CASE STUDIES in BUSINESS ETHICS

SIXTH EDITION

2009

Edited by
Al Gini
Loyola University Chicago

Alexei M. Marcoux
Loyola University Chicago

Upper Saddle River, NJ 07458

Case Study

Kozlowski's Tyco—"I Am the Company!"

Denis Collins

He who knows he has enough is rich.

LAO TZU

If you are fully immersed in working long hours every day over the course of many years, the line between your work life and your personal life may start to blur. You also might begin to feel entitled to special "perks," particularly if the organization you work for has prospered because of your efforts and personal sacrifices. To counter this very human tendency, company policies and accounting regulations seek to clearly differentiate between corporate use of assets and personal use of assets; employees, of course, are financially responsible for the latter.

Dennis "Deal-A-Month" Kozlowski, one of the highest paid CEOs in the world, ignored this distinction. He considered his entire life to be work-related, treating Tyco's executive loan programs as a personal line of credit, despite an income of $170 million in 1999. He schemed to not pay sales tax on artwork purchased for his company-funded, luxury apartment. After Kozlowski was indicted for tax fraud, an investigation revealed that he and other Tyco executives had defrauded shareholders of more than $600 million. As a result, Kozlowski, at 60 years of age, entered a federal prison to serve a sentence of up to 25 years, and unable to benefit from the lucrative pension plan he had set up for his retirement.

MOVING UP THE SOCIAL AND CORPORATE LADDER

Kozlowski was born in 1946 to middle class parents in Newark, New Jersey. Ironically, his father was a false claims investigator with the

Copyright © 2006, Denis Collins. Reprinted with permission.

New Jersey bus system; his mother was a school crossing guard. Kozlowski's jobs as a youth included being a paperboy and car wash attendant. In college, he worked 30 hours a week, mostly playing guitar for a wedding band, while obtaining a business degree in finance and accounting at nearby Seton Hall University. He also earned a pilot's license. When dreams of becoming a commercial pilot collapsed, Kozlowski became an auditor in the Mergers & Acquisitions department of SCM in New York City.[1]

Talented, ambitious, and restless, Kozlowski changed jobs several times early in his career. In 1975, at age 28, a headhunter recruited him to help Tyco CEO Joseph Gaziano fulfill a plan to grow the $15 million Exeter, New Hampshire firm into a $1 billion corporation through mergers and acquisitions. Tyco was a public company, founded in 1960 as a research laboratory for energy conversion. Kozlowski served as the internal auditor for Tyco's latest acquisition, a fire protection company whose corporate staff would be reduced from 200 to 30 employees.

In 1982, with new acquisitions pushing Tyco's annual revenue over $500 million, Gaziano died unexpectedly of cancer. John F. Fort III, the new CEO, added healthcare to complement the company's three other business segments: fire protection, electronics, and packaging. Kozlowski's continued climb up the corporate ladder enabled him to purchase a $900,000 estate in North Hampton, New Hampshire for his family, which consisted of his wife and two daughters. Fort gave him a seat on Tyco's Board of Directors in 1987. Two years later, Kozlowski was promoted to President and Chief Operating Officer. In July 1992, as Tyco struggled with a nationwide recession, the Board replaced Fort with Kozlowski. At the age of 46, Kozlowski had reached the top of the corporate ladder, CEO and Chairman of the Board of a $3 billion corporation, with a $1 million salary and $2.6 million in stock grants.

CROSSING THE LINE

Unfortunately, Kozlowski's corporate success took a toll on his marriage. He spent most of his time flying from one acquisition meeting to another. Kozlowski had an affair with a Tyco employee in the late 1980s and then fell in love with a married waitress, Karen Lee Mayo. He separated from his wife, let her and his two children keep the estate, and purchased a second New Hampshire mansion for his own residence. Kozlowski muddied the line between his corporate and personal expenditures, charging Tyco $269,000 in furnishings for his new home and its yearly maintenance costs.[2]

CEOs have a fiduciary duty to act in the best interest of the company's shareholders. Charging the company to furnish a corporate office is acceptable. Charging such large amounts to the company to furnish a home, even if the CEO works conducts business and entertains clients there, is suspicious. Kozlowski, a professionally trained auditor, was manipulating accounting rules and regulations for his own benefit. He got away with it, and would get away with a lot more before being exposed.

MISUSING THE RELOCATION LOAN PROGRAM

By 1995, Tyco had outgrown its modest, two-story, New Hampshire headquarters. Yet, Kozlowski wanted to maintain shareholders' assumption that Tyco had very low corporate overhead. With minimal publicity, Kozlowski quietly purchased a new corporate office overlooking Central Park in New York City, a mere 12 miles from his middle class childhood neighborhood. Economically, Kozlowski had evolved from a tadpole in the New Jersey swamps, to a big fish in a small New Hampshire pond, to a moderate size fish in the world's largest and most exciting lake.

