UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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CASHIERS

UNITED STATES SECURITIES AND EXCHANGE COMMISSION, Plaintiff,	06 CV 15343
v.	ECF CASE
RICHARD D. POWER, EDWARD FEDERMAN, and RICHARD J. "SKIP" HEGER, Defendants.	COMPLAINT DEMAND FOR JURY TRIAL

Plaintiff, United States Securities and Exchange Commission ("Commission"), alleges as follows:

SUMMARY OF ALLEGATIONS

1. The Commission brings this case for violations of the federal securities laws by former officers and executives of Tyco International Ltd. ("Tyco"). For more than five years, defendants engaged in multiple improper accounting practices – including structuring sham transactions, employing improper acquisition accounting, and manipulating reserves to boost and smooth earnings – all designed to fraudulently inflate Tyco's reported financial results and conceal its true performance from investors and analysts.

2. Defendants Richard D. Power ("Power") and Edward Federman ("Federman") were involved in Tyco's financial reporting. Defendant Power held a number of titles at Tyco, and at all relevant times reported directly to Tyco's former CEO, L. Dennis Kozlowski ("Kozlowski"); Federman was an Assistant Controller at Tyco, later Tyco's Controller, and subsequently the CFO of a major Tyco division.

3. Defendants Power and Federman devised and implemented various improper accounting practices at Tyco. The most significant among these improper practices was a sham transaction devised by Power in 1997, and subsequently maintained and improved by Federman. One of Tyco's major business activities consisted of the sales and monitoring of electronic security systems, which it conducted through its Fire & Security Services division. As part of that business, Tyco purchased commercial and residential security monitoring contracts from independent dealers. The sham transaction structured by Power was inserted into these monitoring contract purchases. Pursuant to this sham transaction, Tyco and the dealer purportedly made identical and offsetting "payments" to each other, though no money changed hands; Power's sham transaction was effectively a round trip, lacked economic substance, and provided no pecuniary benefit to either Tyco or the dealer.

4. The sham transaction was designed to have, and did have, a specific false accounting effect and purpose, namely, to fraudulently inflate Tyco's reported financial performance. From Tyco's fiscal year ended September 30, 1998, through its fiscal quarter ended December 31, 2002, the sham transaction resulted in the fraudulent overstatement of Tyco's operating income by approximately $567 million, and in the overstatement of Tyco's reported cash flows from operations by approximately $719 million.

5. Between 1996 and 2002, Tyco acquired numerous companies. Kozlowski, Tyco's CEO, regularly dispatched Power and Federman to supervise the accounting for Tyco's most important acquisitions. In that process, both Power and Federman repeatedly proposed improper accounting entries designed to further falsely inflate Tyco's operating income. Power's and Federman's abusive acquisition accounting practices resulted in millions of dollars of fraudulent overstatements in Tyco's operating income.

6. As Tyco's Controller, Federman directed the improper reversal of reserves to offset unanticipated charges. During his tenure as the CFO of a major Tyco division, Federman was aware of the division's improper practice of aggressively using reserves to meet its earnings targets.

7. Defendant Richard J. "Skip" Heger ("Heger"), was the principal financial officer of, and oversaw accounting and financial reporting at, Tyco's Fire & Security Services division. Heger repeatedly approved financial results at the Fire & Securities Services division that he knew, or was reckless in not knowing, had been artificially inflated by the sham transactions and improper acquisition accounting, and improperly enhanced and smoothed by reserve manipulations.

8. By engaging in this conduct, defendants Power and Federman violated, and aided and abetted violations of, antifraud provisions of the federal securities laws, and all defendants violated books and records provisions of those laws. Moreover, all defendants aided and abetted Tyco's violations of periodic reporting and books and records provisions of the federal securities laws. The Commission requests, among other things, that this Court permanently restrain and enjoin each defendant from further violations of the federal securities laws as alleged in this Complaint, and order each defendant to disgorge all ill-gotten gains from his unlawful conduct, including prejudgment interest thereon, and to pay monetary penalties. The Commission also requests that the Court issue orders pursuant to Section 20(e) of the Securities Act of 1933 ("Securities Act") and Section 21(d)(2) of the Securities Exchange Act of 1934 ("Exchange Act") prohibiting defendants Power and Federman, and each of them, from acting as an officer or a director of any public company.

JURISDICTION AND VENUE

9. The Commission brings this action pursuant to Sections 20(b) and 20(d) of the Securities Act [15 U.S.C. §§ 77t(b) and (d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)].

