

CSI Investment Partners II, L.P. v Cendant Corp.

2001 NY Slip Op 30096(U)

July 27, 2001

Supreme Court, New York County

Docket Number: 600797/00

Judge: Barbara R. Kapnick

Republished from New York State Unified Court System's E-Courts Service.
Search E-Courts (<http://www.nycourts.gov/ecourts>) for any additional information on this case.

This opinion is uncorrected and not selected for official publication.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon. Barbara H. Kaprielian
J.S.C. Justice

PART 12

CSI Investment Partners
- v -
Condant Corp et al

INDEX NO. 600797/00
MOTION DATE _____
MOTION SEQ. NO. 001
MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...
Answering Affidavits — Exhibits _____
Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE WITH
ACCOMPANYING MEMORANDUM DECISION**

MOTION/CASE IS RESPECTFULLY REFERRED TO
JUSTICE
DATED: _____ J.S.C.

Dated: 7/27/01

Check one: FINAL DISPOSITION

[Signature]
NON-FINAL DISPOSITION
Barbara H. Kaprielian
J.S.C.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IA PART 12

-----X

CSI INVESTMENT PARTNERS II, L.P.,
et al.
Plaintiff,

DECISION/ORDER
Index No.600797/00
Motion Seq. No. 001
and 002

- against -

CENDANT CORP., et al.

Defendants.

-----X

BARBARA R. KAPNICK, J.:

Motion sequence nos. 001 and 002 are consolidated for disposition, and decided in accordance with the opinion below.

In motion sequence no. 001, defendant Amy Lipton moves, pursuant to CPLR 3211(a)(7) and 3016(b), for an order dismissing the complaint.

In motion sequence no. 002, defendant Cendant Corporation ("Cendant") moves, pursuant to CPLR 3211(a)(7) and 3016(b), for an order dismissing the complaint.

Facts

The following facts are alleged in the complaint, and, for purposes of these motions, are assumed to be true. Plaintiffs in this action are the former owners of 100 per cent of the stock of Credentials Services International, Inc. ("Credentials"). Defendant Cendant, a corporate marketing conglomerate, was created by the December 1997 merger of HFS, Inc. ("HFS") and CUC

International, Inc. ("CUC"). A substantial portion of Cendant's business has been the sale to consumers of individual memberships in approximately 23 different purchasing "clubs" which offer such services as travel, dining, entertaining, and so-called "credit card protection." Prior to April 1998, consumers were solicited to buy memberships in these clubs principally through direct mail and telemarketing.

In or about October 1994, plaintiff CIS Acquisition Partners, L.P. ("CIS"), acting through its affiliate, CIS Acquisition Corp., purchased a division of TRW, Inc., called Consumer Information Services ("Information Services"). Information Services was in the business of selling credit information to consumers through membership in a club for an annual fee. The club memberships were sold through direct marketing techniques. Shortly after its purchase of Information Services, CIS Acquisition Corp. changed its name to Credentials Services International, Inc. Credentials sold consumers credit information through annual and multi-year memberships. Credentials entered into co-marketing arrangements with financial and other institutions, including Citibank (South Dakota), N.A. (the largest issuer of credit cards in the world), whereby Credentials obtained access to mailing lists containing the names, addresses and telephone numbers of tens of millions of individuals. Pursuant to certain of these marketing arrangements, Credentials' advertisements were mailed together with the credit card bills that the credit card companies sent to their customers.

In late 1997, as Credentials was considering an initial public offering of its capital stock, Cendant expressed an interest in purchasing Credentials. Following exhaustive negotiations, in which Cendant was represented primarily by defendants Corigliano (who had been chief financial officer of CUC and, after the merger of CUC and HFS, became chief financial officer of Cendant Membership Services, Inc., a division of Cendant) and Lipton (who had been general counsel of CUC, and, after the merger, became deputy general counsel and executive vice president of Cendant), plaintiffs and Cendant entered into a stock purchase agreement on April 10, 1998 (the "Purchase Agreement").