The move to New York City meant finding new housing for his management team. Kozlowski proposed a very generous 15-year interest-free relocation loan program for six executives, himself included. Corporate lawyers and the Board's Compensation Committee approved a more modest plan, available to all salaried employees relocating to New York. Without informing the Board, Kozlowski implemented his initial proposal.[3] Among the recipients of his largesse was his former mistress, Tyco's events planner, who kept her New Hampshire apartment and purchased a $500,000 Fifth Avenue apartment that she only used 35 days a year.[4] Given the Manhattan real estate market, it was an excellent long-term personal investment.

Also in 1995, Kozlowski promoted Mark Swartz, the Director of Mergers & Acquisitions, to Chief Financial Officer and Executive Vice President, and gave him a seat on the Board of Directors. Similar to Kozlowski, the 35 year old Swartz had an auditing background, having worked for Deloitte & Touche before joining Tyco in 1991. CFOs, like CEOs, have a fiduciary duty to serve the best interests of stockholders. As part of his New York City relocation, Swartz, who would be indicted along with Kozlowski in 2002, sold his New Hampshire home to a Tyco subsidiary far above market housing rates, earning a windfall profit for himself at the expense of shareholders.

MISUSING THE KEY EMPLOYEE LOAN PROGRAM

As did most corporations, Tyco provided executives with company stock as part of their compensation package, to further align management interests with shareholder interests. After a pre-determined length of time, the executive can purchase company stock at the price when the option to buy was first granted. If the stock price went up, which benefited all shareholders, the executives earned a corresponding profit. But immediate tax liabilities on the stock profit provided a disincentive to cashing in. In 1983, Tyco established an employee benefit called the Key Employee Loan Program (KELP) that allowed executives to borrow money at a low-interest rate in order to pay these taxes.

Beginning in 1996, Kozlowski and Swartz began misusing KELP loans to pay for personal expenditures. In addition, they did not disclose these loans on executive financial indebtedness forms that would have been accessible to shareholders. By August 1999, Kozlowski owed Tyco $55.9 million in low-interest KELP loans, and $28.5 million in interest-free relocation loans.[5] He used KELP loans to buy a $15 million yacht, an $8.3 million investment in a professional basketball team, a $700,000 investment in a Hollywood movie, $72,042 for jewelry, $155,067 for clothing, $96,943 for flowers, $60,427 for club memberships, and $52,334 for wine. He also purchased a $90,000 Porsche Carrera and a $5 million diamond ring for Karen, his long-term mistress.[6] Tyco's executive loan programs had become his personal piggy bank, though he promised to repay the money. Other times, Kozlowski simply charged personal expenditures to the company.

Tyco's loan programs sparked Kozlowski's interest in real estate. Shortly after relocating corporate offices to New York City, Kozlowski secured a Fifth Avenue apartment with an annual rent of $264,000, and charged it to Tyco. He also bought an $875,000 New Hampshire estate from board member John Fort, Tyco's former CEO, through a Tyco subsidiary, and a summer estate in Nantucket, Massachusetts for $5 million. Kozlowski eventually repaid Tyco for the latter two houses, although he expensed their maintenance to the firm.[7]

MINIMIZING CORPORATE TAXES AND A FLORIDA RELOCATION

Multinational firms incorporated in the United States are taxed for income earned by businesses they own in other countries. Many other countries, such as Bermuda, do not tax income earned in other countries.[8] In 1997, Tyco acquired ADT, a home security system company incorporated in Bermuda, for $6.2 billion, the company's largest acquisition at that time. Kozlowski worked out a "reverse merger" deal with Sir Michael Ashcroft, CEO of ADT, in which ADT would acquire Tyco and then change its name to Tyco. The company, now incorporated in Bermuda, no long had to pay U.S. taxes on overseas businesses.[9]

Kozlowski and Swartz also established a subsidiary in Luxembourg to finance Tyco's debt. Tyco could now, legally, obtain loans from the Luxembourg subsidiary and deduct the interest payments from its taxable income. The new Bermuda incorporation and the Luxembourg subsidiary enabled Tyco to reduce its tax rate from 36% to 25%, a $500 million tax savings. Tyco's U.S. tax rate soon dropped below 20%, approximately half that of other corporations.[10]

