

UNITED STATES DISTRICT COURT
DISTRICT OF CONNECTICUT

UNITED STATES OF AMERICA : No. 3:02CR00264 (AWT)
: :
: VIOLATIONS:
: :
v. : 18 U.S.C. § 371 (Conspiracy)
: 18 U.S.C. § 1341 (Mail Fraud)
: 18 U.S.C. § 1343 (Wire Fraud)
: 15 U.S.C. §§ 78j(b) & 78ff
: 17 C.F.R. § 240.10b-5
WALTER A. FORBES and : (Securities Fraud/False
E. KIRK SHELTON : Statements to SEC)

SUPERSEDING INDICTMENT

The Grand Jury charges that:

COUNT 1

(Conspiracy to Commit Securities Fraud, Mail Fraud, Wire Fraud and to Make False Statements in Reports Required to Be Filed with the SEC)

BACKGROUND

CUC

1. Prior to December 17, 1997:

a. CUC International, Inc. ("CUC") was a publicly held corporation with headquarters in Stamford, Connecticut; and

b. CUC's principal business was selling memberships in its buying clubs, which included programs for home shoppers, travelers, restaurant patrons, and automobile purchasers, among others. CUC marketed these membership programs primarily through its Comp-U-Card Division ("Comp-U-Card"), its largest business unit, which maintained separate offices in

Trumbull, Connecticut.

2. In or about 1983, CUC, then known as Comp-U-Card International, Inc., conducted an initial public offering of its stock. Its stock was then traded on the over-the-counter market. On or about August 23, 1989, CUC stock was listed for trading on the New York Stock Exchange.

3. From at least as early as the mid-1980's, CUC pursued a strategy of fueling its growth with frequent acquisitions. From in or about the mid-1980's to in or about 1997, CUC purchased more than 25 other companies, which it then either operated as subsidiaries or consolidated with its existing businesses. In most of these cases, CUC paid at least a substantial part of the purchase price with CUC stock.

4. In 1996, CUC made the three largest acquisitions in its history. In July 1996, it acquired two software publishers, Davidson & Associates, Inc. ("Davidson") and Sierra On-Line, Inc. ("Sierra"), for a total of approximately \$1.858 billion. In August 1996, it acquired Ideon Group, Inc. ("Ideon"), a provider of credit card enhancement packages, for approximately \$393 million. CUC paid for all three purchases with CUC stock.

The Formation of Cendant

5. Prior to December 17, 1997, HFS, Inc. ("HFS") was a publicly-held corporation with headquarters in Parsippany, New Jersey. Its principal business was the franchising of brand-name

hotels, rental car agencies, and real estate brokerage offices.

6. In or about May 1997, CUC and HFS agreed to merge into a single company. The merger was approved by the shareholders of CUC and HFS on or about October 1, 1997 and became effective on December 17, 1997. The resulting new company adopted the name Cendant Corporation ("Cendant"). Cendant established its headquarters in Parsippany, New Jersey.

7. After the Cendant merger became effective, the former CUC businesses continued to be grouped together for management purposes within Cendant under the name Cendant Membership Services, Inc. ("CMS"). CMS maintained its headquarters, including its own separate accounting unit, in the former CUC offices in Stamford, Connecticut.

8. Before the Cendant merger, CUC's fiscal year ended on January 31. After the merger, Cendant adopted a fiscal year ending December 31.

The Defendants

9. From at least as early as in or about 1980 to in or about December 1997, defendant **WALTER A. FORBES**, who received a Master in Business Administration degree from Harvard University in 1968, was employed as the Chief Executive Officer of CUC. From in or about 1983 to in or about December 1997, defendant **FORBES** also served as the Chairman of CUC's Board of Directors. From on or about December 17, 1997 to in or about July 1998, he

held the title of Chairman of the Board of Cendant.

10. From in or about 1981 to in or about 1991, defendant **E. KIRK SHELTON**, who received a Master in Business Administration degree with distinction from Harvard University in 1978, was employed in various senior executive positions at CUC. From in or about 1991 to in or about December 1997, defendant **SHELTON** was employed as CUC's President and Chief Operating Officer. From on or about December 17, 1997 to in or about April 1998, he held the title of Executive Vice President and Vice Chairman of Cendant.

Named Co-conspirators

11. Cosmo Corigliano, who is named as a co-conspirator but not as a defendant herein, was licensed as a Certified Public Accountant in or about 1983. From in or about 1983 to in or about December 1994, Corigliano was employed as the Controller of CUC. From in or about December 1994 to the day the Cendant merger became effective, he served as both CUC's Chief Financial Officer and a Senior Vice President. From on or about December 17, 1997 to in or about April 1998, he held the title of Executive Vice President of Cendant. Among other duties, he reported financial results for CMS for the year ending December 31, 1997 to Cendant's corporate headquarters.

12. Anne Pember, who is named as a co-conspirator but not as a defendant herein, was licensed as a Certified Public

Accountant in or about 1983. Pember was employed as Director of Accounting at Comp-U-Card from in or about 1989 to in or about June 1997 and as the Controller of CUC from in or about June 1997 until the Cendant merger on or about December 17, 1997. From in or about 1996 to on or about December 17, 1997, she also held the title of Senior Vice President of CUC. From on or about December 17, 1997 to in or about March 1998, Pember was employed in the accounting unit at CMS.

13. Before the Cendant merger became effective, Casper Sabatino, who is named as a co-conspirator but not as a defendant herein, was employed as an accountant in CUC's corporate accounting department from in or about 1985 to on or about December 17, 1997. From in or about December 1994 to in or about late 1997, Sabatino was the member of the department in charge of CUC's external reporting, including its quarterly and annual reports to the Securities & Exchange Commission ("SEC"). After the Cendant merger became effective, he was employed in the accounting unit at CMS.