Initially, the parties had contemplated that at the closing, plaintiffs would be paid approximately \$170 million for the Credentials stock. However, at Cendant's urging, the Purchase Agreement provided, inter alia, for a payment of \$125 million less certain deductions, which amount was to be paid on the closing date, and for a contingent payment which would be paid quarterly following the fiscal quarter ending March 31, 1999, the total amount of which would depend upon the number of net new memberships added by Credentials between January 1, 1998 and March 31, 2000.¹

In the 18 months immediately preceding the sale of

¹ Net new memberships were defined as excluding memberships that had not been paid for or that had been cancelled prior to the renewal date. Accordingly, there was a lag between the time that a membership began and the time at which it could be counted for purposes of the contingency payment.

Credentials, it had generated considerable growth in its membership base, and, therefore, in its income. Plaintiffs had projected adding 2,000,000 net new members in 1998. The Purchase Agreement required Cendant to market Credentials' products in accordance with the historical marketing practices of Cendant's Comp-U-Card Division, i.e., in accordance with the practices of CUC. Until this time, Cendant had been reporting double-digit growth rates in its CUC membership sales, and it was consistently meeting or exceeding Wall Street analysts' growth expectations. Accordingly, plaintiffs expected that with the deployment of Cendant's greater resources, more than an additional 1,000,000 net new memberships would be added, on top of the 2,000,000 that plaintiffs had already projected, resulting in contingency payments totalling more than \$50 million.

Several days before the closing, things began to go noticeably awry. Three high-level executives of Cendant, including Corigliano and Lipton, resigned without public explanation. Plaintiffs were assured that these resignations were not connected to the forthcoming purchase of Credentials, and that the purchase would go forward. Shortly thereafter, however, Cendant disclosed, through an ever more alarming series of statements, that CUC had perpetrated one of the largest accounting frauds in history, and that its growth as reported for 1995, 1996, and 1997, was illusory, having been based on fabricated membership figures. Although Cendant knew about the CUC fraud at the time that it was

negotiating with plaintiffs, it failed to disclose the fraud to them.

As a result of the fraud, Cendant fired a number of executives who had formerly been associated with CUC, replaced them with personnel from the former HFS, and scaled back the direct marketing, club membership portion of its business. Within a year of the acquisition, Cendant had terminated Credentials' employees, closed its offices, and substantially stopped marketing its products. On May 10, 1999, Cendant certified that there were no new net memberships, and, therefore, that the first contingent payment was zero. Credentials' business had simply been destroyed.

On August 28, 1998, Cendant filed with the Securities and Exchange Commission a lengthy Audit Report which described the pervasive accounting fraud at CUC. In December 1999, Cendant settled shareholder lawsuits that had been brought as a result of the fraud for \$2.8 billion, the largest settlement of a class action securities case in history.

The complaint alleges eight claims for relief. The first and seventh (fraud and negligent misrepresentation, respectively) are alleged against all of the defendants. The second through fourth (breach of contract), the fifth (breach of implied covenant of good faith and fair dealing), the sixth (for an accounting), and the eighth (for declaratory relief) are alleged only against Cendant.

Discussion

Lipton's Motion

The complaint, which is 32 pages long, mentions Lipton only three times after identifying her as one of the defendants. It alleges that Lipton, Corigliano and non-party Samuel Katz (who was Cendant's Executive Vice President for Strategic Development) represented during Cendant's negotiations with Credentials that Cendant "would aggressively seek to grow Credentials' business and customer base and that Credentials would benefit synergistically from other CUC operating units." This statement of expectations as to the future (which is not even alleged to have been false when made) is neither an affirmative statement of present fact, nor a failure to disclose something known. Accordingly, it can support neither the cause of action alleging fraud on Lipton's part, nor that alleging negligent misrepresentation. See, Sandra Greer Real Estate, Inc. v. Johansen Org., 182 A.D.2d 468 (1st Dep't 1992); Tutak v. Tutak, 123 A.D.2d 758 (2nd Dep't 1986).