10. This Court has jurisdiction over this matter pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Sections 21(e) and 27 of the Exchange Act [15 U.S.C. §§ 78u(e) and 78aa]. The defendants, directly or indirectly, singly or in concert, used the means or instrumentalities of interstate commerce, or of the mails, or the facilities of a national securities exchange, in connection with the transactions, acts, practices, and courses of business alleged in this Complaint.

11. Venue lies in the Southern District of New York, pursuant to Section 22(a) of the Securities Act [15 U.S.C. § 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. § 78aa], as certain of the acts, practices, and courses of conduct constituting the violations of law alleged in this Complaint occurred within this judicial district.

12. Defendants Power and Federman, directly and indirectly, singly or in concert, have engaged in, and unless restrained and enjoined by this Court will continue to engage in, transactions, acts, practices, and courses of business that violate Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)] and violate, and aid and abet violations of, Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]. All defendants, directly or indirectly, singly or in concert, have engaged in, and unless restrained or enjoined by this Court will continue to engage in, conduct, transactions, practices, and courses of business that violate Exchange Act Rule 13b2-1 [17 C.F.R. § 240.13b2-1], and aid and abet violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and

78m(b)(2)(A)] and Rules 12b-20, 13a-1, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13].

DEFENDANTS

13. Defendant Richard D. Power, age 58, resides in Palm Beach, Florida. He joined Tyco in 1979. From 1979 to 1992, Power held a series of senior financial reporting positions, including Chief Financial Officer. Power left Tyco in 1992, and rejoined it in 1995. Power was briefly fired from Tyco in December 1998, only to be rehired by Kozlowski the next month. Power held a series of titles at Tyco, including President of Carlisle Plastics (1997), Vice President of Tyco's Fire & Security Services division (1997-1998), and Executive Vice President of Tyco Medical Group (1998), which culminated in the title of Vice President – Special Projects (1999-2002). Power's specialty was acquisition accounting, and, despite his various titles, at all times relevant, he reported directly to Tyco Chief Executive Officer Kozlowski. Power was highly compensated, and received performance-based bonuses at Kozlowski's discretion. In June 2002, new management terminated Power. Prior to joining Tyco, Power was an accountant with the public accounting firm PricewaterhouseCoopers LLP ("PwC") for approximately eight years, rising to the level of Manager.

14. Defendant Edward Federman, age 53, resides in Boca Raton, Florida. Federman joined Tyco in 1983 as Assistant Corporate Controller. From February 1998 through April 1999, Federman was the Controller and Vice President of Finance at Tyco, reporting directly to Tyco Chief Financial Officer Mark H. Swartz. From 1999 until his resignation in January 2001, Federman was the Executive Vice President and Chief Financial Officer of Tyco Electronics, one of Tyco's operating divisions. Federman was highly compensated, and received performance-

based bonuses. Prior to joining Tyco, Federman was an accountant with PwC for four years, rising to the level of Senior Accountant.

15. Defendant Richard J. "Skip" Heger, age 61, resides in Boca Raton, Florida. From 1993 until he retired at the end of 2002, Heger served as the Vice President – Finance of Tyco's Fire & Security Services division. Heger was highly compensated, and received performance-based bonuses. Before joining Tyco, Heger held senior accounting and finance positions at several publicly traded U.S. companies.

RELEVANT ENTITY

16. Tyco is a multi-billon dollar company presently incorporated in Bermuda, with its headquarters located in Pembroke, Bermuda. At all relevant times, Tyco was a diversified manufacturing and service company with worldwide business operations. Tyco's major business segments include fire protection and safety systems, electronic security services, electrical and electronic components, medical products, and engineered products and services. At all times relevant, Tyco's common stock was listed and traded on the New York Stock Exchange, and registered with the Commission pursuant to Exchange Act Section 12(b) [15 U.S.C. § 78*l*]. Tyco's financial performance was covered and reported on by Wall Street analysts. Tyco filed annual and other periodic reports with the Commission pursuant to Exchange Act Section 13 [15 U.S.C. § 78m]. Tyco's fiscal year-end was September 30.

FACTS

17. In July 1997, Tyco merged with ADT Limited, an electronic security services company. After the merger, Tyco operated the security services business within its Fire & Security Services division, through its ADT Security Services, Inc. ("ADT") subsidiary. That business involved a "direct program," in which Tyco directly sold security monitoring equipment

and services to residential and commercial customers, and an "authorized dealer program," in which ADT purchased security monitoring contracts from independent security alarm dealers.

