength of our renewal rates contributed to our increasing operating margins which were 19% for the quarter, up from 17.8% for the first quarter of last year.

b. In the August 8, 1995 press release, Walter Forbes stated:

> Not only is our membership base experiencing strong growth, but our solid renewal rates continue to generate improved operating margins. For this past quarter, our operating margin was 19.4%, an increase over the 18% operating margin reported for last year's second quarter.

c. In the November 29, 1995 press release, Walter Forbes stated:

> The strength of our services is reflected in our ability to maintain high renewal rates. As a result of our success with retaining members, our net income growth exceeded our revenue growth, and our operating margin expanded to 18.9% from 18.2% for the same nine-month period a year ago.

d. In the September 4, 1996 press release, Walter Forbes stated: "We are pleased to report record operating results during our second quarter, which reflect the continued strength of our consumer-service offerings."

e. In the December 2, 1996 press release, Walter Forbes stated: "We are proud to report record operating results for our most recently completed quarter. Our performance reflects the continued strength of our membership business as well as the integration and consolidation of our software acquisitions."

f. In the March 11, 1997 press release, Walter Forbes stated:

> Fiscal 1997 was characterized by strong, double-digit growth in our core membership-services business, which was a key component in our realizing growth of 21.1% in revenue and 32.1% in earnings per share, before one-time charges.

g. In the December 2, 1997 press release, Walter Forbes stated: "We are pleased to report another quarter of record results for CUC."

Those statements were materially false and misleading, because growth in CUC's and Cendant's membership revenues, and improvements in earnings and margins, resulted not from improving CUC's and Cendant's membership business, but from the financial wrongdoing described herein.

C. The Registration Statement, Joint Proxy Statement/Prospectus, and Other SEC Filings Were Materially False and Misleading

1. The Registration Statement Was Materially False and Misleading

83. On or about August 28, 1997, CUC filed the Registration Statement, which was signed by the CUC Individual Defendants except defendant Pember, and names as directors of Cendant after the Merger those same CUC Individual Defendants and the HFS Individual

Defendants except defendant Scott Forbes. The Registration Statement reported selected annual financial data for CUC for, *inter alia*, 1995 and 1996, as well as selected financial data for the first quarters of 1996 and 1997. As described above, the assertions in that financial information were materially false and misleading when made.

84. The Registration Statement included, as Exhibit 23.1 thereto, the consent of E&Y to its inclusion under the caption "Experts" in the Registration Statement and the Joint Proxy Statement/ Prospectus, and to the incorporation by reference of E&Y's report dated March 10, 1997 with respect to the 1996 10-K (which included CUC's financial statements for 1995 and 1996). As described below, E&Y's unqualified audit report was materially false and misleading.

85. In addition, as provided in the "Where You Can Find More Information" section of the Joint Proxy Statement/Prospectus, that document "is part of the Registration Statement." As a result, the Registration Statement, through the Joint Proxy Statement/Prospectus, was materially false and misleading for the reasons set forth in paragraphs 86-102 below.

2. The Joint Proxy Statement/Prospectus Was Materially False and Misleading

a. Financial Statements

86. The Joint Proxy Statement/Prospectus incorporated by reference CUC's 1996 10-K, which included audited balance sheets for CUC as of January 31, 1996 and 1997, and the related statements of income for each of the three years in the period ended January 31, 1997. The Joint Proxy Statement/Prospectus also incorporated by reference CUC's first and second quarter 1997 10-Qs, and E&Y's unqualified audit report in connection with the 1996 10-K. Those documents,

as described in paragraphs 69-79 above and paragraphs 168-70 below, were materially false and misleading. Accordingly, the Joint Proxy Statement/Prospectus was materially false and misleading.

b. <u>CUC's Representations and Warranties</u>

87. The Merger Agreement was attached as Appendix A to the Joint Proxy Statement/Prospectus. In the Merger Agreement, the CUC represented and warranted that HFS would have complete access to CUC's books and records, that CUC's financial statements were prepared in accordance with GAAP, that CUC's SEC filings were free of material misstatement and omission, that CUC had conducted its business in the ordinary course, and that, since the date of the Merger Agreement to the effective date of the Merger, there had been no material changes in any of the foregoing. As described herein, those representations and warranties were materially false and misleading.

c. <u>HFS's "Due Diligence"</u>

88. The Joint Proxy Statement/Prospectus was further materially false and misleading based on the representations made therein concerning the "due diligence" supposedly conducted by HFS in connection with the Merger.

89. CUC had a history of accounting and reporting problems. In 1989, CUC's revenue and expense recognition policies came under attack. In a March 27, 1989 press release carried over *Business Wire*, CUC announced that it would change its policy to amortizing membership acquisition costs over the initial service period, usually twelve months, rather than over three years as it had previously done. As a result of this change, CUC made a cumulative adjustment -- a one-time charge in a current period to correct prior accounting -- through October 31, 1988 of $51.4 million, and a fourth quarter charge of another $7.5 million. The change to a more proper

accounting policy was significant to CUC: That correction caused CUC to post a loss for the year ended January 31, 1989 of $11.3 million, or $0.58 per share, compared with net income for the previous fiscal year of $17.4 million, or $0.90 per share.

90. The SEC had also questioned CUC's accounting and reporting. In 1991, according to an August 13, 1998 article in *The Wall Street Journal*, "the SEC questioned the completeness of CUC's financial documents and required numerous amendments to them." In fact, according to an article entitled "Hear No Fraud, See No Fraud, Speak No Fraud," appearing in the October 1, 1998 issue of *CFO* magazine, the SEC compelled CUC to amend its previously filed financial statements six times between October and December 1991. Yet, that was not disclosed in the Joint Proxy Statement/Prospectus.

91. During this period, CUC's executive officers included defendants Walter Forbes, Shelton and McLeod, and its Audit Committee was comprised of defendants Perfit, Donnelley and Greyser; CUC's auditor was defendant E&Y. All of the information about CUC's past accounting and reporting problems was available to the HFS Individual Defendants during HFS's "due diligence" in connection with the Merger, and should have heightened HFS's need for access to CUC's books and records.

92. In the "Background of the Merger" section of the Joint Proxy Statement/Prospectus, HFS described the "due diligence" it supposedly performed in connection with the Merger. HFS used that term -- due diligence -- several times in that section, and repeatedly referred to its "financial advisors." However, it did not state that, contrary to customary business combination practice, as well as its practice in its other significant business combinations, HFS did not retain the services of D&T or of any other public accounting firm to perform required substantive financial due

diligence. Moreover, HFS's access to CUC's books and records was substantially limited by CUC. As a result, contrary to the representations made in the Joint Proxy Statement/Prospectus, HFS was satisfied with relying solely on the audit reports of E&Y and the unsubstantiated representations of CUC management.

93. Prior to the Merger, HFS had participated in numerous significant business combinations. In fact, HFS had closed or considered billions of dollars of business combinations since January 1996. In each of those significant business combinations, HFS did not rely solely upon the financial statements prepared by the entities it was combining with, even though those financial statements were audited by the independent public accountants retained by those entities. Instead, as is required in most significant business combinations, HFS retained its own independent public accounting firm to undertake substantive financial due diligence on HFS's behalf. In fact, HFS regularly used due diligence teams, which included HFS's outside auditors, with whom defendant Silverman himself communicated daily. For example, in HFS's acquisition of Avis Rent-A-Car and its later failed attempt to acquire Alamo Rent-A-Car, HFS used its own employees and teams of auditors from D&T, HFS's auditors, to conduct thorough reviews of accounting records and systems, including extensive testing of general ledger entries and volumes of related documentation. Such substantive due diligence provided HFS with information concerning such matters as the reliability of accounting and reporting systems and the financial reports generated therefrom, the propriety of accounting policies and practices, the quality of earnings, and other information that cannot be obtained solely through reading and analyzing audited financial statements.

94. HFS prided itself on the thoroughness of its due diligence procedures. As reported in articles appearing in *CFO* magazine on September 1, 1997 ("Diligence Undone") -- while HFS

was performing its "due diligence" in connection with the Merger -- and on October 1, 1998 ("Hear No Fraud, See No Fraud, Speak No Fraud"), HFS did not rely on audited financial statements alone, because even prominent auditors cannot be relied upon to have performed procedures sufficient to satisfy due diligence requirements. Defendant Monaco stated in the September 1, 1997 *CFO* article that HFS routinely performed painstaking due diligence when scouting acquisition targets and that detailed analyses of a company's books was HFS's standard practice. For example, according to Monaco, HFS customarily sampled a target company's journal entries to determine the significance of the adjustments made to the target's books and records. Monaco recited the general principle, adhered to by HFS, that "the less human intervention you see in the accounting, the better." As described below, had HFS performed its customary procedures in connection with the Merger, it could not have failed to detect the hundreds of unsupported journal entries made quarterly and annually by CUC to create hundreds of millions of dollars of fictitious income.

95. In an April 17, 1998 article in *The Wall Street Journal*, Silverman discussed the due diligence HFS had performed in connection with the Merger. Silverman stated that HFS "did all the due diligence that one does when one buys a public company." Notwithstanding HFS's past practices and Silverman's April 17, 1998 statement, however, Silverman later conceded that HFS did not follow its customary practice in connection with the Merger. In an August 13, 1998 article in *The Wall Street Journal*, Silverman admitted that HFS's due diligence in connection with the Merger was "based almost entirely on public information audited by Ernst & Young, CUC's auditor." HFS failed to inform its stockholders prior to their vote to approve the Merger that, even in the face of "red flags" concerning CUC's past accounting and reporting problems and SEC criticism, HFS had failed to perform required substantive financial due diligence.

96. In its acquisitions, HFS was confronted with issues of confidentiality in connection with the performance of thorough substantive financial due diligence. In such cases, confidentiality agreements are customarily executed to protect all parties to the proposed business combination, and allow either the acquirer or the target access to confidential business information and accounting records necessary for management and directors to reach a conclusion concerning whether the acquisition is beneficial to shareholders. That was exactly what occurred in connection with both the Avis and Alamo due diligence procedures. In fact, when HFS was performing its due diligence in connection with its Alamo transaction, HFS already owned Avis and, therefore, already was Alamo's competitor. Nevertheless, Alamo did not constrain HFS's access to Alamo's non-public financial and other records, nor was HFS satisfied with anything less than complete due diligence.

97. In the Report, Cendant's Board confirms that HFS failed to perform required substantive financial due diligence in connection with the Merger. Prior to the signing of the Merger Agreement, HFS was provided only very limited access to non-public information concerning CUC's business. CUC claimed that such limitations were necessary to preserve confidentiality in the event that the Merger was not completed. However, this limitation was contrary to accepted due diligence practices, and contrary to HFS's own practice and experience with scores of business combinations. Even though HFS and CUC had executed the Confidentiality Agreement and the Merger Agreement, HFS inexplicably accepted CUC's claims that CUC's confidentiality concerns outweighed HFS's need to perform its required substantive financial due diligence.

98. The November 9, 1998 *Fortune* article entitled "A Merger Made In Hell," which was based in part on interviews with defendants Silverman and Walter Forbes, among others, also confirms HFS's failure to perform required substantive financial due diligence as a result of HFS's

unprecedented acceptance of CUC's "confidentiality" excuse. According to that article, due diligence became nearly impossible as mistrust grew between CUC and HFS. As a result, CUC denied HFS access to CUC records. As a result, HFS could not perform the substantive financial due diligence that was required in all business combinations of this magnitude, and that HFS had regularly performed in its many prior business combinations. HFS chose instead to rely on E&Y's reports -- even though over eight months had passed since E&Y's last audit report was issued -- without testing CUC's financial health itself. By denying access to HFS -- resulting in HFS's acceptance of CUC's unverifiable representations -- CUC rendered required substantive due diligence impossible.