In addition, ADT's U.S. headquarters was located in luxurious Boca Raton, Florida, which meant more housing relocations for Tyco executives. Without the Board's permission, Kozlowski added Boca Raton to Tyco's housing relocation program. In 1998, more than forty Tyco employees were given 15-year relocation loans, with little or no interest, to purchase homes in Florida. Kozlowski was the primary beneficiary, purchasing $29.7 million of real estate with interest free loans. Ashcroft, who joined Tyco's board, sold his Boca Raton home to his wife, who then immediately sold it to a Tyco Vice President as a guest house for visiting executives. Kozlowski lived in that home at company expense while his new waterfront mansion was under construction.[11]

Kozlowski's continued misuse of Tyco's executive loan programs required the cooperation of Tyco's new Chief Corporate Counsel, Mark Belnick. Kozlowski met Belnick through former New Hampshire Senator Warren Rudman, who served as a $35,000 per year Tyco consultant. While new acquisitions were being forced to cut labor costs, Kozlowski granted Belnick a $5.9 million three-year contract, more than doubling his previous salary, and 200,000 shares of Tyco stock. Belnick, whose previous office was a few blocks from Tyco's Central Park headquarters, already owned a suburban New York City home. Nonetheless, he was granted a $4 million relocation loan to purchase a Central Park apartment.[12]

SECRETLY FORGIVING EXECUTIVE LOANS

Under Kozlowski's acquisition leadership, Tyco became a "hot" stock in the second half of the 1990s, increasing at an annual rate of 67%. During his first seven years as CEO, Tyco acquired 400 companies, most of them small and medium-sized. His six person Mergers & Acquisition team screened one thousand potential acquisitions annually and finalized deals within two weeks, while competitors took ten times longer.[13] For his efforts, Kozlowski's official salary was a modest $1.25 million a year. However, the stock portion value of his annual compensation package escalated. Over a three year period, Kozlowski's total annual income rose from $8.9 million in 1997, to $70 million in 1998, to $170 million in 1999, making him the second highest paid CEO in the world.[14]

But Kozlowski also owed Tyco $84.4 million for his relocation and KELP loans. In August 1999, Swartz fraudulently credited Kozlowski's KELP account $25 million and his own KELP

account $12.5 million in August 1999. Neither Tyco's Vice President of Human Resources, PricewaterhouseCooper's auditors, Board members, nor stockholders were informed of this action. As a result, company shareholders lost $37.5 million in loan obligations. According to tax laws, an employee must declare the amount of a loan forgiveness as income on tax returns. Neither executive disclosed this new compensation in annual reports, proxy statements, or SEC forms. Kozlowski and Swartz also forgave a $1 million loan to a Tyco employee who had been Kozlowski's mistress in the 1980s, and a $300,000 loan to another mistress who had since left the company.[15]

Kozlowski and Swartz repeated this process twice in 2000, and included more executives in their scheme to defraud shareholders. In September, they falsely informed Patricia Prue, Tyco's Vice President of Human Resources, that the Board approved a $100 million loan forgiveness plan for the more than 40 Tyco employees who moved to Florida in 1998. This included Prue, who had received a $748,309 Florida relocation loan.[16] Prue was told that Tyco would pay all income taxes associated with the loan forgiveness plan. Under the guise of preventing Tyco's 215,000 other employees from becoming jealous, Prue obtained signed confidential agreements from each loan forgiveness recipient that, if breached, would cancel the new perk. Everyone signed. The largest Florida relocation loan forgiveness amounts were received by Kozlowski ($32.9 million) and Swartz ($16.6 million). Three months later, Kozlowski gave himself another $16 million in loan forgiveness, and gave Swartz half that amount.[17]

Kozlowski was also using Tyco's philanthropic contributions for personal gain. He no longer differentiated himself from Tyco. What was good for him was good for Tyco, and vice versa. Between 1997 and 2002, Tyco donated more than $100 million to nonprofit organizations. Many of these donations directly benefited Kozlowski, such as $1.3 million to the Nantucket Conservation Foundation to preserve undeveloped land adjacent to his estate, and $5 million to Seton Hall University, his alma mater, to have its Business School building named after him.[18]

MORE REAL ESTATE AND INCOME

In 2000, Kozlowski finalized his divorce so he could marry Karen Mayo, his long-term mistress. After the divorce, a Tyco subsidiary purchased from Kozlowski the New Hampshire estate occupied by his ex-wife for $4.5 million, three times its fair market value; she continued to live there at company expense. Kozlowski then purchased the Tyco-owned $7 million Fifth Avenue apartment, at no profit for Tyco despite soaring New York City real estate prices, and gave it to his ex-wife. He borrowed the full purchase price from Tyco, repaid $5.1 million, and forgave the remaining $1.9 million he still owed Tyco on the transaction.[19]