A. Defendants Used a Sham Transaction to Falsely Inflate Reported Income

18. In the weeks following Tyco's acquisition of ADT, defendant Power, then Vice President of Tyco's Fire & Security Services division, compared the accounting treatment of the direct program to that of the dealer program and determined that security monitoring contracts purchased from independent dealers benefited Tyco's earnings to a lesser degree than did contracts generated through direct sales. Power then invented an accounting "fix" that was designed to falsely inflate Tyco's reported income derived from the purchase of monitoring contracts. That fix was the dealer connection fee sham transaction ("DCF Sham Transaction"), which purportedly inserted new identical and offsetting payments between ADT and the dealer every time ADT purchased a monitoring contract.

19. Pursuant to the DCF Sham Transaction, Tyco imposed a new $200 "dealer connection fee" ("DCF"), which it purported to require dealers to pay for each security monitoring contract purchased, and simultaneously increased the price it purportedly paid the dealer for each contract by the same $200, an equal and offsetting amount that Tyco initially called a "growth bonus."

20. The imposition of the $200 DCF and the offsetting $200 "growth bonus" purportedly paid to the dealers did not alter the economic realities of the purchase transactions. Prior to these changes, ADT paid dealers approximately $800 per contract. After implementing the DCF Sham Transaction, ADT continued to pay approximately $800 per contract. No additional money changed hands as a result of the DCF Sham Transaction. The DCF Sham Transaction had no economic substance, and provided no benefit to either Tyco or the dealer.

21. The DCF Sham Transaction was designed to, and did, have a specific and false accounting effect. Tyco treated the dealer's $200 "connection fee" as income, which it recognized immediately in its income statement. Although the "connection fee" was negated by the offsetting "growth bonus," Tyco nevertheless treated the "growth bonus" as a capital expenditure and amortized the illusory "growth bonus" payments over ten years. Thus, as a result of the DCF Sham Transaction, Tyco immediately recognized a $200 increase to operating income on every contract it purchased. Tyco's recognition of income from the DCF Sham Transaction was not in conformity with generally accepted accounting principles ("GAAP").

22. In the course of its review of Tyco's financial statements for the fiscal quarter ended March 30, 1998, PwC, Tyco's independent accountant, listed the DCF Sham Transaction on its Summary of Unadjusted Differences. A series of meetings between PwC and Tyco was held to discuss the DCF. At those meetings, concerns were raised that the Commission would view the purported "growth bonus" as a payment that was just going to come right back to the company, and therefore lacked substance.

23. Federman, then Tyco's Controller, was Tyco's senior financial reporting officer at those meetings with PwC. Federman knew or was reckless in not knowing, that the DCF Sham Transaction lacked economic substance. He was aware that the DCF and the growth bonus were instituted by Tyco at the same time. While the discussions with PwC were underway, Federman received a facsimile transmission that contained the organic documents for the DCF Sham Transaction. Those documents showed that the DCF was completely offset by the growth bonus. Moreover, Federman and Power had exchanged accounting literature that indicated that Tyco's accounting for the DCF Sham Transaction was improper.

24. At the meetings with PwC, Federman vigorously defended the purported offsetting "payments" as unrelated and independently justifiable, despite his knowledge to the contrary. Federman was integral in modifying the DCF Sham Transaction to conceal the transaction's lack of substance and prevent discovery of its fraudulent purpose and effect. This modification involved no longer calling the purported $200 payment to the dealers a "growth bonus" and repackaging and concealing that payment as a purported across-the-board $200 increase in the average purchase price for each monitoring contract. That sum continued to offset the purported $200 connection fee ADT charged the dealers. Indeed, when this modification was implemented, Tyco reassured its dealers that it would not alter the economics of the transactions. As a result of Federman's defense of the DCF Sham Transaction in 1998, and the cosmetic changes he was instrumental in effecting, the DCF Sham Transaction accounting "fix" remained in place and its fraudulent impact on Tyco's income continued unabated for more than four years thereafter.

25. During his time as Corporate Controller, Federman approved Tyco financial statements which he knew, or was reckless in not knowing, included operating income and cash flow that had been improperly inflated by the DCF Sham Transaction.