The SEC and Publicly Held Companies

14. At all times relevant to this Indictment:

a. the SEC was an independent agency of the United States government which was charged by law with preserving honest and efficient markets in securities;

b. federal law required publicly held companies to

submit various reports containing detailed financial data to the SEC, including quarterly reports on Form 10-Q and annual reports on Form 10-K. Federal law required this data to be truthful and consistent with the underlying facts and further required the accounting treatments employed in these reports to be in accordance with generally accepted accounting principles ("GAAP"); and

c. federal law required all publicly held companies to undergo an annual audit by an independent accounting firm to ensure that its financial data was prepared and reported in accordance with GAAP.

Communications With Investors

15. At all times relevant to this Indictment, the management officials of many public companies, including CUC and Cendant, provided the investing public with predictions of, or "guidance" regarding, the anticipated earnings of the companies for upcoming reporting periods. Relying at least in part on a company's guidance, many professional securities analysts then disseminated to the public their own estimates of that company's expected performance. These earnings estimates or analyst expectations were closely followed by investors. Typically, if a company announced earnings that failed to meet or exceed analysts' expectations, the price of that company's securities declined.

16. In addition to the above, CUC and Cendant issued periodic reports of its financial performance to its shareholders and the investing public in the form of annual and quarterly reports and periodic press releases. Among the financial data CUC and Cendant included in these reports and releases was an earnings figure referred to at different times as "operating income" or "income before one-time charges" (hereafter "operating income"). In calculating operating income, CUC and Cendant regularly excluded non-recurring expenses, including merger costs, and often excluded the impact of taxes and interest. Operating income or similar figures were generally considered by securities analysts and the investing public to be a more accurate indicator of the company's performance than net income because these figures eliminated the impact of one-time, or unusual, events on a company's earnings, while net income included the impact of those events.

THE CONSPIRACY

17. From at least as early as the late 1980's to in or about April 1998, in the Districts of Connecticut and New Jersey, and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

did knowingly and willfully conspire and agree with Cosmo Corigliano, Anne Pember, Casper Sabatino and others to commit offenses against the United States, that is:

(a) by use of the means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges, directly and indirectly, knowingly and willfully to use and employ manipulative and deceptive devices and contrivances in contravention of Title 17, Code of Federal Regulations, Section 240.10b-5 ("Rule 10b-5") in connection with the purchase and sale of CUC and Cendant securities, by, in connection with such transactions, (i) employing devices, schemes, and artifices to defraud holders of CUC, HFS, and Cendant securities and other members of the investing public; (ii) making untrue statements of material facts and omitting to state material facts

necessary in order to make the statements made, in the light of the circumstances under which they which they were made, not misleading; and (iii) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit on holders of CUC, HFS, and Cendant securities and other members of the investing public, contrary to Title 15, United States Code, Sections 78j(b) and 78ff(a) and Rule 10b-5;

(b) to devise a scheme and artifice to defraud holders of CUC, HFS, and Cendant securities and other members of the investing public and to obtain money from those securities holders and members of the investing public by means of materially false pretenses, representations, and promises, and to utilize the United States mails, private and commercial interstate carriers, and interstate wire communications for the purpose of executing that scheme and artifice, contrary to Title 18, United States Code, Sections 1341 and 1343; and

(c) willfully and knowingly to make, and cause to be made, in quarterly reports on Form 10-Q, annual reports on Form 10-K, and other reports and documents filed with the SEC by CUC and Cendant pursuant to the Securities Exchange Act of 1934, Title 15, United States Code, Sections 78a et seq., statements which were false and misleading with respect to material facts, contrary to Title 15, United States Code, Section 78ff(a).

The Principal Goals of the Conspiracy
and the Role of The Defendants

18. The principal goals of the conspiracy were: a) to fraudulently inflate the earnings CUC reported to the SEC and the investing public in order to artificially increase the price of CUC stock; b) to fraudulently inflate the earnings of CMS, which fraudulently inflated earnings Cendant reported to the SEC and the investing public, and thereby artificially increased the price of Cendant stock; c) to use CUC stock, the price of which had been artificially increased, to pay for CUC's acquisition of other companies; d) to use the artificially increased price of CUC stock, CUC's fraudulently inflated earnings reports, and fraudulently inflated projections of CUC's future earnings to induce HFS and its shareholders to merge with CUC; and e) for defendants **WALTER A. FORBES** and **E. KIRK SHELTON** to personally

enrich themselves through salary, bonuses, stock options and capital appreciation of shares they held.

19. Defendants **WALTER A. FORBES** and **E. KIRK SHELTON**, who were principal officers and directors of CUC and Cendant, engaged in the conspiracy with the assistance of co-conspirators who were their corporate subordinates.

The Conspirators' Execution of Their Fraudulent Scheme

20. From at least as early as in or about the late 1980's to in or about 1997, defendants **WALTER A. FORBES** and **E. KIRK SHELTON**, along with other members of the conspiracy, sought to support and increase the price of CUC stock by causing CUC to misrepresent the true growth rate of the company to the SEC and the investing public.

21. From at least as early as in or about the late 1980's to in or about 1997, defendants **WALTER A. FORBES** and **E. KIRK SHELTON**, along with other members of the conspiracy, acted to ensure that the earnings CUC reported each quarter closely matched the results predicted by Wall Street stock analysts, for fear that any shortfall could trigger a decline in the price of CUC stock.

22. To ensure that the earnings CUC reported would meet the expectations of analysts, defendant **WALTER A. FORBES**, along with co-conspirator Cosmo Corigliano, kept members of the analyst community well informed as to the amount of growth in

earnings CUC was targeting.

The Conspirators' Inflation of Reported
Earnings to Meet Their Targets

23. At the end of the first three quarters of each fiscal year, each of CUC's operating units reported its quarterly earnings figures to the company's Stamford headquarters. These earnings figures were consolidated into one earnings figure for the company. These earnings from the operating units' books had typically been inflated by the methods described in paragraphs 44 through 53 below.