In honor of Karen's 40th birthday, Kozlowski instructed Tyco's events planner to organize a $2 million party on the exotic Italian island of Sardinia. Plans for the Romanesque themed event included gladiators welcoming the seventy guests to the island, an ice sculpture of Michelangelo's David where Soli vodka was poured into the upper back area and came out the statue's genitals, and a concert performance by pop-singer Jimmy Buffet that cost $250,000. Kozlowski charged half the birthday celebration expenses to Tyco, on the grounds that the event coincided with a subsidiary's board meeting at the same resort and half the attendees were company employees.[20]

Needing a new place to live in New York City, Kozlowski purchased another Fifth Avenue apartment for $16.8 million, charged

it to Tyco, and lived in it rent-free. Kozlowski charged his KELP account $3 million in improvements and $11 million in furnishings, such as a $6,000 shower curtain in the maid's bathroom and a $15,000 umbrella stand.[21] Following in the footsteps of his mentor, Swartz bought an Upper East Side apartment in Tyco's name and lived there for an annual savings of $216,000.[22] These financial dealings were done without board permission, nor were they reported as executive income on financial statements.

Meanwhile, Kozlowski's reported W-2 income for 2000 was $137.5 million. His end of the year bonuses included 148,000 more shares of common stock and a $700,000 cash bonus. Swartz received half these totals. Belnick, the Chief Legal Counsel, was rewarded with a $4 million cash bonus and 300,000 shares of Tyco stock. During the year, Belnick cashed in $11 million in stock options.[23]

Kozlowski and Swartz continued to scheme ways, both legal and illegal, to charge their personal expenses to Tyco and to take as much compensation from the company as they could get away with. Kozlowski developed very generous retention agreements for his management team. To ensure Kozlowski's continued leadership the next seven years, until his anticipated retirement on his 62nd birthday in 2008, Kozlowski and Swartz proposed to the Board, and the Board agreed, that Kozlowski be granted a retention plan consisting of 800,000 shares of stock with a current value of $38 billion, a continuation of benefits after age 62, ongoing compensation and proxy bonuses until age 65, a $135 million severance payment, and a lifetime consulting contract worth $3.4 annually.[24]

Swartz and Belnick also signed retention agreements. Swartz was entitled to a $63 million severance payment, $8.5 million in stock, and 500,000 shares of Tyco stock worth $24 million that would start vesting five years later.[25] Belnick signed a retention agreement that entitled him to $10.6 million if still employed by Tyco on October 1, 2003.[26]

ACQUIRING A FINANCIAL SERVICES COMPANY

Kozlowski long admired Jack Welch's management accomplishments at General Electric, including an acquisition that resulted in GE Capital Services, which financed customer purchases of GE products. Kozlowski sought a similar benefit for Tyco and focused on The CIT Group, the nation's largest independent commercial finance company, which could provide $4–6 billion in customer financing.[27] This would be particularly ironic: early in his professional career, the New Jersey company had rejected Kozlowski for a low-level auditing position.

Frank Walsh, who joined the board when Kozlowski became CEO in 1992, initiated acquisition discussions between Kozlowski and Al Gamper, CIT's Chairman and CEO. Tyco bought CIT Group for $9.5 billion, a 54% premium. After terms of the agreement were finalized in June 2001, Kozlowski paid Walsh a $20 million acquisition finder's fee, with $10 million in cash and $10 million donated to a charitable fund for which Walsh served as trustee. Kozlowski, already with a long list of compensation secrets, told Walsh not to inform the Board about the $20 million payment.[28] Walsh, who as a board member had a fiduciary duty to act in the best interest of stockholders, remained quiet.

With Tyco's stock price robust and his personal expenses mounting, Kozlowski, without Board approval, accelerated the vesting of some employee stock options owned by a few key executives. This resulted in an $8 million profit for himself, $4 million for Swartz, and $3 million for other senior managers, all at the expense of shareholders.[29]

SALES TAX AVOIDANCE SCAMS

Kozlowski's managerial skills were lauded by the media. *Business Week* ranked Tyco #1 on the magazine's best performing company list and Kozlowski among the top 25 corporate managers. Kozlowski's picture adorned the cover of *Business Week*'s May 28, 2001 issue. While the rest of the corporate world struggled through a deepening national recession, Tyco earned $4.7 billion in profits on sales of $30.3 billion for 2000, and 26% sales growth and 30% earnings growth for the first quarter of 2001.[30]

Yet Tyco had its critics. A research analyst accused Tyco of questionable accounting and tax practices. For instance, three weeks prior to finalizing the acquisition of Raychem, Tyco instructed Raychem to pay $60 million in outstanding bills, even if not immediately due. The extra pre-Tyco acquisition supplier payments made it easier for Kozlowski to claim that Raychem immediately improved financially under Tyco's new ownership.[31] Although the SEC, following a six month informal investigation of 120 acquisitions, dismissed these concerns in 2000, the SEC investigation and Kozlowski's huge personal write-offs caught the attention of fraud investigators in Manhattan District Attorney Robert Morgenthau's office and New York State banking authorities.[32]