26. From the inception of the DCF Sham Transaction until 2002, Heger was the Vice President – Finance at Tyco's Fire & Security Services division, which included ADT. The DCF Sham Transaction falsely inflated the Fire & Security Services division's financial performance, and Heger was responsible for its administration and continued use.

27. From time to time, the Fire & Security Services division created data schedules that were provided to PwC in an attempt to support Tyco's assertion that the DCF purportedly reimbursed Tyco's expenses associated with acquiring a new contract. Heger was aware of those

schedules. As a result, Heger knew that Tyco could not identify $200 in direct costs from the acquisition of a dealer contract, and he was aware of the effect that the DCF Sham Transaction had in artificially inflating his division's reported financial results. While aware of these things, Heger approved Fire & Security Services division financial statements that he knew, or was reckless in not knowing, included operating income and cash flow amounts that had been falsely inflated by the DCF Sham Transaction.

28. From Tyco's fiscal year ended September 30, 1998, through its fiscal quarter ended December 31, 2002, Tyco purchased hundreds of thousands of security monitoring contracts annually from dealers. During those periods, the DCF Sham Transaction falsely and fraudulently inflated Tyco's reported operating income by approximately $567 million and falsely and fraudulently increased its reported cash flow from operations by approximately $719 million.

29. As a result of the DCF Sham Transaction, Tyco filed with the Commission registration statements and periodic reports that contained materially false and misleading statements, including fraudulently overstated operating income and cash flow from operations for the above periods. For example, in Tyco's fiscal 2001 annual Report on Form 10-K and in its Form S-4 registration statement filed on January 8, 2002 (which incorporated Tyco's fiscal 2001 annual Report on Form 10-K), the DCF Sham Transaction falsely and fraudulently inflated the reported operating income of Tyco's Fire & Security Services division by more than 11%. In Tyco's quarterly Report on Form 10-Q for the second fiscal quarter of 2002, the company falsely and fraudulently reported $42.1 million of operating income. Tyco would have reported a net operating **loss** of $67.1 million in that period, but for the fraudulent effect of the DCF Sham Transaction on the company's operating income.

30. In July 2003, Tyco restated its financial statements for its fiscal year ended September 30, 1998, through its fiscal first quarter ended December 31, 2002, to restate, among other things, for its DCF accounting.

31. Power and Federman knew, or were reckless in not knowing, that the DCF Sham Transaction was an improper accounting device which was designed to, and did, artificially and falsely inflate Tyco's reported operating income and deceive investors and analysts. Moreover, Power, Federman, and Heger, and each of them, knew, or were reckless in not knowing, that his conduct substantially assisted Tyco's filing of materially false and misleading periodic reports with the Commission during that time.

B. Defendants Employed Improper Acquisition Accounting to Falsely Increase Income

32. From 1996 through 2002, Tyco acquired hundreds of companies. Tyco engaged in abusive acquisition accounting on multiple occasions during that period. Tyco's improper acquisition accounting practices included the pre-acquisition reduction of assets and overstatement of liabilities on the books and records of companies Tyco acquired; the improper valuation of acquired assets and acquired liabilities on Tyco's own books and records post-acquisition; and the establishment and use of purchase accounting reserves for items that do not qualify for purchase accounting treatment. The result was a significant, artificial enhancement of Tyco's reported operating income.

33. Power and Federman each played a significant role in the implementation of Tyco's improper acquisition accounting. Power and Federman were dispatched by Kozlowski to cut costs and manage acquisition accounting at several of Tyco's most significant acquisitions.

34. From 1996 through 2002, Power operated outside the usual Tyco chain of command, reporting directly to Kozlowski and working on whatever acquisitions or "special

projects" Kozlowski assigned him. Those assignments included most of Tyco's largest business combinations. In that capacity, he directed the improper establishment of purchase accounting reserves and restructuring reserves and the improper valuation of the assets and liabilities of acquired companies.

35. Power was involved in these activities as early as 1996. He oversaw the acquisition accounting for Tyco's 1996 acquisition of Carlisle Plastics, Inc. ("Carlisle"). At Tyco's request, Carlisle management made pre-acquisition entries to its books and records that reduced its assets and increased its liabilities by $26.4 million. Power referred to the Carlisle balance sheet adjustments as "financial engineering" and described the related reserves on Carlisle's closing balance sheet as "potentially in excess of the actual exposure." As a result of the Carlisle entries, Tyco overstated its post-acquisition earnings in its periodic reports filed with the Commission.