24. After the earnings for the operating units were consolidated into one quarterly earnings figure for CUC, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and other conspirators reviewed that figure to determine whether it met their earnings target for the quarter. If the consolidated quarterly earnings failed to meet the earnings target, defendants **FORBES** and **SHELTON** directed other conspirators to increase the earnings figure so that it met or exceeded that target.

25. These increases had no basis in fact. The purpose of these increases was to meet or exceed CUC's quarterly earnings target. After CUC's quarterly earnings figure was fraudulently increased in this manner, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators caused the fraudulently increased quarterly earnings figure to be reported to the SEC and the investing public.

The Fraudulent Methods Used by the Conspirators to
Cover Up Their Inflation of CUC's and Cendant's Earnings

26. Because CUC's independent accounting firm audited the company's books only at the end of each fiscal year, the conspirators typically found it unnecessary to make detailed entries on the company's books at the end of the first three quarters of the fiscal year to cover up their fraudulent inflation of the company's consolidated quarterly earnings figures. As a result, the conspirators typically changed only the consolidated quarterly earnings figure at the end of the first three fiscal quarters.

27. At the end of the fourth fiscal quarter, which was also the end of the fiscal year, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** directed other conspirators to increase the consolidated earnings figures for that quarter and the fiscal year by the amounts necessary to meet or exceed their respective earnings targets for that quarter and fiscal year. Defendants **FORBES** and **SHELTON** and their co-conspirators caused these fraudulently inflated earnings figures to be reported to the SEC and the investing public.

28. In order to permit CUC to withstand the scrutiny of its required annual audit, the conspirators caused fraudulent entries to be made to CUC's books and knowingly failed to make accurate entries to CUC's books that would negatively impact CUC's earnings. These fraudulent entries and failures to make

accurate entries were designed to support all fraudulent increases in earnings that the conspirators had made during the past fiscal year.

29. In order to disguise their fraudulent inflation of CUC's earnings, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their conspirators used fraudulent accounting machinations, including: a) using merger reserves to inflate operating income, as described in paragraphs 30 through 43 below; b) failing to maintain an adequate membership cancellation reserve at Comp-U-Card, as described in paragraphs 44 through 48 below; c) misallocating revenues and expenses among Comp-U-Card programs so as to qualify them for more favorable accounting treatment, as described in paragraphs 49 through 53 below; d) making various other fraudulent accounting entries, as described in paragraphs 54 through 59 below; and e) falsely representing to the SEC and the investing public that the company was following its publicly declared accounting policies.

Merger Reserves

30. From at least as early as the late 1980's to in or about 1998, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators established excessive merger reserves and then drew upon them to fraudulently inflate the reported operating income of CUC and Cendant.

31. Acquisition and merger reserves ("merger

reserves") were permitted by GAAP as a means of accounting for one-time expenses arising from an acquisition or a merger. These one-time expenses included professional fees, employee severance or relocation costs, and the costs of consolidating operations.

32. Under GAAP, a company engaged in an acquisition or merger could establish a merger reserve in the year the acquisition or merger took place. Once a company's managers made a good faith estimate of the total of the one-time costs arising from an acquisition or merger, they created a merger reserve in that amount. Generally, the creation of a merger reserve reduced the company's net income for that year, but not its operating income.

33. After the establishment of the merger reserve, one-time costs resulting from the merger were deducted from the merger reserve rather than current income, in contrast to expenses arising from the normal operation of the company that directly reduced income. GAAP did not permit companies to establish excessive merger reserves that were not based on good-faith estimates of the costs of the merger or acquisition and further did not allow companies to use merger reserves to offset normal expenses not related to the merger or acquisition. The use of merger reserves to increase revenue was also not permitted under GAAP.

CUC's Acquisition of Ideon,
Davidson, and Sierra

34. CUC acquired Ideon, Davidson and Sierra in 1996 as described in paragraph 4 above. During CUC's fiscal year ending January 31, 1997, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators caused CUC to establish a merger reserve of approximately \$127 million to pay expenses arising from CUC's acquisition of Ideon, and additional merger reserves totaling approximately \$53 million to pay expenses arising from CUC's acquisition of Davidson, Sierra, and other, smaller companies. All these reserves together, totaling approximately \$180 million, were known at CUC, and are hereafter collectively referred to, as the "Ideon reserve."

35. The conspirators falsely represented, and caused CUC to falsely represent, to the SEC and the investing public that the size of the Ideon reserve was based on CUC's good-faith estimate of the probable amount of such acquisition-related costs. In fact, the conspirators knew that they had fraudulently included tens of millions of dollars in the Ideon reserve in excess of that amount.

36. The conspirators caused CUC and Cendant to falsely represent to the SEC and the investing public that expenses charged to the Ideon reserve were non-recurring costs incurred principally in connection with the acquisitions of Ideon, Davidson and Sierra.

The Cendant Merger

37. In or about early 1997, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators caused CUC to merge with HFS to form Cendant. To induce HFS and its shareholders to agree to the merger, the conspirators referred HFS and its shareholders to CUC's fraudulently inflated earnings reports and provided them with projections of CUC's future earnings which they had fraudulently inflated beyond their actual expectations.

38. On or about December 17, 1997, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators caused CMS to establish a merger reserve of approximately \$556 million (the "Cendant reserve") to pay costs arising from CUC's merger with HFS and its acquisition of another company.

39. The conspirators falsely represented, and caused Cendant to falsely represent, to the SEC and the investing public that the size of the Cendant reserve was based on their good-faith estimate of the probable amount of such merger related expenses. In fact, the conspirators knew that they had intentionally included more than \$200 million in the Cendant reserve in excess of that amount.

40. The conspirators caused Cendant to falsely represent to the SEC and the investing public that expenses charged to the Cendant reserve were non-recurring costs incurred

principally in connection with the merger with HFS.

