2 Top Tyco Executives Charged With $600 Million Fraud Scheme

By Andrew Ross Sorkin

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The former chief executive and the former chief financial officer of Tyco International Ltd. were indicted yesterday on charges that they reaped $600 million through a racketeering scheme involving stock fraud, unauthorized bonuses and falsified expense accounts.

The company's former general counsel was also indicted, on charges that he falsified company records to conceal $14 million in improper loans to himself.

L. Dennis Kozlowski, 55, the son of a Newark police officer who as chief executive helped build Tyco into an international conglomerate, and Mark H. Swartz, 42, his financial adviser and second-in-command, are accused of using the money to pay for everything from an apartment on Park Avenue and homes in Boca Raton, Fla., to jewelry from Harry Winston and Tiffany's.

Among the accusations against Mr. Kozlowski are that he had the company pick up half the cost of a multimillion-dollar 40th-birthday party on the Italian island of Sardinia for his wife, a former waitress at a restaurant near Tyco's headquarters in New Hampshire.

The New York grand jury indictments -- including the charge against the former general counsel, Mark Belnick, 55, who was an investigator in the Senate's Iran-contra hearings in 1987 -- also accuse Mr. Kozlowski and Mr. Swartz of bribing a Tyco board member and several Tyco employees, apparently to try to keep their scheme secret. The indictment accuses Mr. Kozlowski and Mr. Swartz of ''enterprise corruption,'' a charge often used in Mafia prosecutions.

The indictment, as well as a separate civil lawsuit filed by the Securities and Exchange Commission, are the latest government moves against corporate executives amid a series of earnings restatements, accounting scandals and sudden bankruptcies at Enron, WorldCom, Adelphia and other big companies.

Tyco, which is nominally based in Bermuda for tax purposes but operates out of Exeter, N.H., and Boca Raton, owns dozens of companies that make products ranging from surgical instruments to security systems. It is also among the biggest suppliers of undersea fiber optic cables and electrical connectors, and it employs more than 270,000 people.

In the indictment, Robert M. Morgenthau, the Manhattan district attorney, contends that Mr. Kozlowski and Mr. Swartz created an elaborate, covert system beginning in 1995 that he called the ''top executives' criminal enterprise,'' which, he said, allowed them to spend millions of dollars in company money for personal expenses. The men then covered their tracks by limiting the scope of internal audits and bypassing the company's legal department when filing disclosure documents with the Securities and Exchange Commission, the indictment says.

The authorities accuse Mr. Kozlowski and Mr. Swartz of stealing $170 million from the company itself and reaping $430 million more by covertly selling Tyco stock while ''artificially inflating'' the value of that stock. Tyco stock has fallen 70 percent in value this year, and it closed yesterday at $17.80.

Mr. Morgenthau's office moved to freeze $600 million of assets held by Mr. Kozlowski and Mr. Swartz.

Steven M. Cutler, the director of enforcement for the Securities and Exchange Commission, called the dollar amounts in the Tyco case ''staggering.'' The civil complaint says that the case ''involves egregious, self-serving and clandestine misconduct.''

Appearing in handcuffs and looking somewhat bewildered during a court hearing yesterday, all three men pleaded not guilty to the charges. Justice Michael J. Obus of State Supreme Court in Manhattan set a personal recognizance bond of $100 million for Mr. Kozlowski and $50 million for Mr. Swartz.

Mr. Belnick, a partner at the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison before joining Tyco in 1998, was released on an unsecured personal recognizance bond of $1 million. Mr. Belnick left the firm after the death of his mentor, Arthur L. Liman, who was chief counsel to the Senate committee that investigated the sale of arms to Iran by the Reagan administration and the diversion of profits from those sales to antigovernment guerrillas in Nicaragua. Mr. Belnick was Mr. Liman's deputy at those hearings.

All three men had to surrender their passports and must return to court on Thursday.

If convicted, Mr. Kozlowski and Mr. Swartz could face up to 25 years in prison, while Mr. Belnick faces up to 4 years.

After the hearing, Mr. Kozlowski's lawyer, Stephen Kaufman, said, ''Dennis Kozlowski is a recognized business leader and believes that the charges against him are unfounded and unfair.''