36. In Tyco's 1998 acquisition of Holmes Protection Group, Inc. ("Holmes"), a U.S. electronics security firm, Power proposed that Tyco write off the entire $72 million value of Holmes' installed subscriber alarm assets, despite the fact that the assets were in use generating revenue. Faced with objections from PwC, Tyco accomplished the same goal by instead valuing the acquired assets at salvage value, even though the company continued to use the alarm assets for more than two years after the acquisition. The undervaluation resulted in Tyco's incurring lower depreciation expenses in future periods. As a result, Tyco's annual Reports on Forms 10-K for its fiscal year ended September 30, 1998, through its fiscal year ended September 30, 2002, overstated the company's operating income by an aggregate amount of more than $70 million.

37. Federman was also instrumental in Tyco's improper acquisition accounting, both in his role as Tyco's Controller, and later as the Executive Vice President and Chief Financial Officer of Tyco's Electronics division.

38. Power and Federman worked together on some of Tyco's acquisitions. Power and Federman oversaw accounting decisions for Tyco's 1999 $3.45 billion acquisition of Raychem Corporation ("Raychem"), an electronics manufacturer. Together, they endeavored to improperly inflate Raychem's reserve accounts and oversaw the establishment of Raychem reserves on a "worst-case" basis, in excess of probable and estimable expenses. This practice did not conform to GAAP.

39. Power and Federman also directed that Raychem's acquired inventory be improperly valued on Tyco's books and records. This resulted in the understatement of Raychem's inventory by approximately $34.3 million. This improper accounting gave the illusion of larger profits for Tyco when Raychem's inventory was later sold off after the merger. Due to this improper accounting, Tyco's annual Report on Form 10-K for its fiscal year ended September 30, 1999, overstated the company's operating income by $13.3 million and its annual Report on Form 10-K for its fiscal year ended September 30, 2000, overstated the company's operating income by an additional $21 million.

40. Power and Federman also attempted to implement other improper acquisition accounting practices in the course of the Raychem acquisition. They urged Raychem to shift post-merger expenses into the unreported "stub" period between Raychem's final reporting period and Tyco's first post-acquisition reporting period to improperly enhance Tyco's reported performance; Federman even told Raychem accountants that the stub period would "never see the light of day" and represented a "once in a lifetime opportunity" to conceal the expenses.

Power also suggested consolidating Raychem and Tyco revenues a week before the merger was completed to falsely increase Tyco's reported financial performance.

41. Power and Federman also oversaw Tyco's acquisition accounting for its $3.3 billion acquisition of United States Surgical Corporation ("U.S. Surgical") in fiscal 1999. Power and Federman directed U.S. Surgical to make multiple improper pre-merger adjustments that reduced assets and increased liabilities to enhance Tyco's post-acquisition operating income. The improper entries included an asset write-off designed to result in $11.3 million in amortization savings; a $10 million overaccrual for expenses; a $5 million early accrual of various rebates; and a $5 million increased accrual for certain legal liabilities. They directed U.S. Surgical to accrue for pre-acquisition liabilities on a "worst-case" basis, in excess of probable and estimable expenses. This practice did not conform to GAAP. Both later took credit for the improper reserves, which Power admitted in an internal Tyco document were devised to help Tyco meet its first-year, post-merger financial earnings targets.

42. Some of Power's and Federman's improper accounting instructions and suggestions were not followed by internal accountants or were subsequently reversed at the request of PwC; indeed, the PwC engagement partner during this period noted that Power and Federman "engaged in aggressive and clearly inappropriate accounting," a fact that he brought to the attention of senior Tyco officials. However, other improper acquisition accounting devised by Power and Federman was not reversed and falsely inflated Tyco's reported financial performance during this period. Through improper acquisition accounting, not in conformity with GAAP, Power and Federman each knowingly or recklessly attempted to falsely enhance and overstate, and in fact did falsely enhance and overstate, Tyco's reported operating income. Moreover, Power and Federman knew, or were reckless in not knowing, that their improper

acquisition accounting activities had substantially assisted Tyco in its fraudulent overstatement of its operating income.

43. As Vice President – Finance at Tyco's Fire & Security Services division, Heger oversaw the accounting for multiple Tyco acquisitions. Several of those acquisitions included improper accounting practices which reduced the reported value of acquired assets and increased the reported value of acquired liabilities. These efforts were designed to improperly inflate enhanced operating income following the acquisition.