99. The *Fortune* article went on to say that "[d]espite Silverman's disillusionment, he never once suggested calling off the merger." Silverman, who has walked away from other business combinations, such as HFS's proposed $175 million acquisition of Value Rent-A-Car, as a result of HFS's due diligence findings, never mentioned to his HFS stockholders his "disillusionment" over the $14.1 billion Merger. As reported on July 15, 1998 by *Dow Jones Online News*, Silverman stated that the Merger "should be characterized as a terrible transaction."

100. In the "Background of the Merger" section of the Joint Proxy Statement/Prospectus, defendants misleadingly stated that confidentiality issues in connection with HFS's due diligence process were "business as usual": "On May 9, 1997, CUC and HFS entered into a confidentiality agreement . . . pursuant to which they agreed to exchange non-public information, subject to certain customary terms and conditions." This was highly misleading, because HFS did not and could not perform required substantive financial due diligence as a result of CUC's refusal to permit HFS or any of HFS's "financial advisors" access to the types of non-public financial information necessarily

provided in connection with business combinations, especially business combinations as significant as the Merger. CUC's denial rendered inadequate *any* substantive financial "due diligence" performed by HFS.

101. The Joint Proxy Statement/Prospectus, in the "Access to Information; Confidentiality" section of the Merger Agreement, also misleadingly informed HFS shareholders that HFS had unencumbered access to non-public CUC information essential to the performance of customary substantive financial due diligence:

> [E]ach of HFS and CUC shall, and shall cause each of its respective subsidiaries to, afford to the other party and to the officers, employees, accountants, counsel, financial advisors and other representatives of such other party, reasonable access during normal business hours during the period prior to the Effective Time *to all their respective properties, books, contracts, commitments, personnel and records* and, during such period, each of HFS and CUC shall, and shall cause each of its respective subsidiaries to, furnish promptly to the other party (a) a copy of each report, schedule, registration statement and other document filed by it during such period pursuant to the requirements of federal or state securities laws and (b) all other information concerning its business, properties and personnel as such other party may reasonably request. (Emphasis added.)

102. In the Joint Proxy Statement/Prospectus, HFS's Board of Directors advised and urged HFS's stockholders to approve the Merger. However, because HFS did not perform required substantive financial due diligence, the HFS Board had no means to verify the truthfulness of the CUC representations and warranties that formed the basis for the Merger, namely, that CUC's financial statements were prepared in accordance with GAAP, that CUC's SEC filings were free of material misstatement and omission, that CUC had conducted its business in the ordinary course, and that, since the date of the Merger Agreement to the effective date of the Merger, there had been no material changes in any of the foregoing. As a result, the HFS Individual Defendants had no reasonable basis on which to rely for the following statements:

a. The following statement appeared in uppercase text "By Order of the Board of Directors" at the very beginning of the Joint Proxy Statement/Prospectus:

> YOUR BOARD OF DIRECTORS HAS APPROVED THE MERGER AGREEMENT AND THE NEW STOCK PLAN, HAS DETERMINED THAT THE MERGER IS FAIR AND IN THE BEST INTERESTS OF HFS AND ITS STOCKHOLDERS, AND RECOMMENDS THAT STOCKHOLDERS VOTE FOR APPROVAL AND ADOPTION OF THE MERGER AGREEMENT AND THE NEW STOCK PLAN AT THE HFS SPECIAL MEETING.

b. Under the caption "Questions and Answers About the Merger," the HFS and CUC Boards told their respective stockholders that they believed that the Merger would create a company that had benefits to CUC and HFS stockholders that were not available to the two companies independent of the Merger:

> The Boards of CUC and HFS believe that the merger will create a preeminent worldwide consumer and business services company that will result in significant benefits to the two companies' stockholders, customers and employees. By combining HFS's brands and consumer reach of more than 100 million customers annually who use its travel and real estate services with CUC's direct marketing expertise, club membership system and approximately 69 million members worldwide, the combined company will be one of the foremost consumer and business services companies in the world with new growth opportunities not available to either company on its own.

c. Under "HFS's rationale for the Merger; Recommendation of the HFS Board of Directors," the Joint Proxy Statement/Prospectus listed the potential benefits in connection with the Merger. Among the potential benefits were the following:

> (i) the combination of the businesses, operations, financial strengths, earnings and prospects of each of HFS and CUC will likely create a combined company with greater financial stability, purchasing power, marketing infrastructure and other advantages associated with greater scale;
>
> * * *

> (iii) the breadth of the merged company's operations, strong balance sheet, liquidity and significant ongoing cash flow should allow for continued growth through strategic acquisitions . . .

d. Under the same rubric, HFS listed the potential negative factors it considered. However, nowhere among those potential negative factors, nor anywhere in the Joint Proxy Statement/Prospectus, did the HFS Individual Defendants inform HFS stockholders of the severe -- and unprecedented – limitations on HFS's access to CUC's books and records.

e. In concluding that the Exchange Ratio was "fair, from a financial point of view, to the holders of HFS common stock, HFS and HFS's "financial advisor", Bear Stearns & Co. ("Bear Stearns") relied on the fact that "HFS [was] not aware of any material adverse changes in the business, operations or financial condition of either it or CUC which would in its judgment cause Bear Stearns to alter its fairness determination." HFS purported to have performed all procedures necessary to determine whether or not CUC's reported financial condition was accurately represented, when, in fact, HFS did not do so.

f. In recommending that HFS's stockholders approve the Merger, the HFS Board stated that it relied for its conclusions on, *inter alia*, "information concerning the financial performance and condition, business operations, earnings and prospects of each company." However, the HFS Board only had CUC's audited financial statements; it did not have the information that would have been provided through the performance of required substantive financial due diligence.

3. The Other SEC Filings Were Materially False and Misleading

103. The Other SEC Filings, described in paragraph 66 above, included and incorporated by reference financial statements (or financial information derived therefrom) included in CUC's 1995, 1996 and 1997 10-Ks, and its 1995, 1996 and 1997 10-Qs, and incorporated by reference E&Y's unqualified audit reports, each as expressly set forth in those Other SEC Filings. Those financial statements (or financial information derived therefrom), as described in paragraphs 68-79 above, and E&Y's unqualified audit reports thereon, as described in paragraphs 168-70 below, were materially false and misleading. Accordingly, the Other SEC Filings, also, were materially false and misleading.

COUNT I

Against Cendant for Violations of Section 11 of the Securities Act

104. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth herein. This Count is asserted against Cendant, as successor to CUC, for violations of Section 11 of the Securities Act, 15 U.S.C. § 77k, on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Registration Statement.

105. The Registration Statement was materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in the Registration Statement, under the circumstances in which they were made, not misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained

in, or the material facts omitted from, the Registration Statement included, but were not limited to, the overstatement of annual revenue for 1996 and net earnings for 1995, 1996, and the first and second quarters of 1997, as well as misrepresentations concerning HFS's due diligence and CUC's compliance with its representations and warranties in the Merger Agreement.

106. Cendant is the registrant for the shares issued pursuant to the Merger, and filed the Registration Statement as the issuer of its common stock, as defined in Section 11(a)(5) of the Securities Act.

107. Cendant, as successor to CUC, is the issuer of its common stock issued pursuant to the Registration Statement. As issuer of such common stock, Cendant is liable to plaintiffs and the members of the Class who exchanged HFS common stock for CUC common stock pursuant to the Registration Statement.

108. Plaintiffs and members of the Class who exchanged their HFS common stock for CUC common stock each acquired CUC's common stock pursuant to the Registration Statement.

109. At the time they acquired CUC's common stock pursuant to the Registration Statement, neither plaintiffs nor any member of the Class knew, or by the exercise of reasonable care could have known, of the facts concerning the inaccurate and misleading statements and omissions alleged herein.

110. In connection with the Merger, Cendant, directly or indirectly, used the means and instrumentalities of interstate commerce and the U.S. mails.

111. This action was brought within one year after the discovery of the untrue statements and omissions and within three years after the common stock was acquired in connection with the Merger.

112. By reason of the foregoing, Cendant has violated Section 11 of the Securities Act and is liable to plaintiffs and the members of the Class who exchanged their HFS common stock for CUC common stock, each of whom has been damaged by reason of such violations.

COUNT II

Against the CUC Individual Defendants Except Pember for Violations of Section 11 of the Securities Act

113. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth herein. This Count is asserted against the CUC Individual Defendants except Pember for violations of Section 11 of the Securities Act, 15 U.S.C. § 77k, on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Registration Statement.

114. The Registration Statement was materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in the Registration Statement, under the circumstances in which they were made, not misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained in, or the material facts omitted from, the Registration Statement included, but were not limited to, the overstatement of annual revenue for 1996 and net earnings for 1995, 1996, and the first and second quarters of 1997, as well as misrepresentations concerning HFS's due diligence and CUC's compliance with its representations and warranties in the Merger Agreement.

115. The CUC Individual Defendants named in this Count were responsible for the contents of the Registration Statement and caused its filing with the SEC.

116. The CUC Individual Defendants named in this Count signed the Registration Statement or otherwise caused it to be prepared, filed with SEC and circulated to the public, including plaintiffs and the other members of the Class.

117. None of the CUC Individual Defendants named in this Count made a reasonable investigation or possessed reasonable grounds for the belief that the statements described above, which were contained in the Registration Statement, were true, were without omissions of any material facts, and were not misleading.

118. Plaintiffs and members of the Class who exchanged their HFS common stock for CUC common stock each acquired CUC's common stock pursuant to the Registration Statement.

119. At the time they acquired CUC's common stock pursuant to the Registration Statement, neither plaintiffs nor any member of the Class who exchanged their HFS common stock for CUC common stock knew, or by the exercise of reasonable care could have known, of the facts concerning the inaccurate and misleading statements and omissions alleged herein.

120. In connection with the Merger, the CUC Individual Defendants named in this Count, directly or indirectly, used the means and instrumentalities of interstate commerce and the U.S. mails.

121. This action was brought within one year after the discovery of the untrue statements and omissions and within three years after the common stock was acquired in connection with the Merger.

122. By reason of the foregoing, the CUC Individual Defendants named in this Count have violated Section 11 of the Securities Act and are liable to plaintiffs and the members of the Class, each of whom has been damaged by reason of such violations.

COUNT III

Against the HFS Individual Defendants <u>for Violations of Section 11 of the Securities Act</u>

123. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth herein. This Count is asserted against the HFS Individual Defendants except Scott Forbes for violations of Section 11 of the Securities Act, 15 U.S.C. § 77k, on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Registration Statement.

124. The Registration Statement was materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in the Registration Statement, under the circumstances in which they were made, not misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained in, or the material facts omitted from, the Registration Statement included, but were not limited to, the overstatement of annual revenue for 1996 and net earnings for 1995, 1996, and the first and second quarters of 1997, as well as misrepresentations concerning HFS's due diligence and CUC's compliance with its representations and warranties in the Merger Agreement.

125. The HFS Individual Defendants named in this Count were named with their consent in the Registration Statement as about to become directors of Cendant upon the consummation of the Merger.

126. None of the HFS Individual Defendants named in this Count made a reasonable investigation or possessed reasonable grounds for the belief that the statements described above,

which were contained in the Registration Statement, were true, were without omissions of any material facts, and were not misleading.

127. Plaintiffs and members of the Class each acquired CUC's common stock pursuant to the Registration Statement.

128. At the time they acquired CUC's common stock pursuant to the Registration Statement, neither plaintiffs nor any member of the Class knew, or by the exercise of reasonable care could have known, of the facts concerning the inaccurate and misleading statements and omissions alleged herein.

129. In connection with the Merger, the HFS Individual Defendants named in this Count, directly or indirectly, used the means and instrumentalities of interstate commerce and the U.S. mails.