Secondly, the complaint alleges that the "Audit Report ... revealed that Cendant's senior management and Defendants Corigliano and Lipton were fully aware of the nature and scope of the accounting fraud long before the April 10, 1998 closing..." This allegation is contradicted by the Audit Report, which makes no such statement (or implication) about Lipton. Although generally on a motion to dismiss the allegations of a complaint are taken to be

true, and all inferences favorable to the plaintiff are to be drawn (Hoag v. Chancellor, Inc., 246 A.D.2d 224 [1st Dep't 1998]), allegations need not be deemed true when they are flatly contradicted by documentary evidence. Biondi v. Beekman Hill House Apartment Corp., 257 A.D.2d 76 (1st Dep't 1999), affd 94 N.Y.2d 659 (2000).

Finally, the complaint alleges that Lipton's resignation from Cendant was part of the turmoil caused by the accounting fraud at CUC. That allegation supports neither of the causes of action that are alleged against Lipton. Accordingly, even leaving aside the heightened pleading requirement of CPLR 3016(b), which is applicable to both the fraud and the negligent misrepresentation claims (Perl v. Smith Barney Inc., 230 A.D.2d 664 [1st Dep't], lv denied 89 N.Y.2d 803 [1996] [fraud]; Tarzia v. Brokhaven Natl. Lab., 247 A.D.2d 605 [2nd Dep't 1998] [misrepresentation]), Lipton's motion to dismiss the complaint must be granted.

Cendant's Motion

In order to state a cause of action for fraud, a plaintiff must allege a "representation of a material existing fact, falsity, scienter, deception and injury." Mance v. Mance, 128 A.D.2d 448, 449 (1st Dep't 1987). Where the fraud that is alleged is fraud in the inducement of a contract, the plaintiff "must allege 'a representation of present fact, not of future intent' ... collateral to, but which was the inducement for the contract"

Sandra Greer Real Estate, Inc. v. Johansen Org., supra, at 469 (citation omitted). At most, however, the complaint alleges that various Cendant executives voiced hopes and plans for Credentials' business, which they knew to be false.

Moreover, to the extent that such statements were made after April 10, 1998 (the date on which the Purchase Agreement was executed), they cannot have induced plaintiffs to enter into the Purchase Agreement. To the extent that such statements were made prior to April 10, 1998, they reflect at most an intention not to perform section 5.11 of the Purchase Agreement, which requires Cendant to market Credentials' products in accordance with the historical marketing practices of CUC. However, to enter into a contract with the intention of not performing it does not constitute fraud. Gordon v. Dino De Laurentiis Corp., 141 A.D.2d 435 (1st Dep't 1988). Accordingly, the first cause of action will be dismissed.

With regard to the cause of action alleging negligent misrepresentation, Cendant correctly points out that this tort generally presupposes a contractual or fiduciary relationship that imposes a duty on the defendant to speak, and that such an affirmative duty is generally absent, where, as here, parties bargain at arm's length. See, 900 Unlimited, Inc. v. MCI Telecommunications Corp., 215 A.D.2d 227 (1st Dep't 1995); Jolly King Restaurant, Inc. v. Hershey Chan Realty, 214 A.D.2d 422 (1st

Dep't 1995). However, even in arm's-length negotiations, a party with sole knowledge of material information which is unobtainable by the other party, has a duty to disclose such information where the "superior knowledge of essential facts renders a transaction without disclosure inherently unfair." Swersky v. Dreyer & Traub, 219 A.D.2d 321, 327 (1st Dep't 1996) (internal quotation marks and citations omitted).

Here, the complaint alleges that at the very time that Cendant was persuading plaintiffs to accept a portion of the payment for Credentials' stock in the form of a contingency based on the expectation that future sales of Credentials' products would track historical sales of CUC's products, Cendant knew and failed to disclose to plaintiffs that the historical record of CUC's sales was bogus. Cendant's contention that plaintiffs should have uncovered the CUC fraud given the magnitude of the transaction is not supportable absent any suggestion that anyone without access to the former CUC's internal financial records had any reason to suspect fraud prior to Cendant's public disclosure thereof in its April 15, 1998 news release, issued five days after the Purchase Agreement was executed. Accordingly, the negligent misrepresentation claim will not be dismissed as against Cendant.²

² Cendant points out that section 8.6 of the Purchase Agreement provides, in relevant part, that:

[f]rom and after the Closing Date, the indemnification provided for in this Article VIII shall be the sole remedy for any claim for monetary damages arising out of or relating to this Agreement or the transactions contemplated hereby, other than any claim based upon or

Plaintiffs' second cause of action alleges that Cendant failed to use reasonable commercial efforts to market Credentials' products as required by section 5.1 of the Purchase Agreement, and that accordingly, plaintiffs have effectively been cheated of their contingency payments. Cendant argues that plaintiffs have waived this claim, because pursuant to section 2.1(d)(i) of the Purchase Agreement, any objection pertaining to Cendant's failure to make a contingency payment had to be raised within 20 days of May 10, 1999, when Cendant certified that no such payment was owed.