Kozlowski's personal legal problems began when he and his wife went on an art buying spree to decorate their new Fifth Avenue Apartment, and fraudulently charged the purchases to Tyco. In August 2001, Kozlowski instructed a New York art dealer to purchase three paintings for $1,975,000 from a London art gallery. The paintings were unloaded from a plane at Newark International Airport and then transported to Tyco headquarters in New Hampshire. Without ever removing the paintings from the truck, Kozlowski's assistant signed documents verifying that the artwork had been received. The next day the Tyco-owned art was trucked back to New York for display in his apartment.

His illegal art purchasing activities multiplied when Kozlowski conspired to commit tax fraud on locally purchased artwork. According to New York sales tax laws, art purchased in New York for display in New York is subject to an 8.25% sales tax. The sales tax is not charged if the art is purchased for out-of-state use. In late November and early December, the Kozlowskis purchased more than $4.5 million in artwork from Manhattan art galleries for delivery to their Fifth Avenue apartment. Kozlowski avoided paying more than $375,000 in New York sales tax by claiming these were out-of-state sales. When one of the art dealers became uncomfortable with this fraud, the painting was removed from Kozlowski's apartment, trucked to Tyco's New Hampshire headquarters for the appropriate invoice signature, and then returned to his Fifth Avenue apartment. Kozlowski avoided paying an additional $1 million in New York sales tax when he purchased $12.8 million of art from New York galleries and then had five empty art boxes transported to New Hampshire for appropriate corporate signatures, while the actual paintings were delivered directly to his Manhattan apartment.[33]

Kozlowski, well-known for cost-cutting, continued to shower generous benefits among those aware of his misuse of corporate assets. Belnick earned more than $34 million from stock sales between 1999 and 2001 and was illegally granted $10 million in relocation loans by Kozlowski to purchase a ski chalet in Park City, Utah, a state where Tyco had no corporate presence.[34]

BOARD SCRUTINY

The first leak in Kozlowski's wall of secrecy occurred on January 9, 2002. Tyco's Board consisted of ten directors. Six of the eight

external directors had been on the Board for at least a decade, some as long as two decades. It was a close network of friends and business acquaintances who earned annual salaries of $75,000 and 10,000 shares of Tyco stock in return for protecting shareholder interests.[35]

Several Board members reviewing Tyco's annual proxy statements were taken aback when they read that, without their knowledge or approval, Walsh had been paid a $20 million finders fee for the CIT Group acquisition. During the formal Board meeting the following week, they demanded that Walsh return the money to Tyco.[36] Walsh refused, stormed out of the meeting, and resigned his Board seat. The Board, dissatisfied with explanations provided by Kozlowski and Swartz, initiated an investigation of all financial transactions involving senior management, including executive compensation.

STOCK PRICE COLLAPSE

At the beginning of 2002, Tyco's stock stood at a healthy $59 a share. Following the sudden implosion of Enron in late 2001, investigative journalists and short-sellers (investors who profit when a company's stock declines) were looking for the next Enron.[37] Tyco was a prime target due to its aggressive accounting techniques, incomprehensible financial statements, massive debt, and rumors about insider trading; its stock declined steadily the first two weeks of January. In mid-January, Tyco unexpectedly announced an anticipated 20% revenue reduction for its electronics products business unit.[38] By the third week of 2002, Tyco's stock had dropped 25% since January 1, a loss of $30 billion in market value.

Kozlowski disagreed with the public's negative assessment, and maintained that the company was simply too big for any research analyst or investor to understand. He announced a major change in corporate strategy that would untangle Tyco's complex financial statements and improve the company's sagging stock price. Rather than growing through acquisitions, as the firm had been doing for more than thirty years, he planned to break up the $38 billion corporation over the next year. First, Kozlowski would sell the plastics businesses for a quick $3 billion cash infusion. Second, the rest of the corporation would be reorganized into four separate businesses: health care, fire protection, financial services, and home/office securities and electronics. Kozlowski estimated the total share price value of these four business units at $73.50, far higher than Tyco's current $47 selling price.[39] Third, Kozlowski planned to sell the financial services business (CIT Group) to the public as an IPO, followed by the health care and fire protection businesses. The anticipated IPO income would reduce Tyco's $11 million debt to $4 billion. Fourth, Kozlowski would remain in charge of Tyco's largest business unit, securities and electronics.