44. For example, Heger oversaw the acquisition accounting for Tyco's $200 million, fiscal year 1997 purchase of the fire protection operations of Thorn Security Group, Ltd. ("Thorn"). Heger was aware that reserves were established at Thorn in excess of "realistic needs." Despite this knowledge, under Heger's supervision, Tyco managers suggested, and Thorn's accountants recorded, pre-acquisition adjustments of $76.5 million that improperly reduced Thorn's assets or increased its liabilities. These adjustments were made to provide post-acquisition income to Tyco, and, in fact, resulted in Tyco overstating its reported operating income by approximately $29 million.

45. Heger's division also utilized inflated purchase accounting reserves to inflate the profit margins on several acquired companies' in-progress service contracts. The improper purchase accounting reserves were subsequently taken into income. As a result, from its fiscal year ended September 30, 1998, through its fiscal year ended September 30, 2001, Tyco overstated its operating income by at least $94 million.

46. Heger was aware that these improper acquisition accounting practices had improperly inflated his division's financial results. Accordingly, in approving those results, he

knew, or was reckless in not knowing, that he was substantially assisting Tyco's overstatement of its reported operating income.

C. Federman Improperly Managed Reserves to Enhance Earnings and Meet Targets

47. Federman improperly utilized reserves at Tyco to enhance the company's reported earnings. During its audit of Tyco's financial statements for the company's fiscal year ended September 30, 1998, PwC informed Tyco that an additional $40 million should be recorded as compensation expense and that Tyco should include the charge in the company's financial statements for that fiscal year. When PwC informed Tyco of the expense, the company was days away from its October 1998 earnings release and had already conditioned Wall Street analysts to expect earnings that did not include the charge. Taking an additional multi-million dollar compensation charge would have caused the company to report earnings per share that would have been lower than those Wall Street was anticipating.

48. In response to the crisis, Federman, then Tyco's Controller, and other Tyco Corporate financial officers compiled a list of "excess" accruals that could be reversed to offset the surprise $40 million charge. Although all or virtually all of those excess accruals had been previously listed by PwC as items that should be reversed, the accruals nevertheless remained on Tyco's books. Utilizing the list, Federman and the other Tyco Corporate financial officers selected $40 million in excess accruals to be released, thereby negating the earnings impact of the unexpected $40 million charge. Federman then created a memorandum that detailed these adjustments and directed that they be entered.

49. These adjustments included a $12.25 million reversal of an "accrued restructuring reserve" which was credited against Tyco's income statement line item for "selling, general, and administrative expense." This entry did not conform to GAAP, which provides that excess

restructuring reserves should be reversed to a separate line item for restructuring and other non-recurring items, instead of being included in selling, general, and administrative expense.

50. The adjustments also included a $2 million partial reversal of a general, unallocated reserve maintained on Tyco's Corporate books. Neither the general unallocated reserve nor the reversal conformed to GAAP, as GAAP does not permit establishment or use of "reserves for general contingencies." Even though PwC had repeatedly informed Tyco that the entire general unallocated reserve was improper and should be reversed, Tyco carried it on its books, using only a portion of the general reserve to offset the unexpected $40 million charge. Indeed, Tyco's improper general unallocated reserve had been used to help meet Tyco's earnings targets on other occasions during Federman's tenure as Controller. Tyco's general ledger reveals the improper use of $14.1 million from the general unallocated reserve in Tyco's third quarter of its 1998 fiscal year, and an additional improper use of $6.4 million in the fourth quarter of that fiscal year. Those reversals improperly and falsely enhanced Tyco's reported earnings during those periods.

51. Federman knew that Tyco's divisions or operating units sometimes used reserves to meet their earnings forecast. While he was Controller, Federman received documents that discussed the practice of using reserves to meet earnings targets. An April 1998 memo from a Tyco Corporate accountant to Federman and other senior financial managers states that Tyco had "barely" met its earnings estimates and, therefore, had not built reserves as "forecasted." The memo also states that one manager, reporting on the earnings of a newly acquired company, was "a little squeamish about being overly aggressive on the reserve usage right out of the box."

52. During his subsequent tenure as Chief Financial Officer of Tyco's Electronics division, Federman sent an e-mail to Tyco Chief Financial Officer Swartz stating that the

Electronics division had "used $11.4 million in reserves to make [its] January 2000 forecast." That same month, Federman was copied on an Electronics division e-mail to a regional controller suggesting that the regional controller "hold some of the excess [earnings] back and put it on [his] balance sheet." The e-mail suggested that the resulting accrual could be held "for a rainy day."

