

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK**

SECURITIES AND EXCHANGE COMMISSION,	:	
	:	
	:	
Plaintiff,	:	
v.	:	06-CV-2942 (RWS)
	:	ECF CASE
TYCO INTERNATIONAL LTD.,	:	
	:	
	:	
Defendant.	:	

**PLAINTIFF’S MOTION FOR AN ORDER APPROVING
A DISTRIBUTION PLAN FOR THE TYCO FAIR FUND**

Plaintiff, United States Securities and Exchange Commission (“Commission” or “SEC”), moves the Court for an order authorizing a plan of distribution for the funds paid by defendant Tyco International Ltd. (“Tyco”) and certain former Tyco officers and employees in settlement of the SEC’s securities law enforcement actions to injured investors.

BACKGROUND

On April 17, 2006, the Commission filed its Complaint in this action. *See SEC v. Tyco International Ltd.*, No. 06-cv-02942-RWS, Docket No. 1. The Complaint alleged that from 1996 through 2002, Tyco engaged in various improper accounting practices that violated the federal securities laws by, among other things, overstating its reported financial results, improperly using reserve accounts to enhance and smooth reported financial results, engaging in improper acquisition accounting practices, and concealing from investors substantial amounts of senior executive compensation and a large number of related party transactions.¹

¹ One of the more significant improper accounting practices was the so-called “Dealer Connection Fee,” instituted by senior Tyco management in October 1997 which improperly inflated Tyco’s reported operating income. *See* Complaint, ¶ 28 at 11. Tyco discontinued the

On April 27, 2006, this Court entered a final judgment in the Commission's case against Tyco, which, among other things, ordered Tyco to pay disgorgement of \$1 and a \$50,000,000 civil penalty. *See id.*, Docket No. 4 (Final Judgment as to Defendant Tyco International Ltd.). These funds were paid into an account in the Court Registry Investment System ("Tyco CRIS Account"). The final judgment against Tyco further provided that the Commission may propose a plan to distribute the funds in the Tyco CRIS Account to injured investors pursuant to the "Fair Fund" provisions of the Sarbanes-Oxley Act of 2002. *See* Final Judgment, Section VII.

The Commission subsequently filed a related case against three former Tyco officers and employees, alleging that they were involved in devising, implementing, or furthering certain of Tyco's improper accounting practices, including the Dealer Connection Fee transaction. *See SEC v. Richard D. Power, Edward Federman, and Richard J. "Skip" Heger*, No. 06-CV-15343 (RWS) (SDNY filed Dec. 21, 2006). Between 2006 and 2009, final judgments were entered against each of these defendants. *See id.*, at Docket Nos. 4, 20, and 38. Each final judgment ordered the defendant to pay disgorgement and civil penalties into the Tyco CRIS Account, and each judgment further provided that these sums could be distributed in a "Fair Fund" distribution to injured investors.²

The Commission moved the Court to establish the Tyco Fair Fund to distribute the disgorgement and civil money penalties in the Tyco CRIS Account on August 5, 2009. At that time, the Commission requested that the Court appoint the Garden City Group, Inc. ("Garden City") as the Tyco Fair Fund Administrator, charged with assisting the Commission in

Dealer Connection Fee and restated its historical financial statements in 2003. While it was in use, the Dealer Connection Fee inflated Tyco's operating income by approximately \$567 million.

² The current balance in the Tyco CRIS Account is approximately \$55.9 million.

developing a plan of distribution and administering the distribution itself. The Court granted the Commission's motion to establish the Tyco Fair Fund and appoint Garden City as its Fund Administrator on August 12, 2009. *See SEC v. Tyco Int'l Ltd.*, Docket No. 48.

Garden City, in consultation with Commission staff, has prepared a Distribution Plan for the Tyco Fair Fund, which the Commission now submits to this Court for its approval.³

ARGUMENT

The Commission's Proposed Plan for Distributing the Tyco Fair Fund Should be Approved as Fair and Reasonable

A. Courts Give Significant Deference to the SEC's Distribution Plans

It is the rare case where the funds recovered in a securities law enforcement action could completely compensate all investors for the losses they suffered due to the conduct that violated the federal securities laws. Consequently, nearly every plan to distribute funds obtained in SEC enforcement actions requires choices to be made between and among potential claimants to the amounts recovered. In recognition of the difficulty of this task, courts give the Commission significant discretion to design and set the parameters of a distribution plan. *See SEC v. Wang*, 944 F.2d 80 (2d Cir. 1991); *SEC v. Levine*, 881 F.2d 1165 (2d Cir. 1989). Consistent with this discretion, a court's review of a plan proposed by the Commission to distribute the disgorgement and penalties obtained in its civil enforcement actions focuses on whether the plan is fair and reasonable. *See Official Comm. of Unsec. Creditors of Worldcom, Inc. v. SEC*, 467 F.3d 73, 81 (2d Cir. 2006) ("unless the consent decree specifically provides otherwise[,] once the district court satisfies itself that the distribution of proceeds in a proposed SEC disgorgement plan is fair and reasonable, its review is at an end"), *citing Wang*, 944 F.2d at 85. The Commission submits

³ A copy of the proposed Distribution Plan for the Tyco Fair Fund is attached as Exhibit 1 to this Motion.

that the proposed distribution plan for the Tyco Fair Fund, outlined below, constitutes a fair and reasonable allocation of the limited funds available, and should be approved.