Fraudulent Use of Merger Reserves

41. Defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators fraudulently charged expenses not related to the mergers described above against the excess funds in the Ideon and Cendant reserves so that those expenses would not reduce operating income below target levels. Defendants **FORBES** and **SHELTON** and their co-conspirators also fraudulently credited a portion of the excess funds in the Ideon and Cendant reserves directly to revenue.

42. As the defendants and their co-conspirators knew, there was no justification in fact, or under GAAP, for this treatment of the merger reserves. The defendants and their co-conspirators caused these fraudulent accounting treatments to be used while knowing and intending that: a) they would ultimately be reflected in CUC's and Cendant's financial statements and public filings with the SEC; b) CUC's and Cendant's financial statements and public filings would falsely overstate CUC's and Cendant's operating income; and c) the investing public would rely upon such overstated operating income.

43. By the above means, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators fraudulently caused: a) the operating income CUC reported for many of its fiscal years from in or about the late 1980's through January 31,

1995 to be overstated by millions of dollars; b) the operating income CUC reported for its fiscal year ending January 31, 1996 to be overstated by approximately \$10 million; c) the operating income CUC reported for its fiscal year ending January 31, 1997 to be overstated by approximately \$23 million; and d) the CMS operating income that Cendant reported for its fiscal year ending December 31, 1997 to be overstated by at least \$110 million. In addition, defendants **FORBES** and **SHELTON** and their co-conspirators took steps to similarly draw on the Cendant reserve to meet their target for the CMS operating income to be reported in the fiscal year ending December 31, 1998.

Underfunding of the Company's Membership Cancellation Reserve

44. Members of CUC's and Cendant's buying and other clubs were required to pay their membership fees in full upon joining the clubs or upon renewal of their memberships. Some members subsequently canceled their memberships and obtained refunds, while other members failed to pay their membership fees upon renewal.

45. Defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators represented to the SEC and the investing public that CUC and Cendant placed a portion of the membership fees received into a membership cancellation reserve to allow both for cancellations and refunds and for the failure of some members to pay membership fees upon renewal. The

conspirators were able to estimate from CUC's and Cendant's experience how many members would cancel or fail to pay their membership fees upon renewal each year. The conspirators represented that the amount of membership fees placed into the membership cancellation reserve was sufficient, based on their experience, to cover what they called "estimated cancellations."

46. Rather than follow the stated practice, from at least the late 1980's to in or about 1998, the conspirators intentionally underfunded this membership cancellation reserve, thereby fraudulently increasing earnings.

47. As the defendants knew, there was no justification in fact, or under GAAP, for their treatment of this membership cancellation reserve. By failing to set aside sufficient amounts of membership fees in the membership cancellation reserve, the defendants and their co-conspirators knew and intended that: a) their fraudulent treatment of the membership cancellation reserve would ultimately be reflected in CUC's and Cendant's financial statements and public filings with the SEC; b) CUC's and Cendant's financial statements and public filings would falsely overstate CUC's and Cendant's earnings; and c) the investing public would rely upon such overstated earnings.

48. By failing to set aside sufficient amounts of membership fees in the membership cancellation reserve, the conspirators fraudulently caused: a) the earnings CUC reported

for each of its fiscal years from in or about the late 1980's through January 31, 1995 to be overstated by millions of dollars; b) the earnings CUC reported for its fiscal years ending January 31, 1996 and January 31, 1997 to be overstated by approximately \$48 million and \$19 million, respectively; and c) the earnings Cendant reported for its fiscal year ending December 31, 1997 to be overstated by approximately \$12 million.

Misallocation of Comp-U-Card Program Revenues and Expenses

49. From at least as early as the late 1980's to in or about 1998, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators inflated CUC's and Cendant's reported earnings by falsely attributing revenues and expenses that had arisen from certain membership programs to other membership programs that qualified for more favorable accounting treatment.

50. CUC immediately recognized membership fees as revenue in some membership programs (the "immediate recognition programs"). In other membership programs, CUC was required to recognize membership fees as revenue on a pro-rated basis over the life of the membership (the "deferred recognition programs"). The company disclosed to the SEC and the investing public that it recognized membership fees as revenue it received on a pro-rated basis over the "average membership period," which it represented to be "generally one to three years." CUC also disclosed that it recognized expenses incurred by a particular program over

approximately the same period of time that it recognized the revenue from that program.

51. However, from at least as early as the late 1980's, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators deliberately misallocated revenue generated from deferred recognition programs to immediate recognition programs. As a result, the conspirators fraudulently accelerated Comp-U-Card's recognition of that revenue in a manner contrary to CUC's stated policy. In addition, on at least one occasion during this period, the conspirators deliberately misallocated expenses from a program in which expenses would have been recognized immediately to another program in which expenses were to be recognized over a one-year period. By this action, the conspirators fraudulently decelerated Comp-U-Card's expense recognition in a manner contrary to CUC's stated policy. By increasing revenue and decreasing expenses in this manner, the defendants and their co-conspirators fraudulently inflated earnings.

52. As the defendants knew, there was no justification in fact or under GAAP for the misallocations set forth in paragraph 51. The defendants and their co-conspirators made these misallocations knowing and intending that: a) the misallocations would ultimately be reflected in CUC's and Cendant's financial statements and public filings with the SEC;

b) CUC's and Cendant's financial statements and public filings would falsely overstate CUC's and Cendant's earnings; and c) the investing public would rely upon such overstated earnings.

53. By the actions set forth in paragraph 51, the defendants and their co-conspirators fraudulently caused: a) the earnings CUC reported for each of its fiscal years from in or about the late 1980's through January 31, 1996 to be overstated by millions of dollars; b) the earnings CUC reported for its fiscal year ending January 31, 1997 to be overstated by approximately \$10 million; and c) the earnings Cendant reported for its fiscal year ending December 31, 1997 to be overstated by approximately \$17 million.