130. This action was brought within one year after the discovery of the untrue statements and omissions and within three years after the common stock was acquired in connection with the Merger.

131. By reason of the foregoing, the HFS Individual Defendants named in this Count have violated Section 11 of the Securities Act and are liable to plaintiffs and the members of the Class, each of whom has been damaged by reason of such violations.

COUNT IV

Against E&Y for
Violations of Section 11 of the Securities Act

132. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth herein. This Count is asserted against E&Y for violations of Section 11 of the Securities Act, 15 U.S.C. § 77k, on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Registration Statement.

133. Pursuant to Section 11(a)(4) of the Securities Act, E&Y consented, in its "Consent of Independent Auditors," dated August 27, 1997, included as Exhibit 23.1 to the Registration Statement, to the incorporation by reference in the Registration Statement of E&Y's unqualified audit report on CUC's 1995 and 1996 financial statements, as set forth in the 1996 10-K, and to reference to E&Y under the caption "Experts" in the Registration Statement. Accordingly, as set forth under the caption "Experts" in the Registration Statement, those financial statements were included "in reliance upon" E&Y's unqualified audit report, "given upon the authority of [E&Y] as experts in accounting and auditing."

134. The Registration Statement was materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in the Registration Statement, under the circumstances in which they were made, not materially misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained in, or the material facts omitted from, the Registration Statement included, but were not limited to, the financial statements certified by E&Y for 1995 and 1996, and E&Y's unqualified report thereon, dated May 10, 1997. In particular, the misrepresentations included the overstatement

of annual revenue for 1996 and net earnings for 1995 and 1996, as well as the certification in E&Y's unqualified audit report issued in connection with E&Y's audits of CUC's financial statements for 1995 and 1996, in which E&Y certified that (i) it had audited CUC's financial statements in accordance with GAAS; (ii) it had planned and performed those audits "to obtain reasonable assurance about whether the financial statements are free of material statement"; (iii) in its opinion, CUC's financial statements "present fairly, in all material respects, the financial position" of CUC "in conformity with generally accepted accounting principles"; and (iv) E&Y's audits provided a "reasonable basis" for its opinions.

135. As detailed herein, E&Y did not made a reasonable investigation or possess reasonable grounds for the belief that the statements described above, which were contained in the Registration Statement, were true, were without omissions of any material facts, and were not materially misleading.

136. Plaintiffs and members of the Class who exchanged their HFS common stock for CUC common stock each acquired CUC's common stock pursuant to the Registration Statement.

137. At the time they acquired CUC's common stock pursuant to the Registration Statement, neither plaintiffs nor any member of the Class who exchanged their HFS common stock for CUC common stock knew, or by the exercise of reasonable care could have known, of the facts concerning the inaccurate and misleading statements and omissions alleged herein.

138. In connection with the Merger, E&Y, directly or indirectly, used the means and instrumentalities of interstate commerce and the U.S. mails.

139. This action was brought within one year after the discovery of the untrue statements and omissions and within three years after the common stock was acquired in connection with the Merger.

140. By reason of the foregoing, E&Y has violated Section 11 of the Securities Act and is liable to plaintiffs and the members of the Class, each of whom has been damaged by reason of such violations.

COUNT V

Against Cendant for Violations of Section 12(a)(2) of the Securities Act

141. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth herein. This Count is asserted against Cendant, as successor to CUC, for violations of Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77l(a)(2), on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Joint Proxy Statement/Prospectus.

142. By means of the Joint Proxy Statement/Prospectus, CUC exchanged 2.4031 shares of its common stock for each share of HFS common stock held by plaintiffs and certain members of the Class. CUC, acting through employees and others including, but not limited to, the CUC Individual Defendants and the HFS Individual Defendants, solicited such exchanges primarily through the preparation and dissemination of the Joint Proxy Statement/Prospectus.

143. The Joint Proxy Statement/Prospectus contained untrue statements of material facts, and concealed and failed to disclose material facts, as detailed above. CUC, its employees and agents, owed plaintiffs and the other members of the Class the duty to make a reasonable and

diligent investigation of the statements contained in the Joint Proxy Statement/Prospectus to ensure that such statements were true and that there was no omission to state a material fact required to be stated in order to make the statements contained therein not misleading. CUC, in the exercise of reasonable care by its employees and agents, should have known of the misstatements and omissions contained in the Joint Proxy Statement/Prospectus as set forth above.

144. Plaintiffs did not know, nor in the exercise of reasonable diligence could they have known, of the untruths in, or the omissions from, the Joint Proxy Statement/Prospectus at the time they exchanged their HFS common stock for CUC common stock pursuant to the Joint Proxy Statement/Prospectus.

145. By reason of the conduct alleged herein, Cendant, as successor to CUC, violated Section 12(a)(2) of the Securities Act. As a direct and proximate result of such violations, plaintiffs and the members of the Class sustained substantial damages in connection with their exchange of HFS common stock for shares of CUC common stock. Accordingly, plaintiffs and the other members of the Class who acquired CUC common stock pursuant to the Joint Proxy Statement/Prospectus and who still hold such stock have the right to rescind and recover the consideration exchanged for their shares, and hereby tender their shares to the Company. Class members who have sold the CUC common stock they acquired pursuant to the Joint Proxy Statement/Prospectus seek damages to the extent permitted by law.

COUNT VI

Against CUC Individual Defendants Walter Forbes, Shelton,
<u>McLeod and Corigliano for Violations of Section 15 of the Securities Act</u>

146. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against CUC Individual Defendants Walter Forbes, Shelton, McLeod and Corigliano for violations of Section 15 of the Securities Act, 15 U.S.C. § 77o, on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Registration Statement and the Joint Proxy Statement/Prospectus.

147. During the Class Period, each of the CUC Individual Defendants named in this Count was a controlling person of CUC within the meaning of Section 15 of the Securities Act. At the time the Registration Statement and the Joint Proxy Statement/Prospectus were filed with the SEC and declared effective, each of the CUC Individual Defendants named in this Count had the power and authority to cause CUC to engage in the wrongful conduct complained of herein by reason of the following:

a. Walter Forbes had the power and authority to cause CUC to engage in the wrongful conduct complained of herein by virtue of his positions as CUC's Chairman of the Board and Chief Executive Officer;

b. Shelton had the power and authority to cause CUC to engage in the wrongful conduct complained of herein by virtue of his positions as CUC's President and Chief Operating Officer;

c. McLeod had the power and authority to cause CUC to engage in the wrongful conduct complained of herein by virtue of his position as CUC's Executive Vice President; and

d. Corigliano had the power and authority to cause CUC to engage in the wrongful conduct complained of herein by virtue of his position as a CUC Senior Vice President and its Chief Financial Officer.

148. None of the CUC Individual Defendants named in this Count made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Registration Statement or the Joint Proxy Statement/Prospectus were true and devoid of any omissions of material fact. Therefore, by reason of their positions of control over CUC, as alleged herein, each of the CUC Individual Defendants named in this Count is liable jointly and severally with and to the same extent that Cendant, as successor to CUC, is liable under sections 11 and 12(a)(2) of the Securities Act to plaintiffs and the members of the Class as a result of the wrongful conduct alleged herein.

COUNT VII

Against Cendant and CUC Individual Defendants
Walter Forbes, Shelton, McLeod, Corigliano and Pember
for Violations of Section 10(b) of the Exchange Act and
Rule 10b-5 Promulgated Thereunder

149. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against Cendant, as successor to CUC, and CUC Individual Defendants Walter Forbes, Shelton, McLeod, Corigliano and Pember for violations of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, on behalf of purchasers of all Cendant and CUC publicly traded securities during the Class Period who were damaged thereby.

150. Throughout the Class Period, Cendant and the CUC Individual Defendants named in this Count, individually and in concert, directly and indirectly, by the use and means of

instrumentalities of interstate commerce and of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about CUC and Cendant, including its true financial results, as specified herein. Such defendants employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue and misleading statements of material facts and omitting to state material facts necessary in order to make the statements made about CUC and Cendant not misleading. Specifically, those defendants knew or should have known that CUC's and Cendant's 1995, 1996 and 1997 financial results reported throughout the Class Period, as filed with the SEC and disseminated to the investing public, as well as the Press Releases, were materially overstated and were not presented in accordance with GAAP.

151. Cendant and the CUC Individual Defendants named in this Count, as directors and among the top executive officers of CUC and Cendant, are liable as direct participants in the wrongs complained of herein. Through their positions of control and authority as officers and directors of CUC and Cendant, the CUC Individual Defendants named in this Count were able to and did control the content of the public statements disseminated by CUC and Cendant. With knowledge of the falsity and misleading nature of the statements contained therein and in reckless disregard of the true financial results of CUC and Cendant, the CUC Individual Defendants named in this Count caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein.

152. The CUC Individual Defendants named in this Count acted with scienter throughout the Class Period, in that they either had actual knowledge of the misrepresentations and omissions

of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them. The CUC Individual Defendants named in this Count constituted the senior management of CUC and were among the senior management of Cendant, and, therefore, were directly responsible for the false and misleading statements and omissions disseminated to the public through press releases, news reports, and filings with the SEC.

153. The misrepresentations and omissions of Cendant, CUC, and the CUC Individual Defendants named in this Count were intentional or reckless and done for the purpose of enriching themselves at the expense of plaintiffs and the Class and to conceal CUC's and Cendant's true operating condition from the investing public. Those defendants engaged in this scheme to inflate CUC's and Cendant's reported net income in order to create the illusion that CUC (and Cendant) was a successful, strong and profitable company, which would enable CUC (and Cendant) to continue its acquisition strategy, among other things. The following facts indicate actual evidence, as well as a strong inference, that the CUC Individual Defendants named in this Count acted with scienter:

a. Walter Forbes, Shelton, McLeod and Corigliano sold CUC and Cendant common stock during the Class Period, obtaining proceeds of over $38.5 million, $23 million, $15.9 million and $822,000, respectively.

b. Cendant has admitted that the financial wrongdoings alleged herein were undertaken with an intent to deceive:

i. In the Company's July 14, 1998 press release, carried over *Business Wire*, defendant Monaco referred to the financial wrongdoing as "accounting errors made with an intent to deceive."

ii. In Cendant's August 27, 1998 press release carried over *PR Newswire*, defendant Silverman referred to the results of the Company's investigation: "The investigation identified how a group of people at CUC deliberately deceived and mislead investors and business partners -- and reveals a corporate culture that encouraged this behavior."

iii. In the "Additional Conclusions of the Audit Committee of Cendant Corporation With Respect to Investigation into Accounting Irregularities," dated August 24, 1998, attached as Exhibit 99.1 to the August 28, 1998 8-K, Cendant's Audit Committee found defendants Walter Forbes and Shelton culpable for the financial wrongdoing. The Audit Committee stated:

> First, Walter Forbes and Kirk Shelton, because of their positions, had responsibility to create an environment in which it was clear to all employees at all levels that inaccurate financial reporting would not be tolerated. The fact that there is evidence that many of the senior accounting and financial personnel participated in irregular activities and that personnel at many of the business units acquiesced in practices which they believed were questionable suggests that an appropriate environment to ensure accurate financial reporting did not exist. Second, senior management failed to have in place appropriate controls and procedures that might have enabled them to detect the irregularities in the absence of actual knowledge of those irregularities. Third, Walter Forbes and Kirk Shelton, [CUC]'s most senior managers, had a responsibility to fully understand the sources and the true level of CUC's profitability. To the extent that they were unaware of the irregularities, the amount by which CUC's earnings were inflated as reported in the Restatement suggests that they did not adequately inform themselves as to the sources and level of profit-

> ability of [CUC]. For these reasons at least, Walter Forbes and Kirk Shelton are among those who must bear responsibility for what occurred.