Section 2.1(d)(i) of the Purchase Agreement provides, in relevant part, that:

[p]romptly following March 31, 1999, the Company [Credentials] shall deliver to the Sellers' Representative a certificate signed by a duly authorized officer of the Company setting forth the number of new one-year and, separately, multi-year memberships added by the Company during each month of the 1998 calendar year ... and, as to each such month, the number of such new one-year memberships that were cancelled prior to March 31, 1999. Promptly following each calendar quarter during the calendar year ending December 31, 1999 and the calendar quarter ending March 31, 2000, the Company shall deliver to the Sellers' Representative a certificate ...

arising out of the fraud of any party hereto. Cendant argues that negligent misrepresentation differs from fraud, and, accordingly, that the negligent misrepresentation claim is barred by section 8.6 of the Purchase Agreement. Leaving aside the question of whether negligent misrepresentation is included or excluded by the term "fraud," within the meaning of section 8.6, plaintiffs' misrepresentation claim does not arise "out of or relating to the [Purchase Agreement] or the transactions contemplated [thereby]." Rather, that claim alleges that in the pre-contractual negotiations, Cendant failed to disclose information that it was duty-bound to disclose.

Cendant does not contend that section 8.6 bars any of plaintiffs' contractual claims, and the court expresses no opinion on that question.

signed by a duly authorized officer of the Company setting forth the number of Net New Memberships ... as of the last day of such immediately preceding calendar quarter and the Contingent Payment, if any, payable by Cendant with respect to such calendar quarter, calculated in accordance with Section 2.1(d)(iii) below (which calculations shall be included in such certificate in reasonable detail). Cendant shall cause the Company to, and the Company shall, maintain books and records sufficient to permit the Sellers' Representative to verify Cendant's and the Company's compliance with the foregoing and shall provide the Sellers' Representative with access ... to such books and records upon request. Each Contingent Payment Certificate shall be final and binding upon the parties unless the Sellers' Representative shall deliver to the Company and Cendant, within twenty (20) days after receipt of such certificate (the "Objection Period"), a notice of objection, which notice shall specify, in reasonable detail, the basis for such objection. (Underlining supplied)

It is clear from the context of the emphasized passage that the finality of the contingent payment certificates rests on the availability of books and records that would allow the Sellers' Representative to verify Cendant's compliance with the requirement to report the number of new net memberships periodically, and to make contingency payments based on those reports. This reading is confirmed by section 2.1(d)(ii) of the Purchase Agreement, which provides, in relevant part, that:

[i]f, within ten (10) days after delivery of any such objection notice, the Seller's Representative and Cendant are unable to resolve such dispute, such dispute shall be resolved by a "big six" accounting firm which does not at the time provide, and has not in the prior two years provided, material services to any of Cendant, the Company, HFS... or CUC... and which shall be selected by the Sellers' Representative and Cendant. ... The determination of the Independent Accounting Firm shall be final, conclusive and binding on the parties.

This section provides that the Independent Accounting Firm may

audit Cendant's books in order to determine whether the contingency payment certificates are truthful and accurate, and thus resolve any dispute on that score. The section does not provide for the accounting firm to assess the adequacy of Cendant's operation of Credentials' business.

Plaintiffs' second cause of action does not allege that the May 10, 1999 payment certificate was inaccurate, or that the zero contingency payment did not accurately reflect the contents of that certificate. Rather, plaintiffs contend that the accuracy of that certificate bespeaks Cendant's destruction of Credentials' business, which, plaintiffs contend, constitutes a breach of the Purchase Agreement. Accordingly, Cendant's claim does not come within the 20-day deadline set forth in section 2.1(d)(i) of the Purchase Agreement.