Other Fraudulent Accounting Entries

54. From at least as early as the late 1980's to in or about 1998, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators fraudulently inflated the reported earnings of CUC and Cendant by knowingly causing CUC and CMS to make a variety of other fraudulent accounting entries, including those set forth in paragraphs 55 through 58 below.

55. From in or about the late 1980's to in or about early 1996, the conspirators routinely manipulated some standard calculations of membership solicitation costs so as to fraudulently reduce the expenses recognized by CUC. By so doing, the conspirators fraudulently caused the earnings CUC reported

for many of its fiscal years from in or about the late 1980's through January 31, 1997 to be overstated by millions of dollars.

56. At various times, including in or about early 1997, the conspirators caused CUC to arbitrarily reduce the liability for commission expenses arising from the solicitation of new members that Comp-U-Card carried on its books. The reduced liability was credited directly to revenue or against operating expenses. By so doing, the conspirators fraudulently caused the earnings CUC reported for its fiscal year ending January 31, 1997 to be overstated by at least approximately \$4.5 million.

57. In or about January 1998, the conspirators caused Sierra retroactively to credit approximately \$2.6 million to revenue on the basis of an unsubstantiated entry in Sierra's books indicating that the company might receive an unspecified future tax benefit. By so doing, the conspirators fraudulently caused the earnings Cendant reported for its fiscal year ending December 31, 1997 to be overstated by approximately \$2.6 million.

58. The conspirators knew that January 1997 was the only month of CUC's fiscal year ending January 31, 1997 which was included in Cendant's fiscal year ending December 31, 1997. The conspirators deliberately credited approximately \$22 million which CUC had earned in the months prior to January 1997 to CUC's January 1997 earnings. The conspirators had already fraudulently

inflated CUC's January 1997 earnings in the previous year with approximately \$11 million which they had drawn from merger reserves as set forth in paragraph 43 above. Therefore, by inflating CUC's earnings for January 1997 as described in this paragraph, the conspirators fraudulently caused the earnings Cendant reported for its fiscal year ending December 31, 1997 to be overstated by approximately \$33 million.

59. As the defendants knew, there was no justification in fact, or under GAAP, for the fraudulent acts set forth in paragraphs 55 through 58. The defendants and their co-conspirators committed these acts knowing and intending that: a) that these fraudulent acts would ultimately be reflected in CUC's and Cendant's financial statements and public filings with the SEC; b) CUC's and Cendant's financial statements and public filings would falsely overstate CUC's and Cendant's earnings; and c) the investing public would rely upon such overstated earnings.

The Impact on Earnings Reports of CUC and Cendant and
The Losses to Holders of Cendant Securities

60. By the means set forth above, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators fraudulently caused CUC and Cendant to misreport their earnings as set forth below:

a. The conspirators caused CUC to report operating income for its fiscal year ending January 31, 1996 which was overstated, in all, by at least \$60 million, or more than 28

percent. The conspirators thus caused CUC to report earnings per share for that year before one-time expenses of \$.86, when the true figure was no more than \$.67;

b. The conspirators caused CUC to report operating income for its fiscal year ending January 31, 1997 which was overstated, in all, by at least \$56 million, or more than 14 percent. The conspirators thus caused CUC to report earnings per share for that year before one-time expenses of \$.70, when the true figure was no more than \$.61; and

c. The conspirators caused Cendant to report operating income for its fiscal year ending December 31, 1997 which was overstated by at least \$170 million, which was more than 12 percent of Cendant's total operating income and more than 36 percent of the CMS operating income. The conspirators thus caused Cendant to report earnings per share for that year before one-time expenses of \$1.00, when the true figure was no more than \$.88.

61. By causing CUC to report such rapid and consistent growth in operating income, the conspirators helped cause the price of CUC stock to rise from approximately \$1.56 on August 23, 1989 to approximately \$32.13 on December 17, 1997. (The price on August 23, 1989, the first day CUC stock was traded on the New York Stock Exchange, has been adjusted to reflect stock splits between that date and December 17, 1997.) This increase in the

stock price from 1989 through 1997 helped the conspirators to continue making new acquisitions, since such acquisitions could largely be paid for with stock.

62. By the above means, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators caused holders of Cendant securities to sustain billions of dollars in losses after the fraudulent inflation of Cendant's reported earnings for the year ending December 31, 1997 was disclosed to the public on or about April 15, 1998.

Overt Acts

63. In furtherance of the conspiracy and to accomplish its unlawful objects, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and their co-conspirators committed and caused to be committed the following overt acts in the District of Connecticut, the District of New Jersey, and elsewhere:

a. On or about March 19, 1996, at Stamford, Connecticut, defendants **FORBES** and **SHELTON** and their co-conspirators caused CUC to issue a press release announcing its earnings for the fiscal year ending January 31, 1996 in which those earnings were overstated as set forth in paragraph 60(a) above.

b. On or about April 25, 1996, at Stamford, Connecticut, defendants **FORBES** and **SHELTON** and their co-conspirators caused CUC to file with the SEC an annual report on

Form 10-K for the fiscal year ending January 31, 1996 in which CUC's operating income for that year was overstated by at least \$60 million, or more than 28 percent.

c. On or about March 11, 1997, at Stamford, Connecticut, defendants **FORBES** and **SHELTON** and their co-conspirators caused CUC to issue a press release announcing its earnings for the fiscal year ending January 31, 1997 in which those earnings were overstated as set forth in paragraph 60(b) above.

d. On or about May 1, 1997, at Stamford, Connecticut, defendants **FORBES** and **SHELTON** and their co-conspirators caused CUC to file with the SEC an annual report on Form 10-K for the fiscal year ending January 31, 1997 in which CUC's operating income for that year was overstated by at least \$56 million, or more than 14 percent.