iv. Silverman confirmed the extent of the intentional nature of CUC's fraudulent financial statements, included in the Registration Statement and Joint Proxy Statement/Prospectus, when he was interviewed on the CNBC's "Power Lunch" on October 20, 1998:

> I think it would be hard to believe people will not go to jail. As our Audit Committee report pointed out, over 20 divisions were involved. More than 20 individuals at those divisions were involved in booking -- knowingly booking illegal entries and creating revenue out of air; in manufacturing bogus revenues -- bogus earnings to meet street expectations. So, yes, I think that, clearly, criminal activity was conducted.

c. Throughout the Report, WF&G and AA stated that defendants Corigliano and Pember substantially directed Cendant's and CUC's massive financial fraud. The details of such directions are described in paragraphs 69-78 above.

d. Throughout the Report, WF&G and AA stated that defendant Shelton, to whom defendant Corigliano directly reported, had knowledge of the financial fraud. The details of such knowledge are described in paragraphs 69-78 above.

e. Even though on February 3, 1998 E&Y informed the Cendant Audit Committee that CMS's income for January 1997 was overstated by approximately $23 million, Cendant announced its record 1997 results on February 4, 1998, which included that overstatement.

f. At a March 6, 1998 meeting attended by, *inter alia*, Shelton, Corigliano, Pember and Scott Forbes, Shelton asked Scott Forbes to assist Shelton, Corigliano and

Pember to be "creative" in reversing $165 million of the Cendant Reserve into income in 1998. Shelton suggested at that time that it would be advantageous to distribute portions of that amount to various business units so that the entire amount would not be sitting on one division's books.

g. Defendants Shelton, McLeod and Corigliano received Comp-U-Card's annual budgets, and Shelton and defendant Walter Forbes received binders including the budgets of CUC's subsidiaries.

h. Defendants Walter Forbes and Corigliano were among the CUC officers principally responsible for investor relations. As Cendant's July 14, 1998 press release stated, the accounting fraud was undertaken to assure that CUC would meet or exceed Wall Street's expectations of earnings for CUC.

i. Defendant Shelton negotiated the CNA contract and, along with defendant Corigliano, knew that the relationship was continuing but that the $30 million payment was charged to the Cendant Reserve.

j. Defendants Walter Forbes, Shelton, McLeod, Corigliano and Pember received subsidiary and Comp-U-Card reporting packages, yet failed to correct the improper accounting at those subsidiaries.

k. Defendants Walter Forbes, Shelton, McLeod, Corigliano and Pember had direct knowledge that CUC was reversing merger reserves. In fact, Pember sent Shelton and Corigliano an e-mail on January 14, 1998, in which she referred to, *inter alia*, "reserve adjustments," which clearly referred to the adjustments to be made in January 1998 to increase 1997 income. Shelton responded to Pember. Walter Forbes and McLeod acknowledged they knew that CUC was taking merger reserves into income.

l. Defendant McLeod received all Projection Model schedules, including those with immediate recognition and allocations from deferred recognition to immediate recognition. McLeod and defendant Shelton were aware of Comp-U-Card's practice of recognizing certain revenue immediately, even though it violated CUC's stated policy, yet failed to correct the improper accounting.

m. Defendants Shelton, Corigliano and Pember knew about CUC's long-standing non-GAAP policy of deferring rejects-in-transit, yet failed to correct the improper accounting.

n. Defendant Walter Forbes worked very closely with defendant Shelton, and Shelton was very involved in CUC's operations; for example, Shelton spent at least a day a month at BCI to attend BCI's monthly performance meetings, which included presentations by BCI's controller, and discussions of BCI's budgets and financial performance.

o. Defendants Shelton and McLeod reported directly to defendant Walter Forbes.

p. Defendant Corigliano reported directly to defendant Shelton.

q. Throughout the Report, WF&G and AA explained that the financial fraud was so massive and pervasive - affecting 17 of CUC's 22 business units - that it could not have been missed by CUC's executives and officers, and that several former CUC employees confirmed that the improper unsupported quarterly adjustments were "carefully planned" through backdated journal entries designed so that CUC could meet or exceed Wall Street's earnings expectations.

r. Cendant compelled Walter Forbes to resign, and terminated Shelton and Corigliano for cause.

s. The CUC Individual Defendants prohibited HFS from obtaining pre-merger access to non-public CUC financial information, even though HFS and CUC had executed the Merger Agreement and the Confidentiality Agreement, both of which provided for such access, and even though the Merger Agreement required such access.

t. After the completion of the Merger, Walter Forbes and Shelton requested that Pember keep her job, that former CUC business units continue to report to Corigliano and Pember rather than to new Cendant financial management, and that E&Y, rather than D&T (Cendant's auditors), continue to audit former CUC business units.

u. The operations in which the accounting irregularities occurred all reported to defendants Walter Forbes, Shelton, McLeod, Corigliano and Pember.

v. CUC and Cendant relied heavily on the investing public to finance CUC's and Cendant's acquisition strategy and operations. CUC and Cendant filed with the SEC at least twenty registration statements (without considering amendments thereto) to register approximately 630 million shares of CUC and Cendant common stock and over $7 billion of other CUC and Cendant securities for those purposes. In connection with the Merger, for example, CUC issued 440 million shares of its common stock valued at $14.1 billion.

w. CUC wanted to close the Merger, as a result of which Walter Forbes, Shelton, McLeod and Corigliano obtained substantial monetary and other benefits.

x. The CUC Individual Defendants further sought to increase their personal wealth and positions through the completion of other acquisitions, such as Cendant's pending acquisitions of American Bankers, National Parking Corporation and Providian Insurance.

154. As a result of those deceptive practices and false and misleading statements and omissions, the market price of CUC and Cendant common stock was artificially inflated throughout the Class Period. In ignorance of the false and misleading nature of the representations and omissions described above and the deceptive and manipulative devices employed by defendants CUC, Cendant and the CUC Individual Defendants named in this Count, plaintiffs and the other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of those defendants, purchased CUC and Cendant publicly traded securities at artificially inflated prices and were damaged thereby.

155. Had plaintiffs and the other members of the Class known of the material adverse information not disclosed by defendants CUC, Cendant and the CUC Individual Defendants named in this Count, or been aware of the truth behind those defendants' material misstatements, they would not have purchased CUC and Cendant publicly traded securities, at artificially inflated prices, if at all.

156. By virtue of the foregoing, defendants CUC, Cendant and the CUC Individual Defendants named in this Count have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT VIII

Against HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes for Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder

157. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes for violations of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, on behalf of all purchasers of Cendant publicly traded securities from the date of the Merger through the end of the Class Period who were damaged thereby.

158. The HFS Individual Defendants named in this Count, individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about Cendant, including its true financial results, as specified herein. The HFS Individual Defendants named in this Count employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue and misleading statements of material facts and omitting to state material facts necessary in order to make the statements made about Cendant not misleading. Specifically, the HFS Individual Defendants named in this Count knew or should have known that Cendant's reported financial results throughout the Class Period, as filed with the SEC and disseminated to the investing public, were materially overstated and were not presented in accordance with GAAP, and that HFS had

failed to conduct required substantive due diligence in connection with the Merger, contrary to the representations in the Joint Proxy Statement/Prospectus.

159. The HFS Individual Defendants named in this Count, as directors and among the top executive officers of Cendant, are liable as direct participants in the wrongs complained of herein. Through their positions of control and authority as officers and directors of Cendant, the HFS Individual Defendants named in this Count were able to and did control the content of the public statements disseminated by Cendant since the Merger until the end of the Class Period. With knowledge of the falsity and misleading nature of the statements contained therein and in reckless disregard of the true financial results of Cendant, the HFS Individual Defendants named in this Count caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein.

160. The HFS Individual Defendants named in this Count acted with scienter throughout the period since the Merger through the end of the Class Period, in that they either had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that they failed to ascertain and to disclose the true facts, even though such facts were available to them. The HFS Individual Defendants named in this Count were among the senior management of Cendant, and were, therefore, directly responsible for the false and misleading statements and omissions disseminated to the public through press releases, news reports, and filings with the SEC.

161. The misrepresentations and omissions of the HFS Individual Defendants named in this Count were intentional or reckless and done for the purpose of enriching themselves at the expense of plaintiffs and the Class and to conceal Cendant's true operating condition from the

investing public. Those defendants engaged in this scheme to inflate Cendant's reported net income in order to create the illusion that Cendant was a successful, strong and profitable company, which would enable Cendant to continue its acquisition strategy, among other things. The following facts indicate actual evidence, as well as a strong inference, that the HFS Individual Defendants named in this Count acted with scienter:

a. Defendant Silverman sold his entire holdings of Cendant common stock on February 5 and 6, 1998, obtaining proceeds of over $61.4 million.

b. Defendant Snodgrass, who was President, Chief Operating Officer and a director of HFS from February 1992 until the Merger, was Vice Chairman of HFS from September 1996 until the Merger, and remained as Cendant's Vice Chairman, sold over 1.6 million shares, or 57% of his holdings, of Cendant common stock between December 17, 1997 and April 15, 1998, obtaining proceeds of over $63.2 million. Approximately 1.1 million of those shares were sold between March 17, 1998 and April 7, 1998 for proceeds of over $44.2 million.

c. Defendant Buckman sold 300,000 shares of Cendant common stock on February 6, 1998 for proceeds of over $10.8 million.

d. HFS Individual Defendants Silverman, Monaco, Snodgrass, Buckman, and Scott Forbes caused HFS to fail to undertake required substantive financial due diligence in connection with the Merger. In particular, HFS did not retain D&T, or any accounting firm, to perform such due diligence, and permitted the CUC Individual Defendants, among others, to limit HFS's access to necessary non-public financial information of CUC, notwithstanding the provisions of the Confidentiality Agreement and the Merger Agreement.

e. HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes knew or recklessly disregarded CUC's past accounting and reporting problems and past SEC-compelled accounting restatements, but, rather than heighten HFS's customarily stringent due diligence procedures, failed to perform the due diligence procedures required to be undertaken in business combinations generally, and by HFS in its past business combinations, when urging shareholders to adopt a merger.

f. After the completion of the Merger, HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes permitted CMS to continue to report to Corigliano and Pember, even though CUC had significant past accounting and reporting problems, had been repeatedly compelled by the SEC to restate financial statements, and had exhibited unprecedented pre-merger intransigence concerning HFS's access to CUC's non-public financial information, in violation of the Merger Agreement and the Confidentiality Agreement.

g. Even though on February 3, 1998 E&Y informed the Cendant Audit Committee that CMS's income for January 1997 was overstated by approximately $23 million, Cendant announced its record 1997 results on February 4, 1998, which included that overstatement.

h. At a March 6, 1998 meeting attended by, *inter alia*, Shelton, Corigliano, Pember and Scott Forbes, Shelton asked Scott Forbes, who attended the meeting at the direction of defendant Silverman, to assist Shelton, Corigliano and Pember to be "creative" in reversing $165 million of the Cendant Reserve into income in 1998. Shelton suggested at that time that it would be advantageous to distribute portions of that amount to various business units so that the entire amount would not be sitting on one division's books. Shelton also suggested that E&Y continue to audit the operations of CMS. Those highly unusual requests still did not cause the HFS Individual Defendants to heighten their scrutiny.

i. During a March 7, 1998, telephone call, defendant Corigliano told defendant Silverman that CMS's 1997 results included as much as $100 million of non-recurring income.

j. On March 8, 1998, defendant Silverman held a meeting with defendants Monaco, Buckman, Scott Forbes, and Edelman, among others, at which Silverman updated those present on the non-recurring income included in CMS's 1997 financial statements.

k. During meetings held on March 9 and 10, 1998, defendants Monaco and Scott Forbes, both of whom attended at defendant Silverman's direction, learned that all but approximately $4 million of the $179.9 million Ideon Reserve had been exhausted by December 31, 1997. However, neither Monaco nor Scott Forbes, nor Silverman when he was apprised, called in D&T or undertook any other additional effort to understand this highly suspect circumstance.

l. Defendants Silverman, Monaco and Scott Forbes knew that the relationship with CNA was continuing, and that the $30 million payment was charged against the Cendant Reserve.

m. After the Merger, Cendant continued to rely heavily on the investing public to finance its acquisition strategy and operations. After the Merger, Cendant filed with the SEC several registration statements to register, *inter alia*, Cendant common stock and over $7 billion of other Cendant securities for those purposes.

n. HFS wanted to close the Merger.

o. The HFS Individual Defendants further sought to increase their personal wealth and positions by Cendant's closing of its pending acquisitions of American Bankers, National Parking Corporation and Providian Insurance.