53. Consequently, Federman, as Tyco's Controller, and subsequently as the Chief Financial Officer of Tyco's Electronics division, approved financial results that he knew, or was reckless in not knowing, had been artificially inflated through the improper use of reserves.

54. The utilization of reserves to smooth reported results and meet earnings targets was widespread in Heger's Fire & Security Service division. As part of the monthly closing process at that division, finance managers at the various business units submitted "flash reports," which compared a business unit's preliminary monthly revenue and earnings to its forecast. The division regularly held monthly flash report meetings to review the reports and discuss actual versus forecast results. Typically, when a report indicated that results flowing up from a business unit were falling below forecasts, Heger or another senior financial manager would call the business unit vice president or finance department head to discuss the "flashed" results. The manager would inquire about possible excess accruals at the business unit and, in those cases where "excess" reserves were identified, the business unit would frequently submit revised financial results that met its forecast. Similarly, when a business unit's results showed earnings or revenue that exceeded the forecast, Heger or another division financial manager would typically call the business unit to discuss the situation, and the unit would frequently submit revised, lowered results equaling the unit's forecast.

55. As the senior financial officer at Tyco's Fire & Security Services division, Heger approved division financial results. At the time that he approved those financial results, Heger was aware that the results had been enhanced or smoothed by the improper utilization of reserves. Accordingly, Heger knew, or was reckless in not knowing, that he had substantially assisted Tyco's artificial overstatement or smoothing of its financial results.

D. Tyco's False Filings with the Commission

56. As a result of defendants' conduct described above, Tyco's registration statements on Forms S-3, S-4, and S-8 filed from April 23, 1998 through May 22, 2002, and periodic reports on Forms 10-K and 10-Q for its fiscal year ended September 30, 1997, through its fiscal quarter ended December 31, 2002, were false and misleading. These filings included financial statements that materially misrepresented the company's financial results, overstating its operating income and cash flow from operations due to the DCF Sham Transaction, improper acquisition accounting, and the use of reserve accounts to boost operating income.

E. Defendants' Fraud Remained Concealed Until at Least Late 2003

57. As a result of the conduct described above concealing the fraudulent DCF Sham Transaction, and as a result of that transaction's self-concealing nature, the Commission did not receive information sufficient to alert it to the existence of the fraudulent DCF Sham Transaction until late 2003. The Commission opened an enforcement investigation of Tyco in June 2002. That investigation focused on the DCF only after Tyco announced in October 2002 its intention to restate its reported fiscal year 2002 income to reverse a portion of the income derived from the DCF. For months following that restatement, Tyco continued to assert that its DCF accounting treatment was proper and that the DCF Sham Transaction consisted of "two separate transactions." In or around October 2003, in the course of its investigation, the Commission first

obtained the documents, testimony, and other information that revealed the origins and fraudulent purpose of, and the participants in, the DCF Sham Transaction. The fraudulent nature of the reserve practices and improper acquisition accounting techniques described above was also self-concealing, and only came to light as a result of the Commission's investigation commenced in June 2002.

CLAIMS FOR RELIEF

FIRST CLAIM

Power and Federman Violated Securities Act Section 17(a)
[Fraud in the Offer or Sale of Securities]

58. The Commission realleges and incorporates ¶¶ 1 through 57 above.

59. As set forth more fully above, defendants Power and Federman, and each of them, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce, or by the use of the mails, directly or indirectly: (a) employed a device, scheme, or artifice to defraud; or (b) obtained money or property by means of an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or (c) engaged in a transaction, practice, or course of business which operated or would operate as a fraud or deceit upon purchasers of securities.

60. In connection with the above described acts and omissions, defendants acted knowingly, recklessly, or negligently. Each knew, or was reckless in not knowing, or should have known, that Tyco's filings with the Commission contained material misstatements and omissions. By reason of the foregoing, defendants Power and Federman, and each of them, violated Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

SECOND CLAIM

Power and Federman Violated Exchange Act Section 10(b) and Exchange Act Rule 10b-5 [Fraud in Connection with the Purchase or Sale of Securities]

61. The Commission realleges and incorporates ¶¶ 1 through 60 above.

62. As set forth more fully above, defendants Power and Federman, and each of them, directly or indirectly, by the use or means or instrumentalities of interstate commerce, or by use of the mails, or of the facilities of a national securities exchange, knowingly or recklessly, in connection with the purchase or sale of securities: (a) employed a device, scheme, or artifice to defraud; (b) made an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or (c) engaged in an act, practice, or course of business which operated or would operate as a fraud or deceit upon other persons.