e. On or about December 15, 1997, defendants **FORBES** and **SHELTON** and their co-conspirators caused CUC to file with the SEC CUC's quarterly report on Form 10-Q for the third fiscal quarter ending October 31, 1997 which contained the false statements set forth in paragraph 2(a) through 2(h) of Count 5 of this Indictment.

f. In or about January 1998, defendant **SHELTON** reviewed a budget schedule for the period ending December 31, 1998 that described the manner in which operating income would be

increased by \$110 million by transfers from "reserves to revenue" and noted that "reserves are being managed to meet quarterly targets."

g. In or about January 1998, defendant **SHELTON** approved the release of the fraudulently inflated operating income figure contained in the schedule described in paragraph 63(f) to Cendant's corporate headquarters in New Jersey.

h. In or about January 1998, defendant **SHELTON** destroyed the schedule described in paragraph 63(f) by ripping it into small pieces and then discarding the remains.

i. On or about January 14, 1998, Anne Pember informed defendant **SHELTON** via electronic mail that the year end consolidation of CMS' results was nearly complete with the exception of the "reserve" adjustments.

j. On or about January 20, 1998, Anne Pember sent defendant **SHELTON** an electronic mail message that informed defendant **SHELTON** that the results for CMS' software division had been increased in order to "make" the year. The message also proposed explanations that defendant **SHELTON** could use to continue concealing the fraud from Cendant corporate officials in New Jersey.

k. On or about January 21, 1998, Anne Pember sent CMS' financial data to corporate headquarters in New Jersey and to defendant **SHELTON**. This message contained the same financial

data as the message described in paragraph 63(j) but omitted text and data concerning the true performance of CMS and falsely reported that CMS' software division "came in better than expected as compared to forecast."

l. On or about February 2, 1998, at Stamford, Connecticut, defendants **FORBES** and **SHELTON** and their co-conspirators caused the CMS accounting unit to transmit by facsimile to Cendant headquarters in Parsippany, New Jersey a schedule of the CMS earnings which were to be included in the reported earnings of Cendant for the fiscal year ending December 31, 1997. The schedule overstated the revenue of CMS for the year ending December 31, 1997 by approximately \$139 million.

m. On or about February 4, 1998, at Parsippany, New Jersey, defendants **FORBES** and **SHELTON** and their co-conspirators caused Cendant to issue a press release announcing its earnings for the fiscal year ending December 31, 1997 in which Cendant's results were overstated as set forth in paragraph 60(c) above.

n. On or about March 31, 1998, at Parsippany, New Jersey, defendants **FORBES** and **SHELTON** and their co-conspirators caused Cendant to distribute to Cendant's shareholders and the investing public Cendant's 1997 Annual Report for the fiscal year ending December 31, 1997 in which Cendant's operating income for that year was overstated by at least \$170 million, or more than

12 percent.

o. On or about March 31, 1998, at Parsippany, New Jersey, defendants **FORBES** and **SHELTON** and their co-conspirators caused Cendant to file with the SEC Cendant's annual report on Form 10-K for the year ending December 31, 1997 which contained the false statements set forth in paragraph 2(a) through 2(b) of Count 6 of this Indictment.

All in violation of Title 18, United States Code, Section 371.

COUNT 2

(Mail Fraud)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 of this Indictment are hereby realleged and incorporated as though set forth in full herein.

2. From at least as early as the late 1980's to in or about April 1998, in the District of New Jersey and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

did knowingly and willfully devise and intend to devise a scheme and artifice to defraud holders of CUC, HFS and Cendant securities and to obtain money from those securities holders by means of materially false and fraudulent pretenses, representations and promises, which scheme and artifice was in substance as set forth in paragraphs 18 through 63 of Count 1 of this Indictment.

3. On or about September 16, 1996, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and others caused CUC to file with the SEC a quarterly report on Form 10-Q for the second quarter of CUC's 1997 fiscal year, which ended on July 31, 1996. That quarterly report set forth an income figure indicating that CUC had earned \$.24 per share during the quarter before one-time expenses. However, as defendants **FORBES** and **SHELTON** knew, that income figure was substantially inflated and had not been arrived

at through legitimate accounting procedures or in accordance with GAAP, but had instead been arbitrarily inserted in the quarterly report to meet a quarterly earnings target as set forth in paragraphs 23 through 27 of Count 1 of this Indictment.

4. Prior to in or about 1997, each time CUC filed a quarterly report on Form 10-Q, it mailed to shareholders a summary of the financial data in the report accompanied by a message to shareholders from the company's Chief Executive Officer and Board Chairman, defendant **FORBES**.

5. In or about September 1996, for the purpose of executing the above scheme and artifice and attempting to do so, at Morristown, in the District of New Jersey and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

knowingly and willfully caused to be delivered by mail according to the direction thereon an envelope addressed to N.S., a CUC shareholder, in Morristown, New Jersey, which contained a summary of the financial data set forth in the quarterly report referred to in paragraph 3 of this Count accompanied by a message from defendant **FORBES** in which he falsely stated that CUC had earned \$.24 per share before one-time expenses in the quarter.

In violation of Title 18, United States Code, Sections 1341 and 2.

COUNT 3

(Mail Fraud)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 and paragraph 2 of Count 2 of this Indictment are hereby realleged and incorporated as though set forth in full herein.

2. On or about June 16, 1997, defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and others caused CUC to file with the SEC a quarterly report on Form 10-Q for the first quarter of CUC's 1998 fiscal year, which ended on April 30, 1997. That quarterly report stated that CUC had earned \$.17 per share during the quarter. However, as defendants **FORBES** and **SHELTON** knew, the figure of \$.17 per share was substantially inflated, was not based in fact, and had not been arrived at through legitimate accounting procedures or in accordance with GAAP, but had instead been arbitrarily inserted in the quarterly report to meet a quarterly earnings target as set forth in paragraphs 23 through 27 of Count 1 of this Indictment.