The third cause of action alleges that Cendant has failed to pay certain "Holdback Payments" that it was required to pay pursuant to sections 2.3(c)(y) and 2.3(f) of the Purchase Agreement. Section 2.3 of the Purchase Agreement allowed Cendant, inter alia, to hold back a portion of the purchase price that would otherwise have been due upon closing, to cover Credentials' potential liability in a class action lawsuit captioned Frerichs, et al. v. Credential Services International, et al., No. 98 3684, which was pending in the United States District Court for the Northern District of Illinois. Although Cendant initially argued

that plaintiff's third cause of action was premature because the extent of Credentials' liability in the Frerichs action was as yet unknown, Cendant now acknowledges that the District Court approved a settlement in that action on or about May 30, 2000. In addition, Cendant acknowledges that pursuant to the terms of the settlement, distributions to the members of the plaintiff class had to be made within 35 days after entry of the Court's approval of the settlement, and class members had to cash their checks within six months of the date of distribution. Because that time has now come and gone, Cendant is currently able to calculate Credentials' total liability and associated attorneys' fees in the Frerichs litigation. Under these circumstances, to dismiss the third cause of action as to which, of course, the Statute of Limitations has not run, would merely lead to the filing of a new lawsuit and a waste of the resources of both bench and bar. Accordingly, the third cause of action will not be dismissed.

The fourth cause of action alleges that Cendant failed to cooperate with plaintiffs in the defense of the Frerichs litigation, although Cendant was contractually obligated to provide such cooperation, and plaintiffs are contractually obligated to indemnify Cendant for its costs in that litigation. Cendant argues that this claim must be dismissed since plaintiffs have not (yet) indemnified Cendant for the costs that it incurred in the Frerichs litigation, and thus plaintiffs have not, and cannot, allege any damages. However, as with the third cause of action, Cendant's

Frerichs costs can now be calculated. Accordingly, no useful purpose would be served by dismissing the fourth cause of action on the ground that it is premature.

As plaintiffs acknowledge, their fifth cause of action (violation of the covenant of good faith and fair dealing) -- duplicates their second, third and fourth causes of action. Accordingly, the fifth cause of action will be dismissed. See, Business Networks of New York, Inc. v. Complete Network Solutions, Inc., 265 A.D.2d 194 (1st Dep't 1999).

Plaintiffs' sixth cause of action alleges that although Cendant was obligated to provide plaintiffs with information sufficient to enable plaintiffs to determine the amounts due to them in the form of contingency payments and Holdback Payments, Cendant has failed to provide such information. This alleged failure, however, does not entitle plaintiffs to an accounting. The information that plaintiffs seek is clearly germane to their second and third causes of action, and it should be appropriately requested during discovery.

Finally, plaintiffs' eighth claim for relief seeks a declaration that because Cendant allegedly failed to cooperate with plaintiffs in the defense of the Frerichs litigation, plaintiffs are not obligated to indemnify Cendant for the costs that it incurred as a result of that litigation. This cause of action

duplicates plaintiffs' fourth cause of action, and, therefore, will be dismissed.

Accordingly, it is hereby

ORDERED that Amy Lipton's motion (motion seq. no. 001) is granted and the complaint as to her is dismissed. The Clerk is directed to enter judgment in favor of defendant Lipton, with prejudice and with costs and disbursements to be taxed by the Clerk; and it is further

ORDERED that Cendant's motion (motion seq. no. 002) is granted to the extent that the first, fifth, sixth, and eighth claims for relief are dismissed; and it is further

ORDERED that the remainder of this action is severed and continued, and it is further

ORDERED that defendant Cendant is directed to serve an answer to the complaint, which is deemed amended in conformance with this opinion, within twenty days after service of a copy of this order with notice of entry; and it is further

ORDERED that counsel for plaintiffs and counsel for defendant Cendant shall appear for a preliminary conference in IA Part 12, 80 Centre Street, Room 308 on September 26, 2001 at 10:00 a.m.

This constitutes the decision and order of this Court.

Dated: July 27, 2001



BARBARA R. KAPNICK
J.S.C.

BARBARA R. KAPNICK
J.S.C.