But one week after this grand plan was announced, the *Wall Street Journal* published an article exposing Walsh's $20 million finders' fee; Tyco's stock dropped 20% by the end of the trading day.[40] Two days later, Tyco's "the next Enron" aura gained additional substance when the *Wall Street Journal* reported that Kozlowski had sold 748,000 shares of stock worth $40 million back to the company, rather than on the open market.[41] Then, on February 4, a *Wall Street Journal* headline blared that "Tyco Made $8 Billion of Acquisitions Over 3 Years But Didn't Disclose Them." The article noted that Tyco wasn't required to do so by law, as many of these were small acquisitions, but the secrecy sounded a lot like another Enron. Tyco's stock closed that day at $29.20, a one day decline of 20%. Tyco's stock had declined by 50% in slightly more than one month.[42] Over the following week, the *Wall Street Journal* reported that Tyco would layoff

2,250 employees in its Telecom unit, and that it would have to rely on a back-up line of credit to pay nearly $10 billion in debt payment due within a year.[43] Kozlowski had to do something to stop the mass sell-off of Tyco stock, the primary basis of his fortune.

UNSUCCESSFULLY BACKTRACKING

Kozlowski changed his mind about restructuring Tyco. In mid-February, he announced that Tyco would not sell either the health care or the fire protection business units as IPOs, due to the depressed stock market.[44] Investors wondered how the Board of Directors could unanimously agree to break-up Tyco in mid-January and one month later unanimously agree that this was not a good idea.

Making matters worse, Kozlowski had trouble finding buyers for Tyco's plastic business and CIT Group. He initially projected that the CIT Group IPO would generate $6.5 billion in cash to help pay down Tyco's ballooning debt. Kozlowski now admitted that the CIT Group acquisition, which led to his Board problems, was a colossal mistake. He announced that a CIT Group IPO would raise just $4.6 billion, less than half the $9.5 billion Tyco originally paid for it the previous year.[45] After the company declared a $1.9 million quarterly net loss, Tyco's first quarterly loss in a decade, the stock price declined to $17, its lowest since 1997.[46] Five years of stock market gains had been wiped out. In just four months, Tyco's stock had declined 71%, which felt a lot like Enron.

The Board lost confidence in Kozlowski and initiated new internal investigations. In May, the Board requested all company records on charitable contributions over $10,000, apartments and company assets used by employees, company plane use, executive loans, and stock transactions involving Kozlowski, Swartz, and Belnick.[47] The Board hired independent legal counsel to represent Tyco in its investigation of the Walsh affair.

CRIMES AND PUNISHMENTS

In early May, Kozlowski was subpoenaed by the New York County District Attorney's office for information related to his state sales tax avoidance scheme. Neither Kozlowski nor Belnick informed the Board about the criminal investigation. Then, on Friday, May 31, Kozlowski and Belnick told the Board that Kozlowski would be indicted the following week for tax fraud. The Board immediately went into crisis management mode and, late Sunday evening, demanded Kozlowski's resignation. John Fort, who preceded Kozlowski as Tyco's CEO, was named interim CEO.

On Tuesday, June 4, Kozlowski was indicted on eleven felony counts for evading more than $1 million in New York sales tax, each count punishable by up to four years in prison. A week later, Fort fired Belnick for removing confidential Tyco documents from the company's New York office.[48] Three months later, Swartz was also forced to resign.

In September 2002, the SEC filed a civil complaint documenting the following wrongdoings by Kozlowski, Swartz and Belnick:[49]

- *Relocation Loans:* Between 1996 to 2002, Kozlowski inappropriately borrowed $28 million, Swartz $9 million, and Belnick $14 million from Tyco's relocation loan programs.
- *KELP loans for stock option taxes:* Between 1997 to 2002, Kozlowski inappropriately borrowed $241 million and Swartz $72 million in KELP loans.
- *Loan Forgiveness:* Between 1999 and 2001, Kozlowski inappropriately forgave approximately $74 million in company loans to himself and $37 million in company loans to Swartz; neither claimed this as income.

In December 2002, Walsh pled guilty to felony charges of receiving $20 million and was fined $2.25 million. Kozlowski and Swartz' criminal

trail began in late 2003. Six months later, with the jury in deliberations, a mistrial was declared because the media released the name of one of the jurors. At the time, eleven of the twelve jurors had already agreed on a guilty verdict.[50]

In July 2004, Belnick was found not guilty by a jury after the government had failed to prove beyond a reasonable doubt that he was guilty of grand larceny, securities fraud, and falsifying business records. The defense lawyers successfully argued that Belnick believed that Tyco's board had approved his compensation and loans. Then the SEC filed suit for fraud, which Belnick settled by agreeing to a $100,000 fine and a five-year ban from serving as a corporate officer.[51]