3. On or about August 28, 1997, the Boards of Directors of HFS and CUC issued a joint proxy statement to their shareholders soliciting their votes in favor of the merger of the two companies. That proxy statement set forth falsified earnings figures reflecting the overstated earnings that defendants **WALTER A. FORBES** and **E. KIRK SHELTON** and others had previously caused

CUC to report for its fiscal years ending January 31, 1996 and January 31, 1997 and the first quarter of its 1998 fiscal year which ended on April 30, 1997.

4. At all times relevant to this Count, the Division of Investment of the State of New Jersey Department of the Treasury (the "State Division of Investment") was an agency of the State of New Jersey with offices in Trenton which was charged with managing and investing a variety of State funds, including pension funds for firemen, teachers, and other public employees. From in or about 1996 to the date of the Cendant merger on December 17, 1997, the State Division of Investment was a shareholder in both HFS and CUC.

5. In or about September 1997, in its capacity as a shareholder of HFS, the State Division of Investment received a copy of the above joint HFS-CUC proxy statement by mail from its corporate proxy voting service in Edgewood, Long Island.

6. In or about September 1997, for the purpose of executing the above scheme and artifice and attempting to do so, at Trenton in the District of New Jersey and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

knowingly and willfully caused to be delivered by mail according to the direction thereon an envelope addressed to the State Division of Investment in Trenton, New Jersey which had been mailed by the Division's corporate proxy voting service in Edgewood, Long Island and which contained the copy of the joint HFS-CUC proxy statement referred to in paragraph 5 of this Count.

In violation of Title 18, United States Code, Sections 1341 and 2.

COUNT 4

(Wire Fraud)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 and paragraph 2 of Count 2 of this Indictment are hereby realleged and incorporated as though set forth in full herein.

2. On or about February 2, 1998, the CMS accounting unit in Stamford, Connecticut sent by fax to Cendant headquarters in Parsippany, New Jersey a schedule of the CMS earnings which were to be included in the reported earnings of Cendant for the fiscal year ending December 31, 1997. That schedule overstated the revenue of CMS for the year ending December 31, 1997 by approximately \$139 million.

3. On or about February 2, 1998, for the purpose of executing the above scheme and artifice, in the District of Connecticut and elsewhere, defendants

**WALTER A. FORBES and
E. KIRK SHELTON**

and others knowingly and willfully caused to be transmitted by means of wire communication in interstate commerce certain signs, signals, and sounds, in that they caused the above schedule of CMS' earnings for the year ended December 31, 1997 to be transmitted by fax from Stamford, Connecticut to Cendant's headquarters in Parsippany, New Jersey.

In violation of Title 18, United States Code, Sections 1343 and 2.

COUNT 5

(False Statement in Report
Required to Be Filed with the SEC)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 of this Indictment are hereby realleged and incorporated as though set forth in full herein.

2. On or about December 15, 1997, in the District of Connecticut, and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

knowingly and willfully made and caused to be made a statement in a report and document required to be filed under the Securities Exchange Act of 1934, Title 15, United States Code, Sections 78a et seq., and the rules and regulations promulgated thereunder, which was false and misleading with respect to material facts, in that the defendants filed and caused to be filed with the SEC CUC's quarterly report on Form 10-Q for the third fiscal quarter ending October 31, 1997, in which, as the defendants knew, CUC's filing had misstated the following:

a. For the three months ending October 31, 1997, total revenue was stated to be approximately \$775 million when, in fact, total revenue was approximately \$44 million less;

b. For the three months ending October 31, 1997, total expenses were stated to be approximately \$612 million when, in fact, total expenses were approximately \$9 million greater;

c. For the three months ending October 31, 1997, income before taxes was stated to be approximately \$163 million when, in fact, it was overstated by 48 per cent, or approximately \$53 million;

d. For the nine months ending October 31, 1997, total revenue was stated to be approximately \$2,168 million when, in fact, total revenue was approximately \$149 million less;

e. For the nine months ending October 31, 1997, total expenses were stated to be approximately \$1,735 million when, in fact, total expenses were approximately \$27 million greater;

f. For the nine months ending October 31, 1997, income before taxes was stated to be approximately \$433 million when, in fact, it was overstated by 68 per cent, or approximately \$176 million;

g. On October 31, 1997, current assets, primarily cash, were stated to be approximately \$2,117 million when, in fact, it was overstated by approximately \$124 million; and

h. On October 31, 1997, accounts payable and accrued expenses, were stated to be approximately \$464 million when, in fact, it was understated by approximately \$77 million.

In violation of Title 15, United States Code, Section 78ff(a) and Title 18, United States Code, Section 2.

COUNT 6

(False Statement in Report
Required to Be Filed with the SEC)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 of this Indictment are hereby realleged and incorporated as though set forth in full herein.

2. On or about March 31, 1998, in the District of Connecticut and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

knowingly and willfully made and caused to be made a statement in a report and document required to be filed under the Securities Exchange Act of 1934, Title 15, United States Code, Sections 78a et seq., and the rules and regulations promulgated thereunder, which was false and misleading with respect to material facts, in that the defendants filed and caused to be filed with the SEC Cendant's annual report on Form 10-K for its fiscal year ending December 31, 1997, in which, as the defendants knew, Cendant's filing had misstated the following:

a. Net revenues for the fiscal year ending December 31, 1997 was stated to be approximately \$5,315 million when, in fact, this amount was overstated by approximately \$139 million; and

b. Merger-related costs and other unusual charges for the fiscal year ending December 31, 1997 was stated to be

approximately \$1,148 million when, in fact, this amount was overstated by approximately \$200 million.

In violation of Title 15, United States Code, Section 78ff(a) and Title 18, United States Code, Section 2.