162. As a result of those deceptive practices and false and misleading statements and omissions, the market price of Cendant common stock was artificially inflated throughout the Class Period. In ignorance of the false and misleading nature of the representations and omissions described above and the deceptive and manipulative devices employed by HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes, plaintiffs and the other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of those defendants, purchased Cendant publicly traded securities at artificially inflated prices and were damaged thereby.

163. Had plaintiffs and the other members of the Class known of the material adverse information not disclosed by the HFS Individual Defendants named in this Count, or been aware of the truth behind those defendants' material misstatements, they would not have purchased Cendant publicly traded securities at artificially inflated prices, if at all.

164. By virtue of the foregoing, the HFS Individual Defendants named in this Count have violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT IX

Against E&Y for Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder <u>as a Result of E&Y's Unqualified Audit Reports</u>

165. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against E&Y, as a result of its unqualified audit reports, for violations of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder on behalf of all purchasers of CUC and Cendant publicly traded securities during the Class Period who were damaged thereby.

166. Throughout the Class Period, E&Y, individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about CUC and Cendant, including its true financial results, as specified herein. E&Y employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue and misleading statements of material facts and omitting to state material facts necessary in order to make the statements made about CUC and CMS not misleading. Specifically, E&Y knew or should have known that CUC's and Cendant's reported annual financial results for 1995, 1996 and 1997, as filed with the SEC in CUC's and Cendant's Forms 10-K and the Other SEC Filings, and disseminated to the investing public, were materially overstated and were not presented in accordance with GAAP, that E&Y's audits were not performed in accordance with GAAS, and, therefore, that E&Y's unqualified audit reports, as included or

incorporated by reference in those annual and quarterly reports and Other SEC Filings, were materially false and misleading.

167. The 1995, 1996 and 1997 10-Ks and the Other SEC Filings were materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in those SEC filings, under the circumstances in which they were made, not misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained in, or the material facts omitted from, those SEC filings included, but were not limited to, the overstatement of revenue for 1996 and 1997, and the overstatement of income from continuing operations and net earnings for 1995, 1996 and 1997, as well as the representations in E&Y's unqualified audit reports issued in connection with E&Y's audits of CUC's and CMS's financial statements for those years, in which E&Y certified that (i) it had audited CUC's and CMS's financial statements in accordance with GAAS; (ii) it had planned and performed those audits "to obtain reasonable assurance about whether the financial statements are free of material statement"; (iii) in its opinion, CUC's and CMS's financial statements "present fairly, in all material respects, the financial position" of CUC and CMS "in conformity with generally accepted accounting principles"; and (iv) E&Y's audits provided a "reasonable basis" for its opinions. As detailed herein, E&Y's audit reports were materially false and misleading. E&Y did not make a reasonable investigation or possess reasonable grounds for the belief that the statements described above, which were contained in the 1995, 1996 and 1997 10-Ks, and incorporated by reference in the Other SEC Filings, were true, were without omissions of any material facts, and were not misleading.

168. E&Y, with knowledge of the falsity and misleading nature of the statements contained in its unqualified audit reports, and in reckless disregard of the true nature of its audits,

caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein. As described herein, E&Y's audit of CMS's financial statements for 1997, and E&Y audits of CUC's financial statements for 1995 and 1996 were not performed in accordance with GAAS, and, in fact, E&Y had no basis for its unqualified opinions. E&Y's unqualified reports dated March 19, 1996, March 10, 1997 and February 3, 1998, issued in connection with those audits, as included in the 1995, 1996 and 1997 10-Ks, in which E&Y certified, *inter alia*, that its audits were performed in accordance with GAAS, were materially false and misleading.

169. E&Y acted with scienter throughout the Class Period, in that it either had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with reckless disregard for the truth in that it failed to ascertain and to disclose the true facts, even though such facts were available to it. E&Y was CUC's and CMS's auditor, and, therefore, was directly responsible for the false and misleading statements and omissions disseminated to the public through its unqualified audit reports.

170. E&Y's misrepresentations and omissions were intentional or reckless. E&Y, as CUC's and CMS's auditor, had unfettered access to CUC's and CMS's books and records throughout the Class Period. E&Y, as a world-renowned "Big 5" public accounting firm, certainly had knowledge of the requirements of GAAS. The following facts indicate a strong inference that E&Y acted with scienter:

a. E&Y knew or recklessly disregarded that it had not performed its audits of CUC's 1995 and 1996 financial statements and its audit of CMS's 1997 financial statements in accordance with GAAS, and, therefore, that its unqualified audit reports on CUC's and

CMS's financial statements for 1995, 1996 and 1997 were materially false and misleading. Under GAAS, "[t]he auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud." AICPA Professional Standards, AU § 110.02 (1998); AU § 316.05 (1997). As described herein, E&Y did not fulfill that responsibility. In fact, E&Y's audits of CUC's and CMS's financial statements for 1995, 1996 and 1997 were so woefully inadequate that E&Y repeatedly violated GAAS. E&Y utterly failed to perform the most fundamental of procedures to provide a basis for its unqualified reports. As described below, E&Y repeatedly and materially violated GAAS in each of those audits, failed to plan or to perform its audits to obtain reasonable assurance that CUC's and CMS's financial statements were free of material misstatement, and, therefore, had no basis on which to state that CUC's and CMS's financial statements were presented in conformity with GAAP. For example:

i. **E&Y Failed to Obtain Sufficient and Competent Evidential Matter.** "Most of the independent auditor's work in forming his or her opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements." AU § 326.02. "The independent auditor's direct personal knowledge, obtained through physical examination, observation, computation, and inspection, is more persuasive than information obtained indirectly." AU § 326.21. Representations from management "are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU

§ 333.02 (1998); AU § 333.02 (1997). "The books of original entry, the general and subsidiary ledgers, related accounting manuals, and records such as work sheets and spreadsheets supporting cost allocations, computations, and reconciliations all constitute evidence in support of the financial statements." "[W]ithout adequate attention to the propriety and accuracy of the underlying accounting data, an opinion on financial statements would not be warranted." AU § 326.16 (1998); AU § 326.15 (1997). E&Y violated GAAS by failing to obtain sufficient competent evidential matter. For example:

(1) E&Y failed to obtain direct evidence in connection with CUC's and CMS's recording of revenue and elimination or reduction of expenses as a result of write-offs of merger reserves. Instead, E&Y relied largely on management's representations. As a result, $108 million of those reserves were written off in 1997 directly to revenue without any conceptual basis under GAAP. Another $7 million of those reserves were used to offset expenses during the Class Period that were not related to the purpose of those reserves, also without conceptual basis. E&Y failed to discover that all of those adjustments were unsupported by documentation. In particular, E&Y failed to determine whether non-reporting-system journal entries (*i.e.*, those entries that come from sources other than CUC's and CMS's revenue, expense, cash receipts, cash disbursement and payroll accounting and reporting systems), particularly those made through CUC's and CMS's intercompany accounts, were valid. As described herein, there were hundreds

of inappropriate and unsupported non-recurring journal entries totaling hundreds of millions of dollars. No one from E&Y reviewed CUC's general ledgers or asked to see any post-closing journal entries. For example:

(a) In "auditing" the balance of the Ideon reserve on Comp-U-Card's books at December 31, 1997, E&Y was "told" that, because of favorable litigation results, excess reserves that had been established for litigation exposure actually were used to offset unanticipated Ideon-related integration costs. E&Y improperly relied on a memorandum from defendant Corigliano on which no audit work was performed to verify those additional integration costs.

(b) When CUC was establishing its component of the Cendant Reserve, E&Y's auditing procedures consisted solely of obtaining explanations provided by defendants Corigliano and Pember. E&Y disregarded the fact that the establishment of merger reserves requires the exercise of judgment by company management, and, therefore, that the auditing of those reserves compels the collection and examination of sufficient competent evidential matter, such as budgets for integration, payroll costs, and anticipated severance costs, to challenge management's judgmentally determined amounts. E&Y also ignored that the establishment of such "big bath" reserves provides incentive for management to overestimate anticipated merger-related costs to benefit future periods. E&Y, thus, failed to determine that a substantial amount of the CUC portion of the Cendant Reserve was, in fact, unnecessary.

(c) E&Y was not satisfied with CUC's determination of the amount of income for January 1997 (which had already been included in CUC's 1996 financial statements) to be included as part of Cendant's 1997 financial statements. Rather than investigate the $23 million discrepancy, which likely would have uncovered the unsupported journal entries made in 1996 that substantially skewed Comp-U-Card's January 1997 income, E&Y ignored the difference.

(2) E&Y treated the December 1997 $30 million contract payment to CNA as if FISI was terminating its relationship with CNA as a result of the Merger, even though E&Y received a copy of the executed final agreement, which indicated that the contract had been renewed.

(3) With respect to Cendant's improper write-off in 1997 of $3.7 million of accounts receivable on the books of LTPC, E&Y failed to speak to Terry Johnson, FISI's Controller, who knew that the receivable impairment was unrelated to the Merger, or to obtain sufficient documentation concerning the collectibility of LTPC's accounts receivable.

(4) E&Y failed to obtain sufficient evidential matter to support Cendant's improper write-off in 1997 of $17.3 million of goodwill originally recorded when SafeCard acquired NLG, or to sufficiently familiarize itself with NLG's operations.

(5) E&Y improperly treated Cendant's improper write-off in 1997 of $2.3 million of NLG's computer costs to the Cendant Reserve as if NLG's computer system was never implemented, and that its development would be abandoned.

(6) E&Y failed to obtain sufficient competent evidential matter in connection with Cendant's improper journal entries in 1997 to record payments made in connection with SafeCard's acquisition of NLG, or even to understand the terms of the purchase agreement or the nature of the payments.

(7) With respect to Cendant's improper write-offs in 1997 against the Cendant Reserve of non-merger-related assets and non-merger-related charges, E&Y failed to speak to the responsible controllers; to understand that the respective subsidiaries' businesses were unrelated to the Merger; to understand that those transactions, expenses, "plugs" and charges were not related to the Merger; and even that its own audit fees were unrelated to the Merger.

(8) E&Y failed to discover throughout the Class Period that Cendant's and CUC's stated policy for accounting for membership revenue and membership acquisition costs failed to properly account for the fact that substantially all club memberships were and are fully refundable throughout the term of the membership, and that the stated policy also failed to properly account for the fact that substantial membership solicitation expenses

incurred by CUC and Cendant were not refundable to CUC or Cendant in the event the related membership was canceled.

(9) E&Y failed to discover that, throughout the Class Period, Cendant and CUC did not comply with the stated membership revenue recognition policy by realizing certain revenue immediately. In addition, E&Y failed to discover that Comp-U-Card improperly deferred expenses in programs that recognized revenue immediately; E&Y did not have a sufficient understanding of Comp-U-Card's accounting procedures and systems, and did not perform sufficient testing to determine the appropriateness of the expenses reported. And E&Y failed to discover that Comp-U-Card improperly reclassified revenue from deferred recognition programs to immediate recognition programs; E&Y never obtained Comp-U-Card's immediate recognition Projection Model schedules, and, therefore, could not agree the amount of membership revenue from the incomplete Projection Model schedules it did have to the total amount of membership revenue reflected in Comp-U-Card's general ledger or trial balances.