63. In connection with the above described acts and omissions, defendants acted knowingly or recklessly. Each knew, or was reckless in not knowing, that Tyco's filings with the Commission contained material misstatements and omissions. By reason of the foregoing, defendants Power and Federman, and each of them, violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

THIRD CLAIM

Power and Federman Aided and Abetted Violations of Exchange Act Section 10(b) and Rule 10b-5

64. The Commission realleges and incorporates ¶¶ 1 through 63 above.

65. Tyco, in connection with the purchase or sale of a security, by the use or means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, knowingly or recklessly: employed devices, schemes, or artifices to defraud; made

untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons, in violation of the Exchange Act's general anti-fraud provisions, Section 10(b) [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5]. As detailed above, defendants Power and Federman, and each of them, knowingly or recklessly provided substantial assistance to Tyco's violations of Section 10(b) of the Exchange Act and Rule 10b-5.

66. By reason of the foregoing, defendants Power and Federman, and each of them, aided and abetted Tyco's violations of Section 10(b) of the Exchange Act and Rule 10b-5.

FOURTH CLAIM

All Defendants Aided and Abetted Violations of Exchange Act Section 13(a) and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [Reporting Violations]

67. The Commission realleges and incorporates ¶¶ 1 through 66 above.

68. In connection with the conduct described above, Tyco did not file with the Commission such financial reports as the Commission has prescribed, and Tyco did not include, in addition to the information expressly required to be stated in such reports, such further material information as was necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading, thereby violating the Exchange Act's reporting provisions, specifically, Section 13(a) [15 U.S.C. § 78m(a)] and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13]. As detailed above, defendants Power, Federman, and Heger, and each of them, acted knowingly or recklessly provided substantial assistance to Tyco in these violations.

69. By reason of the foregoing, defendants Power and Federman, and each of them, aided and abetted Tyco in its violations of Section 13(a) [15 U.S.C. § 78m(a)] and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13].

FIFTH CLAIM

All Defendants Violated Exchange Act Rule 13b2-1 and Aided and Abetted Violations of Exchange Act Section 13(b)(2)(A) [Books and Records Violations]

70. The Commission realleges and incorporates ¶¶ 1 through 69 above.

71. In connection with the conduct described above, defendants Power, Federman, and Heger, and each of them, falsified or caused to be falsified Tyco's books, records, and accounts required by Exchange Act Section 13(b)(2)(A) [15 U.S.C. § 78m(b)(2)(A)], and Tyco violated that provision by failing to make or keep books, records, and accounts, which, in reasonable detail accurately and fairly reflected its transactions and disposition of its assets. As detailed above, defendants Power, Federman, and Heger, and each of them, knowingly or recklessly provided substantial assistance to Tyco in its violation of Section 13(b)(2)(A) of the Exchange Act.

72. By reason of the foregoing, defendants Power, Federman, and Heger, and each of them, violated Exchange Act Rule 13b2-1 [17 C.F.R. § 240.13b2-1], and also aided and abetted Tyco's violations of Section 13(b)(2)(A) of the Exchange Act.

JURY DEMAND

73. The Commission hereby demands trial by jury on all claims so triable.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court enter Orders:

A. Permanently restraining and enjoining Power from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rules 10b-5 and 13b2-1 [17 C.F.R. §§ 240.10b-5 and 240.13b2-1], and from aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)(A)] and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13];

B. Permanently restraining and enjoining Federman from violating Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Exchange Act Rules 10b-5 and 13b2-1 [17 C.F.R. §§ 240.10b-5 and 240.13b2-1], and from aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)(A)] and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13];

C. Permanently restraining and enjoining Heger from violating Exchange Act Rule 13b2-1 [17 C.F.R. § 240.13b2-1] and from aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act [15 U.S.C. §§ 78m(a) and 78m(b)(2)(A)] and Exchange Act Rules 12b-20, 13a-1, and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, and 240.13a-13];

D. Ordering Power, Federman, and Heger, and each of them, to disgorge all ill-gotten gains, with prejudgment interest;

E. Prohibiting defendants Power and Federman, and each of them, pursuant to Section 20(e) of the Securities Act [15 U.S.C. § 77t(e)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)], from acting as an officer or a director of any issuer that has a class of