COUNTS 7 THROUGH 12

(Securities Fraud - Hartford Steam Boiler)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 of this Indictment are hereby realleged and incorporated as though set forth in full herein.

2. The Hartford Steam Boiler Inspection and Insurance Company ("Hartford Steam Boiler") was a public company based in Hartford, Connecticut that provided insurance to commercial clients. It maintained the Employees' Retirement Trust, a pension fund for its employees, that invested in various securities, including Cendant.

3. On or about the dates set forth below, in the District of Connecticut, and elsewhere, defendants

WALTER A. FORBES and
E. KIRK SHELTON

and others did willfully and knowingly, by the use of means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges, directly and indirectly use and employ manipulative and deceptive devices and contrivances in contravention of Title 17, Code of Federal Regulations, Section 240.10b-5 in connection with the purchases of Cendant common stock by the Hartford Steam Boiler Employees' Retirement Trust as set forth below, by, in connection with such transactions, (i) employing devices, schemes, and artifices to defraud; (ii) making untrue statements of material facts and

omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they which they were made, not misleading; and (iii) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit on the Hartford Steam Boiler Employees' Retirement Trust, all as set forth in substance in paragraphs 18 through 63 of Count 1 of this Indictment:

<u>COUNT</u>	<u>DATE</u>	<u>QUANTITY</u>
7	January 22, 1998	7500 shares
8	January 27, 1998	5000 shares
9	January 29, 1998	5000 shares
10	February 6, 1998	5000 shares
11	February 10, 1998	5000 shares
12	February 18, 1998	5000 shares

In violation of Title 15, United States Code, Sections 78j(b) and 78ff(a), Title 17, Code of Federal Regulations, Section 240.10b-5, and Title 18, United States Code, Section 2.

COUNTS 13 through 16

(Insider Trading)

1. The allegations set forth in paragraphs 1 through 16 and 18 through 63 of Count 1 of this Indictment are hereby realleged and incorporated as though set forth in full therein.

Cendant's Policies on Insider Trading

2. At times relevant to this Indictment, Cendant distributed memoranda advising its officers and employees, including defendant **WALTER A. FORBES**, of their responsibilities under the federal securities laws. For example, on or about January 14, 1998, Cendant's Senior Executive Vice President and General Counsel distributed a memorandum to all Cendant employees which summarized the legal prohibition against insider trading and advised the employees of the Cendant's policy on insider trading. This memorandum stated in relevant part:

TRADING IN CENDANT CORPORATION
AND OTHER RELATED SECURITIES

Federal laws and regulations prohibit purchases and sales of the Company's stock and other related securities (including cashless exercises under the Company's stock option plans and purchase and sales of stock in the Company's Benefit Plans) by directors, officers and employees on the basis of material information which is not generally available to the public. . . . To assure compliance with these laws, the following rules apply to directors, officers and employees of the Company (including employees of all Company subsidiaries):

1. *They shall not purchase or sell or otherwise trade in securities of the Company while in possession of material, non-public information about the Company.*

For purposes of this policy, the term "material information" means information as to which there is substantial likelihood that the information would be viewed by a reasonable investor as significantly altering the "total mix" of information available in making investment decisions.

"Non-public information" is information which has not become generally available to the investing public, through such channels as the Company's publications (e.g., press releases, Annual and Quarterly Reports to Stockholders, Proxy Statements, and SEC filings), news articles, stock analysts' reports and similar writings about the Company and subjects relating to its businesses.

. . .

The most dangerous time to engage in a purchase or sale of the Company's securities would be shortly in advance of the public release by the Company of important information, such as quarterly or year-end results or other important news. (The Company strongly discourages the sale of securities for five business days prior to an earnings release (or other material news release) until the day after the earnings are released. Directors and senior executives may not trade during these periods.) The safest time to engage in any purchase or sale of the Company's securities would be the period shortly following the release of such information (always assuming that the

employee, officer or director is not aware of other material information which has not been publicized).

The Unlawful Trading

3. As an officer and director of Cendant, defendant **WALTER A. FORBES** owed fiduciary and other duties to Cendant and its shareholders to abstain from trading in Cendant common stock while in possession of material non-public information concerning Cendant.

4. In breach of those duties and for his own personal benefit, defendant **WALTER A. FORBES** engaged in sales of Cendant shares with total proceeds of approximately \$11.3 million as specified below while in possession of the material non-public information that the earnings of CUC and Cendant had been fraudulently inflated in the manner described in paragraphs 18 through 63 of Count 1 of this Indictment.

5. On or about the dates specified below, in the District of Connecticut and elsewhere, defendant

WALTER A. FORBES

did willfully and knowingly, by the use of means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges, directly and indirectly use and employ manipulative and deceptive devices and contrivances in contravention of Title 17, Code of Federal Regulations,

Section 240.10b-5 in connection with the sale of Cendant common stock, by, in connection with such transactions, (i) employing devices, schemes, and artifices to defraud holders of Cendant securities and other members of the investing public; (ii) making untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they which they were made, not misleading; and (iii) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit on holders of Cendant securities and other members of the investing public, in connection with the sales of Cendant common stock specified below:

<u>COUNT</u>	<u>DATE</u>	<u>SHARES</u>	<u>BROKERAGE FIRM</u>
13	March 5, 1998	100,000	PaineWebber
14	March 5, 1998	50,000	PaineWebber
15	March 6, 1998	50,000	PaineWebber
16	March 6, 1998	100,000	J.P. Morgan

In violation of Title 15, United States Code, Sections 78j(b) and 78ff(a), Title 17, Code of Federal Regulations, Section 240.10b-5, and Title 18, United States Code, Section 2.

A TRUE BILL:

FOREPERSON

CHRISTOPHER J. CHRISTIE
SPECIAL ATTORNEY
UNITED STATES DEPARTMENT OF JUSTICE

UNITED STATES ATTORNEY
DISTRICT OF NEW JERSEY