B. The Commission's Proposed Distribution Plan Fairly and Reasonably Allocates and Expeditiously Distributes the Available Funds

The Commission's principal goal in fashioning a distribution plan for the Tyco Fair Fund was to identify a methodology that would allocate the available funds fairly and reasonably, in a manner proportional to the injury investors in Tyco's common stock suffered from the company's improper accounting practices. Consequently, an event study analysis was performed to determine the impact of these practices on those investors.⁴ The event study analyzed price data for Tyco common stock analyzed starting from December 1, 1997 through July 29, 2003. The start date for the analysis corresponds to the beginning of the first period in which the Dealer Connection Fee (one of the more significant improper accounting practices) impacted Tyco's reported financial results. The end date for the analysis was selected because Tyco filed an amended Form 10-K with the Commission on July 29, 2003. This amended Form 10-K included revised consolidated financial statements for the fiscal years 1998 through 2002 that was intended to correct problems in the company's earlier financial statements resulting from, *inter alia*, the improper accounting practices that formed the basis of the Commission's complaint against Tyco.

The results of this analysis are presented in the chart captioned "Tyco International Ltd. Daily Common Stock Price and Artificial Inflation."⁵ As can be seen from this chart, the price of Tyco's common stock was artificially inflated by Tyco's improper accounting practices at the beginning of the period by approximately \$14 per share (an amount representing over 70% of its

⁴ The Commission will make the event study, which is summarized above, available to the Court on its request.

⁵ Attached as Exhibit A1 to the Distribution Plan.

price). The artificial inflation figure rose to as much as \$40 per share in early 2001 before it declined to zero on March 14, 2003. On March 13, 2003, Tyco filed a Form 8-K with the Commission, announcing that it had identified accounting problems in its Fire and Security Services business; on that day, the stock's price dropped approximately 12%, to \$12.27 per share. The stock's price declined further to \$11.48 on the following day, March 14, 2003, eliminating the artificial inflation component of the stock's price.

The event study indicates that the price of Tyco's common stock was artificially inflated between December 1, 1997 and March 13, 2003. This date range was used to define the potential eligibility of claimants to participate in the Commission's proposed distribution plan.⁶ Accordingly, under the plan proposed by the Commission, potentially eligible claimants include investors who purchased Tyco's common stock between December 1, 1997 and March 13, 2003. *See* Distribution Plan, ¶ 1.24. The loss recognized for each investor ("Eligible Loss Amount") under the proposed plan corresponds to the difference between the inflation price per share on the date the stock was purchased less the inflation price per share on the date the stock was sold as shown on the inflation value chart. (The inflation price for stock sold or held on or after March 14, 2003, is zero.) *See* Distribution Plan, ¶¶ 1.15, 1.23; Plan of Allocation for the Tyco Fair Fund Distribution Plan (attached as Exhibit A to the Distribution Plan).

To the extent that there are not sufficient funds in the Tyco Fair Fund to pay each claimant an amount equal to their entire eligible loss amount, the proposed distribution plan

⁶ The period for eligible claims in the proposed Tyco Fair Fund Distribution Plan is thus significantly longer than the recovery period used in the private *Tyco Int'l Sec. Litig.* class action, which applied to trades during the period from December 13, 1999 through June 7, 2002.

provides that claimants will be paid *pro rata*, in accordance with the percentage that the amount of each claim bears to the total amount of all claims.⁷

In addition to fairly allocating the limited funds available, the Commission sought a plan that would expedite the distribution process and minimize the expenses of the distribution and the burdens on potential claimants.⁸ Garden City - the Fund Administrator for this distribution - was also the claims administrator in the Tyco Class Action. The Commission's proposed distribution plan provides that Garden City may use the claims data previously submitted in the Tyco Class Action in administering the Tyco Fair Fund distribution. As a result, investors who submitted claims that were authorized for payment in the class action are automatically included as potentially eligible claimants in the Tyco Fair Fund distribution with respect to the trades that formed the basis for their claims in the class action. *See* Distribution Plan, ¶¶ 1.9, 3.4, 3.13, 3.18. Although there is not an exact overlap in the periods covered by the Tyco Class Action and the Commission's proposed distribution plan, use of the claims data from the class action will save some claimants the time and expense of completing new claims forms, and will expedite Garden City's efforts to identify and notify potentially eligible claimants. *Id.*, ¶ 3.13.

⁷ The Tyco Fair Fund Plan also provides for a minimum distribution amount to an eligible claimant of \$10. *See* Distribution Plan ¶¶ 1.2, 1.18.

⁸ Tyco is required under the terms of the Final Judgment to pay the costs of the Tyco Fair Fund distribution. *See* Final Judgment, Section VII (*SEC v Tyco Int'l Inc.*, Docket No. 4).

CONCLUSION

The Commission submits that the proposed distribution plan for the Tyco Fair Fund should be approved as fair and reasonable. The plan directs the Tyco Fair Fund's proceeds to investors who were harmed by the fraudulent and improper accounting practices alleged in the Commission's lawsuit, *i.e.*, those investors who acquired Tyco's common stock when its price was inflated by that unlawful conduct, and reasonably and fairly allocates the fund in accordance with the inflation in the stock price caused by the unlawful conduct. Moreover, the proposed plan allows the Fund Administrator to take advantage of claims previously filed and authorized in the Tyco Class Action, which will expedite the notification, submission, processing and payment of eligible claimants in the Tyco Fair Fund distribution.

Accordingly, the Commission respectfully requests that the Court grant the Commission's Motion and issue an Order approving the Commission's proposed Distribution Plan for the Tyco Fair Fund.

Dated: October 28, 2010

Respectfully submitted,

s/
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