The retrial of Kozlowski and Swartz began in January, 2005. Six months later, both former executives were found guilty on 22 of 23 charges for stealing $150 million from Tyco.[52] In September 2005, they were each sentenced to 8 1/3 to 25 years in jail, and taken away from the courthouse in handcuffs.[53] The court ordered Kozlowski to pay $167 million, and Swartz $72 million, in fines and restitution. Ten months later, Karen Kozlowski filed for divorce, requesting half of Kozlowski's remaining fortune.[54]

NOTES

1. Anthony Bianco, William Symonds, Nanette Byrnes & David Polek, "The Rise and Fall of Dennis Kozlowski," *Business Week*, December 23, 2002; William C. Symonds & Pamela L. Moore, "The Most Aggressive CEO," *Business Week*, May 5, 2001.
2. *Tyco International Ltd. v. L. Dennis Kozlowski*, United States Southern District of New York, September 12, 2002, p. 32. [Hereafter *Tyco v. Kozlowski*]
3. *Tyco v. Kozlowski*, pp. 9–10.
4. Mark Maremont, "Tyco Ex-Manager Tells of Her Perks, *Wall Street Journal*, October 24, 2003.
5. *Tyco v. Kozlowski*, pp. 12–13.
6. Chad Bray, "Tyco Ex-Officer Tells of Fund Transfers," *Wall Street Journal*, December 3, 2002; Chad Bray, "Tyco Aide Testifies About Incidents, *Wall Street Journal*, January 6, 2004; *Tyco v. Kozlowski*, pp. 32–33; Tyco, pp. 32–33; *WSJ*, 12/3/03, 1/6/04.
7. David Armstrong, James Bandler, John Hechinger & Jerry Guidera, "Tyco Directors Involved in Deals," *Wall Street Journal*, June 14, 2002; Mark Maremont & Laurie P. Cohen, "How Tyco's CEO Enriched Himself," *Wall Street Journal*, August 7, 2002; *Securities and Exchange Commission v. L. Dennis Kozlowski, Mark H. Swartz, and Mark A. Belnick*, United States Southern District of New York, September 9, 2002 [Hereafter *SEC v. Kozlowski, et al.*]; *Tyco v. Kozlowski*, pp. 10 & 32.
8. Editorial, "The Bermuda Inversion," *Wall Street Journal*, May 21, 2002.
9. Symonds & Moore, May 28, 2001.
10. Mark Maremont, John Hechinger, Jerry Markon & Gregory Zuckerman, "Kozlowski Quits Under a Cloud," *Wall Street Journal*, June 4, 2002.
11. Laurie P. Cohen & Mark Maremont, "Tyco Relocations to Florida Are Probed," *Wall Street Journal*, June 10, 2002; Maremont & Cohen, August 7, 2002; *Tyco v. Kozlowski*, p. 15.
12. Laurie P. Cohen, "Tyco's Top Lawyer Joins CEO on Hot Seat," *Wall Street Journal*, September 13, 2002; Laurie P. Cohen, "How a Tyco Lawyer Channeled Windfall Into Unlikely Cause," *Wall Street Journal*, June 4, 2003; *Tyco v. Kozlowski*, p. 17.
13. Symonds & Moore, May 28, 2001.
14. Bianco, et al., December 23, 2002; Mark Maremont & Joseph Weber, "Tyco's Deal-A-Month Man," *Business Week*, January 27, 1997; *Tyco v. Kozlowski*, p. 12.
15. Chad Bray, "Former Official at Tyco Testifies He Was Directed to Forgive Loans," *Wall Street Journal*, February 17, 2005; Colleen DeBaise, "Kozlowski Aide Details Lucrative Salary, Benefits," *Wall Street Journal*, November 14, 2003.
16. Laurie P. Cohen & Mark Maremont, "Tyco Ex-Director May Face Charges," *Wall Street Journal*, September 19, 2002.
17. *SEC v. Kozlowski, et al.*, pp. 9–10.
18. *Tyco v. Kozlowski*, pp. 33–34.
19. *Tyco v. Kozlowski*, pp. 11 & 32.
20. James Bandler & Jerry Guidera, "Tyco Ex-CEO's Party for Wife Cost $2.1 Million, But Had Elvis," *Wall Street Journal*, September 17, 2002.
21. Colleen DeBaise, "Newest 'Tyco Gone Wild' Video Is Out, and Jurors See $6,000 Shower Curtain," *Wall Street Journal*, November 26, 2003.
22. *SEC v. Kozlowski, et al.*, p. 13.
23. *SEC v. Kozlowski, et al.*, p. 10; *Tyco v. Kozlowski*, pp. 17 & 21.
24. Robert Barker, "The High Cost of Kozlowski's Keep," *Business Week*, February 25, 2002.
25. John Hechinger & Gregory Zuckerman, "Is Clock Ticking for Tyco's Swartz," *Wall Street Journal*, June 6, 2002.
26. Laurie P. Cohen & John Hechinger, "Tyco Dismisses General Counsel After a Dispute," *Wall Street Journal*, June 11, 2002.