Mr. Swartz's lawyer, Charles A. Stillman, portrayed his client as a victim of an overly aggressive team of prosecutors seeking to take down Mr. Kozlowski. ''Mark Swartz has been swept up in this investigation without consideration for the merits of his own individual case,'' he said. ''He is totally innocent of these charges, and we believe these charges should not have been brought against him.''

Mr. Belnick's lawyer, Reid Weingarten, said in a statement issued by his office that his client ''has done nothing wrong,'' adding, ''We are certain when this painful process ends, he will be cleared of the unsupported allegations which have been made against him.''

The charges against Mr. Kozlowski are in addition to a 14-count indictment handed up in June that accuses him of evading more than $1 million in New York sales taxes on six paintings that he said were going to Tyco's headquarters in New Hampshire. Prosecutors say the paintings actually went to his New York apartment. He has also been charged with tampering with evidence by removing a fraudulent cargo document from a file that was turned over to the Manhattan district attorney's office during its investigation of the case.

Separately, Tyco filed its own lawsuit against Mr. Kozlowski yesterday, seeking the return of his income and benefits since 1997 and the forfeiture of all his severance pay. Since 1999, in addition to his salary and bonus of about $5 million a year, he made more than $330 million in profits from exercising stock options and selling stock grants.

The company said in a statement: ''Mr. Kozlowski was one of the highest, if not the highest, compensated executive in the country. Despite his being paid handsomely, he misappropriated hundreds of millions of dollars from Tyco that have not been repaid. He failed to inform, and actively concealed from, the compensation committee the true facts about his compensation.''

Tyco's board also voted yesterday not to support the re-election of 9 of its 11 directors. The move is part of an effort to restore confidence among investors in the company.

Prosecutors, as well as the company, contend that Mr. Kozlowski defrauded Tyco by awarding himself and others unauthorized compensation, mostly in the form of bonuses and loans that were later forgiven. In particular, prosecutors argue that Mr. Kozlowski and Mr. Swartz manipulated two corporate loan programs set up to help employees pay taxes on company stock and to help employees relocate to homes near Tyco's offices in Manhattan.

Prosecutors said Mr. Kozlowski had misappropriated more than $270 million in loans, including $12 million that he used to pay for his personal art collection. Prosecutors said he had borrowed $9 million to buy Boca Raton real estate and borrowed $7 million to buy an apartment for his wife as part of a divorce settlement.

Prosecutors also said Mr. Swartz had used $72 million of Tyco loans, which were intended to cover tax payments, to pay for an assortment of personal investments, business ventures, real estate holdings and trusts. The suit also contends that he used $9 million in relocation loans to buy a yacht and invest in real estate. All of the loans were later forgiven by the company, under the direction of Mr. Kozlowski, prosecutors said.

The authorities contend that Mr. Belnick received $14 million in no-interest loans under a program that was supposed to pay for employees' moving expenses but was used, in part, for the purchase of a $10 million vacation home in Utah and a $4 million apartment on Central Park West. The loans were later forgiven.

The indictment says Mr. Kozlowski and Mr. Swartz concealed the cost of the forgiven loans by instructing subordinates to ''bury'' them in unrelated expenses for mergers and other company business.

Mr. Morgenthau said his office had considered charging the entire company with a crime but had decided not to do so because of the potential effect on the company's employees. Mr. Kozlowski also made millions of dollars of charitable contributions in his own name, but using Tyco funds, to several institutions, including his alma mater, Seton Hall University.

Mr. Kozlowski's largess extended to Wall Street, where he tried to persuade a major brokerage firm to hire a ''more friendly'' stock analyst with whom he exchanged gifts worth thousands of dollars, prosecutors charged yesterday.

The prosecutors did not name the firm in their indictment, but a person close to their investigation identified it as Merrill Lynch. This person said that the gifts included one that the analyst sent to Mr. Kozlowski to thank him for helping the analyst get a new job and one that Mr. Kozlowski sent to the analyst to congratulate him on his move.

Spokesmen for Merrill would not confirm nor deny that the indictment was alluding to Merrill.

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