(10) E&Y failed to discover that, throughout the Class Period, CUC used its membership cancellation reserve improperly by periodically, and without support, reversing that reserve into income.

(11) E&Y failed to discover that, throughout the Class Period, CUC improperly accounted for membership rejects-in-transit. In fact, E&Y was provided with Comp-U-Card's and CMS's bank and accounts receivable

reconciliations, but ignored the significance of the many material reconciling items on those reconciliations, and failed to sufficiently understand Comp-U-Card's and CMS's business practice.

(12) E&Y failed to discover that, throughout the Class Period, CUC improperly understated the membership cancellation reserve. On the contrary, E&Y's workpapers indicate that E&Y determined that the membership cancellation reserve at January 31, 1995 and 1996 was adequate. E&Y did not understand CUC's and CMS's business to the degree necessary to recognize that the formula used by Comp-U-Card and CMS was unsupported, did not perform its own statistical analysis on randomly selected segments of Comp-U-Card's or CMS's cancellation database in order to evaluate CUC's "formula," and ignored substantial reconciling items on Comp-U-Card's bank reconciliations.

(13) E&Y failed throughout the Class Period to sufficiently audit CUC's many unsupported and improper adjusting journal entries made to the membership cancellation reserve, which adjustments were apparent from CUC's general ledger. E&Y did not review the general ledger activity, and failed to obtain sufficient competent evidential matter to support reconciling items. E&Y also failed to recognize that the CUC "policy" of recording rejects-in-transit on a "lag" basis was inconsistent with the stated policy and violative of GAAP.

(14) E&Y failed to discover that, throughout the Class Period, Comp-U-Card improperly understated commissions payable, and recorded improper unsupported post-closing adjusting journal entries at year end to improperly reduce commissions payable and increase various revenue accounts. E&Y failed to gain a sufficient understanding of Comp-U-Card's billing practices for generic clients and, therefore, did not know that Comp-U-Card was required to have four months -- not one month -- of commissions payable on its books. E&Y also failed to coordinate the commissions payable account with the membership fees revenue and receivable accounts, and to review the general ledger activity in the commissions payable and revenue accounts.

(15) With respect to the reversal into 1997 income of the Sierra deferred tax asset, E&Y did not speak to any knowledgeable personnel at Sierra, permitted Sierra to adjust Berkeley's opening balance sheet without any support, and ignored an adjustment to a miscellaneous income account and an unsupported deferred tax asset.

(16) With respect to the improper write-off in 1995 of $14 million of BCI profit-sharing receivables against an intercompany account, E&Y failed to speak to Pedersen, who made the entries, or to review the general ledger activity in BCI's profit-sharing receivable account.

(17) E&Y did not discover that FISI's 1997 adjustment to improperly capitalize $2.3 million of new business solicitation expenses was

in violation of GAAP, was unreasonable in amount, and was contrary to the consistent application of FISI's GAAP policy of expensing such costs as incurred.

(18) E&Y failed to discover or consider the impropriety of CUC's unsupported topside adjustment in 1997 to decrease accounts payable and general and administrative expenses at Hebdo Mag.

(19) E&Y failed to determine whether CUC's and CMS's general ledgers supported CUC's and CMS's financial statements; for example:

(a) E&Y had been "told" that the Ideon Reserve had been exhausted by December 31, 1997; however, just as during the three prior quarters, the actual balance on Comp-U-Card's general ledger was higher than that presented to E&Y and reported to the public: At December 31, 1997 the balance of the Ideon Reserve account as reported in Comp-U-Card's general ledger was actually $64 million. Shortly after December 31, 1997, Cendant made unsupported topside adjustments that wrote off the reserve directly to revenue. E&Y failed to discover or consider that the December 31, 1997 balance in the Ideon Reserve reported to it did not agree to the account balance as reflected in Comp-U-Card's general ledger. E&Y did not review journal entry activity in that account.

(b) There was a gap of approximately $170 million between the revenue amount reported by Comp-U-Card in its reporting package for the first three quarters of 1997 and the amounts reflected on the "topside-adjusted" consolidating report for that period. E&Y had the topside-adjusted consolidating reports for each quarter, as well as the year-end Comp-U-Card reporting package (which did not reflect any of the topside adjustments). E&Y failed to discover or consider the discrepancy.

(c) When CUC improperly took $28.9 million of the Ideon Reserve into income in 1997, it did so through topside journal entries made only on the consolidating report in the columns for Comp-U-Card and for CUC's NUMA, NAOG and NCCI subsidiaries. The general ledgers of Comp-U-Card and the NUMA, NAOG and NCCI subsidiaries were adjusted in 1998 through adjustments to retained earnings. E&Y failed to discover that, as of December 31, 1997, the general ledgers of the Comp-U-Card division and of those three subsidiaries did not agree to the corresponding balances reflected in the consolidating report.

(d) When CUC improperly transferred $2.8 million of the Ideon Reserve to NCCI in 1996 and then improperly decreased NCCI's expenses by that amount, the entries were posted through a topside adjustment made to the consolidating report and then pushed down to NCCI, which did not record the increase to its 1996 revenue, but, instead, recorded the entry as a credit to its retained earnings.

E&Y failed to discover that NCCI's revenue and retained earnings for 1996, as reflected in NCCI's general ledger and reporting package, did not agree to the corresponding balances included in the consolidating report.

ii. **E&Y Failed to Exercise Professional Skepticism.** "Due professional care requires the auditor to exercise *professional skepticism*." This requires the auditor to "diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence." "In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." AU §§ 230.07-09 (1998); AU § 316.16-21 (1997) (professional skepticism is required in planning and performing an audit). The auditor also "must be without bias with respect to the client since otherwise he would lack [the] impartiality necessary for the dependability of his findings." AU § 220.02. Notwithstanding these requirements, in connection with its planning and performing audit procedures concerning, *inter alia*, merger reserves, revenue recognition, membership cancellation reserves and certain other matters described herein, E&Y relied almost exclusively on representations from CUC and CMS management rather than on sufficient competent evidential matter, even though four of the most significant members of CUC's and CMS's accounting and reporting staff upon whom E&Y relied -- Mary Sattler, Kevin Kearney and defendants Pember and Corigliano -- were former E&Y employees. Mary Sattler was CUC's Supervisor of Financial Reporting and later Cendant's Manager of Financial Reporting; Sattler reported to

Kevin Kearney, who was CUC's Manager of Financial Reporting, and to Pember; Kearney, through another CUC employee, reported to Pember, CUC's Corporate Controller, and to Corigliano, CUC's Chief Financial Officer; Pember reported to Corigliano. Thus, essentially CUC's entire accounting and reporting chain of command were former E&Y employees. E&Y, thus, failed to exercise professional skepticism, failed to maintain an independent mental attitude and failed to exercise professional due care in the exercise of its audits.

iii. **E&Y Failed to Properly Plan and Supervise.** The auditor must obtain a level of knowledge of its clients' businesses sufficient to enable it to "obtain an understanding of the events, transactions, and practices that, in his judgment, may have a significant effect on the financial statements." AU § 311.06. In connection with planning its audit procedures, E&Y violated GAAS because E&Y failed to obtain sufficient knowledge:

(1) of CUC's and CMS's accounting and reporting systems to recognize, *inter alia*, that the significance of post-closing adjustments certainly merited special consideration;

(2) upon which to assess the conditions under which CUC's and CMS's accounting data, particularly manual journal entries and consolidating trial balances, were produced and processed;

(3) to properly evaluate CUC's and CMS's estimates and management representations concerning, *inter alia*, the establishment and application of merger and other reserves;

(4) of CUC's and CMS's business and transactions upon which to assess the propriety of management's accounting treatment of, *inter alia*, asset write-offs, renewed contracts (CNA), and the future usefulness of computer systems; and

(5) to properly evaluate the propriety and consistency of CUC's and CMS's application of accounting principles to, *inter alia*, revenue recognition.

iv. **E&Y Failed to Properly Evaluate Audit Findings.** "The risk of material misstatement of the financial statements is generally greater when account balances and classes of transactions include accounting estimates rather than essentially factual data because of the inherent subjectivity in estimating future events." Estimates are subject "to misstatements that may arise from using inadequate or inappropriate data or misapplying appropriate data." AU § 312.36. "Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors." Accordingly, the auditor should consider estimates "with an attitude of professional skepticism." AU § 342.04. "[T]he auditor should obtain an understanding of how management developed the estimate," AU § 342.10, and should "obtain sufficient competent evidential matter to provide reasonable assurance" that, *inter alia*, estimates are reasonable in the circumstances and are presented in conformity with GAAP, AU § 342.07. E&Y violated GAAS, because it failed to obtain sufficient competent evidential matter concerning, and, therefore, failed to properly evaluate, CUC's and CMS's estimates of, *inter alia*, merger and other reserves.

v. **E&Y Failed to Properly Consider Fraud and Irregularities.** "The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed." AU § 316.12 (1998); AU § 316.05 (1997) ("The auditor should assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement."). One of the factors in assessing the risk of fraudulent financial reporting is whether there is a known history of securities law violations or claims against the entity or its senior management alleging fraud or violations of securities laws. AU § 316.17 (1998). Among the conditions that should cause the auditor to consider that a client has attempted financial fraud are discrepancies in the accounting records, such as transactions not properly recorded as to amount, accounting period classification or client policy, or unsupported or unauthorized balances or transactions; conflicting or missing evidential matter, such as significant unexplained items on reconciliations; or denied access to records. AU §§ 316.25, 317.09 (1998); AU §§ 316.21, 317.09 (1997). To limit the risk of financial statement misstatement as a result of fraud, the auditor should perform procedures, including a detailed review of the client's quarter-end and year-end adjusting journal entries and an investigation of any entries that appear unusual as to nature or amount and of significant and unusual transactions, particularly those occurring at or near quarter- or year-end. AU § 316.29 (1998). E&Y violated GAAS because it failed to properly consider the risk that CUC's and CMS's financial statements would be materially misstated as a result of fraud or irregularities. E&Y did not sufficiently consider past allegations against CUC that CUC's revenue recognition policies, among other things, violated GAAP, and past negative SEC activity. E&Y also failed to recognize hundreds of unsupported and improper journal entries, or the significance of the many material reconciling items on bank and other reconciliations, or that it was not provided with certain key account analyses. E&Y also did not sufficiently consider, if at all, that it was not provided with Comp-U-Card's reporting packages. E&Y did not perform a review or investigation of any quarter- or year-end journal entries, nor did E&Y investigate significant and unusual transactions, such as the recording of revenue through the write off of merger reserves, all of which occurred at or after quarter- and year-end.

vi. **E&Y Failed to Properly Consider CUC's and CMS's Lack of Internal Control.** "In all audits, the auditor should obtain an understanding of internal control sufficient to plan the audit." AU § 319.02. "The auditor should obtain sufficient knowledge of the information system relevant to financial reporting to understand," *inter alia*, the classes of significant transactions, "the accounting records, supporting information and specific accounts in the financial statements involved in the processing and reporting of transactions," the accounting processing involved in recording, processing, accumulating and reporting transactions, and the financial reporting process used to prepare financial statements. AU § 319.36. E&Y violated GAAS because it failed to learn or to consider that CUC and CMS had grossly deficient internal controls and procedures. For example, E&Y failed to properly consider:

(1) that CUC and CMS used a financial reporting process that was substantially a manual one that did not contain many system-based checks and balances;

(2) that CUC and CMS did not maintain a formal written accounting policies and procedures manual governing financial reporting;