27. William C. Symonds, Pamela L. Moore & Heather Timmons, "Tyco Breaks Out of Its Mold," *Business Week*, March 26, 2001.
28. Symonds & Moore, May 28, 2001; *Tyco v. Kozlowski*, pp. 25–28.
29. *Tyco v. Kozlowski*, p. 24.
30. Anonymous, "Dennis Kozlowski: Tyco International," *Business Week*, January 8, 2001; Symonds & Moore, May 28, 2001.
31. Mark Maremont, "Tyco Inflated Cash Flow of Acquisition," *Wall Street Journal*, March 19, 2002.
32. Nanette Byrnes, "Kozlowski's Comedown," *Business Week*, June 5, 2002; Mark Maremont & Jerry Markon, "Ex-Tyco Chief Evaded $1 Million in Taxes on Art, Indictment Says," *Wall Street Journal*, June 5, 2002.
33. *The People of the State of New York v. L. Dennis Kozlowski*, Supreme Court of the State of New York, June 4, 2002.
34. Cohen, September 13, 2002; *SEC v. Kozlowski, et al.*, pp. 14–15.
35. Joann S. Lublin, "Two Board Criticized on Kozlowski," *Wall Street Journal*, June 7, 2002.
36. Mark Maremont, "Tyco Discloses It Paid Director on Merger Deal," *Wall Street Journal*, January 29, 2002.
37. Denis Collins, 2006, *Behaving Badly: Ethical Lessons from Enron*, Indianapolis, Ind.: Dog Ear Publishers.
38. David Armstrong, "Tyco International Says Soft Demand Will Depress Fiscal Second-Quarter Results," *Wall Street Journal*, January 16, 2002.
39. Laura Johannes, "Tyco Aims to Boost Shareholder Value With Breakup," *Wall Street Journal*, January 23, 2002.
40. Maremont, January 29, 2002; Mark Maremont, "Tyco Stock Stumbles 20% in Latest Reaction to Corporate Behavior," *Wall Street Journal*, January 30, 2002.
41. Ruth Simon & Kale Kelly, "Executives Use Delaying Tactic in Insider Sales," *Wall Street Journal*, January 31, 2002.
42. Mark Maremont, "Tyco Made $8 Billion of Acquisitions Over 3 Years But Didn't Disclose Them," *Wall Street Journal*, February 4, 2002.
43. John Hechinger, "Tyco to Lay Off 44% of Its Workers at Telecom Unit," *Wall Street Journal*, February 8, 2002; John Hechinger, "Tyco Offers Proof It Is Healthy; Yet It Faces a Huge Debt in 2003," *Wall Street Journal*, February 11, 2002.
44. Mark Maremont, "Tyco Seems to Back Off From Breakup," *Wall Street Journal*, February 14, 2002.
45. William C. Symonds, Heather Timmons & Diane Brady, "Behind Tyco's Accounting Alchemy," *Business Week*, February 25, 2002.
46. Mark Maremont, "Tyco Abandons Plan for Breakup," *Wall Street Journal*, April 26, 2002; Mark Maremont & Robert Frank, "Tyco Shares Fall 15% on Worries About Company's Strategy, Debt," *Wall Street Journal*, April 30, 2002.
47. *Tyco v. Kozlowski*, p. 28.
48. Byrnes, June 5, 2002.
49. *SEC v. Kozlowski, et al.*, pp. 5–11.
50. Mark Maremont, Kara Scannell & Charles Forelle, "Mistrial Scuttles Possible Guilty Verdicts in Tyco Case," *Wall Street Journal*, April 5, 2004.
51. Chad Bray & Colleen DeBaise, "Tyco Ex-Lawyer Is Acquitted in Bonuses Trial," *Wall Street Journal*, July 16, 2004; Jennifer Levitz, "Former Tyco Lawyer Will Pay Fine to Settle SEC Charges Over Loans," *Wall Street Journal*, May 3, 2006.
52. Mark Maremont & Chad Bray, "Tyco Trial Jurors Say Defendants Weren't Credible," *Wall Street Journal*, June 20, 2005.
53. Mark Maremont, "Tyco Figures Will Be Jailed at Least 7 Years," *Wall Street Journal*, September 20, 2005.
54. Anonymous, "Tyco Ex-CEO Is Sued for Divorce," *Wall Street Journal*, August 17, 2006.