(3) that standardized reporting formats and reporting packages were not used;

(4) that a significant number of consolidating entries were unsupported, unreviewed and not approved;

(5) that CUC and CMS did not have an adequate reconciliation process, particularly over critical accounts, such as cash;

(6) that data and information systems were not well integrated, particularly with respect to membership fee revenues;

(7) that CUC and CMS did not prepare a consolidated budget, nor did divisions and subsidiaries prepare uniform budgets;

(8) that CUC and CMS did not routinely compare actual results to budgeted results;

(9) that CUC's internal audit function did not examine or review financial data;

(10) that efforts were not made to assure that all necessary adjustments were made so as to correctly and fairly present CUC's quarterly financial position and results of operations; and

(11) Comp-U-Card's budgets, and thus did not discover that Comp-U-Card's "adjusted" actual results were far in excess of budgeted amounts.

vii. **E&Y Failed to Properly Identify and Consider Related Party Transactions.** An auditor should perform procedures "to identify related party relationships and transactions and to satisfy himself concerning the required financial statement accounting and disclosure." AU § 334.01. "The auditor should place emphasis on testing material transactions with parties he knows are related to the reporting entity. Certain relationships, such as parent-subsidiary or investor-investee, may be clearly evident." AU § 334.07. To identify material transactions with related parties, the auditor should, among other things, "[r]eview accounting records for large, unusual, or nonrecurring transactions or balances, paying particular attention to transactions recognized at or near the end of the reporting period." AU § 334.08(g). Once material related party transactions are identified, the auditor should perform procedures necessary to evaluate "the purpose, nature and extent of these transactions and their effect on the financial statements. The procedures should be directed toward obtaining and evaluating sufficient competent evidential matter and should extend beyond inquiry of management." AU § 334.09. Those procedures should include, among other things, to:

> [a]rrange for the audits of intercompany account balances to be performed as of concurrent dates, even if the fiscal years differ, and for the examination of specified, important, and representative related party transactions by the auditors for each of the parties, with appropriate exchange of relevant information.

AU § 334.10(e). E&Y violated GAAS, because it failed to obtain sufficient competent evidential matter concerning, and, therefore, failed to properly evaluate, the myriad intercompany transactions recorded by CUC and CMS and by and among various subsidiaries to, *inter alia*, improperly transfer and reverse into income merger and other reserves.

b. E&Y affirmatively represented to HFS that CUC's financial statements were accurate, with knowledge that CUC was *not* allowing HFS to inspect CUC's books and records, and with knowledge of E&Y's numerous violations of GAAS. Indeed, even after the Merger was completed, and the Audit Committee investigation was being conducted, E&Y allowed its audit workpapers to be seen by Cendant's Audit Committee, but refused to permit certain of those audit workpapers to be shown to all members of Cendant's Board.

c. CUC was a very valuable client of E&Y's Stamford, Connecticut office. The fees obtained annually, including very profitable regular consulting engagements in the tax and technology areas that generated fees of approximately $1 million, placed CUC among that office's top three clients.

d. E&Y was CUC's auditor at the time of CUC's significant past accounting and reporting problems, including improper revenue recognition policies and practices, and when the SEC compelled CUC to restate its 1991 financial statements. E&Y had concurred with CUC's improper accounting.

171. As a result of E&Y's deceptive practices and false and misleading statements and omissions, the market price of CUC and Cendant common stock was artificially inflated throughout the Class Period. In ignorance of the false and misleading nature of the representations and omissions described above and the deceptive and manipulative devices employed by E&Y, plaintiffs and the other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of E&Y, purchased CUC and Cendant publicly traded securities at artificially inflated prices and were damaged thereby.

172. Had plaintiffs and the other members of the Class known of the material adverse information not disclosed by E&Y, or been aware of the truth behind E&Y's material misstatements, they would not have purchased CUC and Cendant publicly traded securities at artificially inflated prices, if at all.

173. By virtue of the foregoing, E&Y has violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT X

Against E&Y for Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Promulgated Thereunder as a Result of E&Y's Unqualified Review Reports

174. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against E&Y, as a result of its unqualified review reports, for violations of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder, on behalf of all purchasers of CUC and Cendant publicly traded securities during the Class Period who were damaged thereby.

175. Throughout the Class Period, E&Y, individually and in concert, directly and indirectly, by the use and means of instrumentalities of interstate commerce and of the mails, engaged and participated in a continuous course of conduct to conceal adverse material information about CUC, including its true financial results, as specified herein. E&Y employed devices, schemes, and artifices to defraud while in possession of material, adverse non-public information and engaged in acts, practices, and a course of conduct that included the making of, or participation in the making of, untrue and misleading statements of material facts and omitting to state material facts necessary in order to make the statements made about CUC not misleading. Specifically, E&Y knew or should have known that CUC's reported quarterly financial results for the first three quarters of 1995, the first three quarters of 1996 and the first quarter of 1997, as filed with the SEC on Forms 10-Q, and disseminated to the investing public, were materially overstated and were not presented in accordance with GAAP, that E&Y's reviews thereon were not performed in accordance AICPA standards, and, therefore, that E&Y's unqualified review reports, as included in those Forms 10-Q, were materially false and misleading.

176. The 1995, 1996 and first quarter 1997 10-Qs were materially false and misleading; contained untrue statements of material facts; omitted to state material facts necessary to make the statements made in those SEC filings, under the circumstances in which they were made, not misleading; and failed to adequately disclose material facts. As detailed herein, the misrepresentations contained in, or the material facts omitted from, those Forms 10-Q included, but were not limited to, the overstatement of revenue, income from continuing operations, and net earnings, as well as the representations in E&Y's unqualified review reports issued in connection with E&Y's reviews of CUC's financial statements for those quarters, in which E&Y warranted that it reviewed

CUC's financial results for each such quarterly period "in accordance with the standards established by the [AICPA]", and that, based on its reviews, E&Y was "not aware of any material modifications that should be made to the consolidated financial statements . . . for them to be in conformity with generally accepted accounting principles." As detailed herein, E&Y's review reports were materially false and misleading. E&Y did not make a reasonable investigation or possess reasonable grounds for the belief that the statements described above were true, were without omissions of any material facts, and were not misleading.

177. E&Y, with knowledge of the falsity and misleading nature of the statements contained in its unqualified review reports, and in reckless disregard of the true nature of its reviews, caused the heretofore complained of public statements to contain misstatements and omissions of material facts as alleged herein. As described herein, E&Y's reviews of CUC's interim financial statements violated the guidelines established by the AICPA. E&Y's unqualified review reports (dated May 31, 1995, August 29, 1995 and November 29, 1995) issued in connection with E&Y's reviews of CUC's financial statements for first three quarters of 1995; E&Y's unqualified review reports (dated May 22, 1996, September 4, 1996 and December 2, 1996) issued in connection with E&Y's reviews of CUC's financial statements for the first three quarters in 1996; and E&Y's unqualified review report (dated June 13, 1997) issued in connection with E&Y's review of CUC's financial statements for the first quarter of 1997, each as included in the Forms 10-Q filed with the SEC, in which E&Y stated, *inter alia*, that its reviews were performed in accordance with guidelines established by the AICPA, were materially false and misleading.

178. E&Y acted with scienter throughout the Class Period, in that it either had actual knowledge of the misrepresentations and omissions of material facts set forth herein, or acted with

reckless disregard for the truth in that it failed to ascertain and to disclose the true facts, even though such facts were available to them. E&Y was CUC's accountant, and, therefore, was directly responsible for the false and misleading statements and omissions disseminated to the public through E&Y's unqualified review reports.

179. E&Y's misrepresentations and omissions were intentional or reckless. E&Y, as CUC's accountant, had unfettered access to CUC's books and records throughout the Class Period. E&Y, as a world-renowned "Big 5" public accounting firm, certainly had knowledge of the standards established by the AICPA in connection with interim reviews. The following facts indicate a strong inference that E&Y acted with scienter:

a. E&Y knew or recklessly disregarded that it had not performed its reviews of CUC's quarterly financial statements for the first three quarters of 1995, the first three quarters of 1996 and the first quarter of 1997 in accordance with standards established by the AICPA, particularly in light of CUC's weak manual accounting and reporting systems, and, therefore, that its unqualified review reports included in the Forms 10-Q filed with the SEC were materially false and misleading. A review of interim financial statements may bring to the auditor's attention significant matters affecting the financial statements. AU § 770.09. An auditor performing a review of interim financial information must "have sufficient knowledge of a client's internal control as it relates to the preparation of both annual and interim financial information." AU § 722.10. E&Y's reviews of CUC's interim financial statements for the first three quarters of 1995, the first three quarters of 1996 and the first quarter of 1997 violated AICPA standards, because, as described in paragraph 170 above, E&Y did not obtain sufficient knowledge of CUC's internal controls, did not agree the books of original entry to the published financial statements, and did not review the many topside adjusting journal entries made by CUC each quarter. Thus, E&Y never determined whether CUC's books of original entry supported CUC's financial statements. The procedures applied by E&Y in connection with its reviews of CUC's interim financial statements for the first three quarters of 1995, the first three quarters of 1996 and the first quarter of 1997 also repeatedly violated the AICPA's Professional Standards, *see* AU § 722, because, as described below, E&Y utterly failed in its "reviews" to perform the most fundamental of procedures to provide a basis for its unqualified reports. For example:

i. E&Y received all quarterly reporting packages except the reporting packages for Comp-U-Card, CUC's largest division. Indeed, E&Y never obtained the Comp-U-Card reporting package. Accordingly, E&Y could not determine whether the amounts reflected in CUC's publicly filed financial statements agreed to the amounts in CUC's general ledgers. This necessarily means that E&Y never sent auditors to Comp-U-Card during their quarterly reviews, and, therefore, that E&Y did not perform appropriate quarterly reviews for each of those seven quarters. E&Y failed to consider that it had not obtained the Comp-U-Card reporting packages, and, therefore, failed to discover that, because of topside adjustments that were made to Comp-U-Card's quarterly results, as included in the consolidating reports but not on Comp-U-Card's books, the revenue and expense amounts in those Comp-U-Card reporting packages never agreed to the corresponding amounts in the Comp-U-Card columns in the quarterly consolidating reports.

ii. E&Y had the quarterly reporting packages of all CUC subsidiaries, as well as the quarterly consolidating reports. E&Y failed to undertake a proper review of such packages, and thus failed discover that, because improper topside adjustments were made to those subsidiaries' revenue and expense amounts in the consolidating reports, those subsidiaries' reporting packages did not agree to the corresponding amounts as reflected in the quarterly consolidating reports.

iii. E&Y failed to discover that the cash and accounts receivable balances in Comp-U-Card's reporting packages did not agree with the corresponding balances included in the quarterly consolidating reports.

iv. E&Y had the reporting packages for all of CUC's subsidiaries, as well as the quarterly consolidating reports. Nevertheless, E&Y failed to discover that, because of unsupported topside adjustments made to the deferred membership income and accounts receivable balances in the consolidating reports, those reporting packages did not agree to the corresponding amounts as reflected in the quarterly consolidating reports.

v. The balance of the Ideon Reserve, as reflected on Comp-U-Card's general ledger, did not agree to the amounts reported in the 1997 10-Qs. The balance in the Ideon Reserve account at the end of the first quarter of 1997 was approximately $10 million higher than the publicly reported balance, the balance remaining at the end of the second quarter of 1997 was approximately $16.5 million higher than the balance reported in the Form 10-Q, and the balance in the reserve account at the end of the third quarter of 1997 was approximately $94 million higher than the publicly reported balance. E&Y failed to discover that the Ideon Reserve balances for each of those quarters, as reported in the Comp-U-Card reporting packages, did not agree to the balances in the Comp-U-Card columns in the quarterly consolidating reports or in CUC's publicly filed Forms 10-Q.

180. As a result of those deceptive practices and false and misleading statements and omissions, the market price of CUC publicly traded securities was artificially inflated throughout the Class Period. In ignorance of the false and misleading nature of the representations and omissions described above and the deceptive and manipulative devices employed by E&Y, plaintiffs and the other members of the Class, in reliance on either the integrity of the market or directly on the statements and reports of E&Y, purchased CUC publicly traded securities at artificially inflated prices and were damaged thereby.

181. Had plaintiffs and the other members of the Class known of the material adverse information not disclosed by E&Y, or been aware of the truth behind E&Y's material misstatements, they would not have purchased CUC publicly traded securities at artificially inflated prices, if at all.

182. By virtue of the foregoing, E&Y has violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

COUNT XI

Against CUC Individual Defendants Walter Forbes, Shelton, McLeod, Corigliano and Pember for Violations Under Section 20(a) of the Exchange Act

183. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against CUC Individual Defendants

Walter Forbes, Shelton, McLeod, Corigliano and Pember for violations of Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a), on behalf of all purchasers of CUC and Cendant publicly traded securities during the Class Period who were damaged thereby.

184. During the Class Period, each of the CUC Individual Defendants named in this Count acted as a controlling person of CUC and Cendant within the meaning of Section 20 of the Exchange Act. Specifically, defendant Walter Forbes had the power and authority to cause CUC and Cendant to engage in the wrongful conduct complained of herein by virtue of his position as Chairman and Chief Executive Officer of CUC and as Chairman of Cendant. Defendant Shelton also had the power and authority to cause CUC and Cendant to engage in the wrongful conduct complained of herein, by virtue of his position as President and Chief Operating Officer of CUC and as Vice Chairman of Cendant. Defendant McLeod also had the power and authority to cause CUC and Cendant to engage in the wrongful conduct complained of herein by virtue of his position as Executive Vice President and Member of the Office of the President of CUC, and as Chief Executive Officer of Software and Executive Vice President of Cendant. Defendant Corigliano had the power and authority to cause CUC and Cendant to engage in the conduct alleged herein by virtue of his position as Senior Vice President and Chief Financial Officer of CUC and as Chief Financial Officer of CMS. Defendant Pember had the power and authority to cause CUC and Cendant to engage in the conduct alleged herein by virtue of her position as Senior Vice President of CUC and Cendant, as Controller of CUC and as Controller of Comp-U-Card. These CUC Individual Defendants each were in a position to control or influence the contents of, or otherwise cause corrective disclosures to have been made in, CUC's and Cendant's SEC filings, along with CUC's and Cendant's other public statements that contained materially false and misleading statements that were disseminated

during the Class Period, and each CUC Individual Defendant named in this Count was a culpable participant in the fraud alleged herein.

185. By reason of the wrongful conduct alleged herein, each of the CUC Individual Defendants named in this Count is liable jointly and severally with and to the same extent that Cendant is liable to plaintiffs and the members of the Class as a result of the wrongful conduct alleged herein pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of their wrongful conduct, plaintiffs and the other members of the Class suffered damages in connection with their purchases of CUC and Cendant publicly traded securities during the Class Period.

COUNT XII

Against HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes for Violations Under Section 20(a) of the Exchange Act

186. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against HFS Individual Defendants Silverman, Snodgrass, Monaco, Buckman and Scott Forbes for violations of Section 20 of the Exchange Act, 15 U.S.C. § 78t(a), on behalf of all purchasers of Cendant publicly traded securities since the Merger until the end of the Class Period who were damaged thereby.

187. Each of the HFS Individual Defendants named in this Count acted as a controlling person of Cendant within the meaning of Section 20 of the Exchange Act. Specifically, defendant Silverman had the power and authority to cause Cendant to engage in the conduct alleged herein by virtue of his position as President and Chief Executive Officer. Snodgrass had the power and authority to cause Cendant to engage in the conduct alleged herein by virtue of his position as Vice

Chairman. Monaco had the power and authority to cause Cendant to engage in the conduct alleged herein by virtue of his position as Vice Chairman and Chief Financial Officer. Buckman had the power and authority to cause Cendant to engage in the conduct alleged herein by virtue of his position as Senior Executive Vice President and General Counsel. And Scott Forbes had the power and authority to cause Cendant to engage in the conduct alleged herein by virtue of his position as Executive Vice President and Chief Accounting Officer. These HFS Individual Defendants each were in a position to control or influence the contents of, or otherwise cause corrective disclosures to have been made in, Cendant's SEC filings, along with the Company's other public statements that contained materially false and misleading statements that were disseminated during the period since the Merger until the end of the Class Period, and each HFS Individual Defendant named in this Count was a culpable participant in the fraud alleged herein.

188. None of the HFS Individual Defendants named in this Count made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in Cendant's SEC filings, and Cendant's other public statements that were disseminated during the period since the Merger until the end of the Class Period were true and devoid of any omissions of material fact.

189. By reason of the wrongful conduct alleged herein, each of the HFS Individual Defendants named in this Count is liable jointly and severally with and to the same extent that Cendant is liable to plaintiffs and the members of the Class as a result of the wrongful conduct alleged herein pursuant to Section 20(a) of the Exchange Act. As a direct and proximate result of their wrongful conduct, plaintiffs and the other members of the Class suffered damages in connection

with their purchases of Cendant publicly traded securities during the period since the Merger until the end of the Class Period.

COUNT XIII

Against the Defendants Named in This Count for
<u>Violations of Section 20A of the Exchange Act</u>

190. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This claim is asserted against defendants Walter Forbes, Shelton, McLeod, Corigliano, Silverman, Snodgrass and Buckman (the "Insider Trading Defendants") for violations of Section 20A of the Exchange Act, 15 U.S.C. § 78t-1, by plaintiffs CalPERS, the NYSCRF, the NYCTRS, the NYCPDPF, NYCERS, the NYCFDPF, the NYCBERS, the NYCPOVSF, the NYCFOVSF, Dr. Leonard B. Zaslow, Hamid Chalhoub, Patrick A. and Julia A. Sherlock and Jim Perkins on behalf of all persons who purchased CUC and Cendant common stock contemporaneously with the sale of CUC and Cendant common stock by those Insider Trading Defendants and who were damaged thereby.

191. During the Class Period, the Insider Trading Defendants occupied a position with CUC and Cendant that made them privy to confidential information concerning CUC and Cendant, as well as CUC's and Cendant's operations, finances, financial condition and future business prospects, including, but not limited to, the materially false and misleading financial statements disseminated to the investing public. Notwithstanding their duty to refrain from trading in CUC and Cendant common stock unless they disclosed the foregoing material adverse facts, and in violation of their fiduciary duties to plaintiffs and other members of the Class, during the Class Period those Insider Trading Defendants sold their CUC and Cendant common stock for hundreds of millions of

dollars contemporaneously with plaintiffs' and other Class members' purchases of CUC and Cendant common stock, as detailed in Schedules A-C attached hereto.

192. The Insider Trading Defendants sold their shares of CUC and Cendant common stock, as alleged above, at market prices artificially inflated by the nondisclosures and misrepresentations of material adverse facts in the financial statements and other public statements released during the Class Period.

193. The Insider Trading Defendants knew that they were in possession of material adverse information that was not known to the investing public, including plaintiffs and other members of the Class. Before selling their stock to the public, they were obligated to disclose the information to plaintiffs and other members of the Class.

194. By reason of the foregoing, the Insider Trading Defendants, directly and indirectly, by use of the means of instrumentalities of interstate commerce, the mails, and the facilities of a national securities exchange, employed devices, schemes, and artifices to defraud, and engaged in acts and transactions and a course of business which operated as a fraud or deceit upon members of the investing public who purchased CUC and Cendant common stock contemporaneously with the sale of such stock by the Insider Trading Defendants.

195. This action was commenced within five years after the sales by the Insider Trading Defendants while in possession of material, non-public information.

196. As a result of the foregoing, plaintiffs referred to in this Court and the other members of the Class who purchased CUC or Cendant common stock contemporaneously with the sales of CUC or Cendant common stock by the Insider Trading Defendants have suffered substantial

damages that are appropriately measured by the amount of profits gained or losses not incurred by reason of the Insider Trading Defendants' stock sales.

COUNT XIV

Against Cendant, the HFS individual Defendants Except Scott Forbes, and the CUC Individual Defendants except Pember for Violations of Section 14(a) of the Exchange Act and <u>Rule 14a-9 Promulgated Thereunder</u>

197. Plaintiffs repeat and reallege each of the allegations set forth in the foregoing paragraphs, as if fully set forth here. This Count is asserted against Cendant, the HFS Individual Defendants except Scott Forbes, and the CUC Individual Defendants except Pember for violations of Section 14(a) of the Exchange Act, 15 U.S.C. § 78n, and Rule 14a-9, 17 C.F.R. § 240.14a-9, promulgated thereunder, on behalf of all HFS shareholders who exchanged their HFS common stock for CUC common stock pursuant to the Joint Proxy Statement/Prospectus.

198. The Joint Proxy Statement/Prospectus was a "proxy solicitation" within the meaning of Section 14 of the Exchange Act, and Rule 14a-9 promulgated thereunder.

199. The information contained in the Joint Proxy Statement/Prospectus was materially misleading in that it materially misstated CUC's financial results throughout the Class Period, CUC's compliance with the Merger Agreement, and the substantive financial due diligence performed by HFS in connection with the Merger.

200. HFS shareholders, on the basis of the materially false and misleading information contained in the Joint Proxy Statement/Prospectus, approved the Merger. Had the true facts been known, such approval would not have been obtained or, at a minimum, the Exchange Ratio would have been materially different.

201. Cendant, the HFS Individual Defendants named in this Count and the CUC Individual Defendants named in this Count knew, at the time they issued, or caused HFS and CUC to issue, the Joint Proxy Statement/Prospectus, that it was materially false and misleading, or acted recklessly or negligently in distributing, or causing HFS and CUC to distribute, the Joint Proxy Statement/Prospectus containing the false and misleading statements and omissions. Plaintiffs and the members of Class who exchanged their HFS common stock for CUC common stock to the Joint Proxy Statement/Prospectus, in the exercise of due diligence, could not have learned of the true facts, but instead relied to their detriment on the false information contained in the Joint Proxy Statement/Prospectus when making their investment decision and casting their votes.

202. By virtue of the foregoing, plaintiffs and the members of Class who exchanged their HFS common stock for CUC common stock pursuant to the Joint Proxy Statement/Prospectus have been damaged by the wrongful conduct of Cendant, the HFS Individual Defendants named in this Count and the CUC Individual Defendants named in this Count.

PRAYER FOR RELIEF

WHEREFORE, plaintiffs, on behalf of themselves and the other members of the Class, pray for judgment as follows:

1. Declaring this action to be a proper class action maintainable pursuant to Rule 23 of the Federal Rules of Civil Procedure and declaring Lead Plaintiffs to be proper Class representatives;

2. Awarding plaintiffs and the other members of the Class rescissory and compensatory damages as a result of the wrongs alleged in Count V of the Complaint;

3. Awarding plaintiffs and the other members of the Class compensatory damages as a result of the wrongs alleged in Counts I - IV and VI - XIII of the Complaint;

4. Awarding plaintiffs and the other members of the Class rescissory, restitutionary and/or compensatory damages as a result of the wrongs alleged in Count XIV of the Complaint, including, without limitation, redetermination of the Exchange Ratio;

5. Awarding plaintiffs and the other members of the Class their costs and expenses in this litigation, including reasonable attorneys' fees and experts' fees and other costs and disbursements; and

6. Awarding plaintiffs and the other members of the Class such other and further relief as the Court may deem just and proper.

JURY TRIAL DEMANDED

Plaintiffs demand a trial by jury of all issues so triable.

Dated: December 14, 1998

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