

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION**

**IN RE HEALTHSOUTH ERISA
LITIGATION**

Consolidated File No.

CV-03-BE-1700-S

This Document Relates To: All Actions

**CONSOLIDATED AMENDED COMPLAINT FOR
BREACH OF FIDUCIARY DUTY UNDER ERISA**

Plaintiffs Kim Coggins (“Coggins”), Kim French (“French”), Laurie Hunter (“Hunter”), Kristi Renee Kelly Priest (“Priest”), Robert J. Lancaster (“Lancaster”), and Anne K. Low (“Low”) (collectively “Plaintiffs”), participants in the HealthSouth Rehabilitation Corporation and Subsidiaries Employee Stock Benefit Plan (the “Plan”) on behalf of themselves and a class of all others similarly situated, allege as follows:

I. INTRODUCTION

1. This is a class action brought pursuant to § 502 of the Employee Retirement Income Security Act (“ERISA”), 29 U.S.C. § 1132, on behalf of the participants in and beneficiaries of the Plan, an ESOP sponsored by the HealthSouth Corporation (“HealthSouth” or the “Company”) and certain of its affiliated companies as a pension benefit plan for its employees.

2. Plaintiffs were employees of the Company and participants in the Plan during the Class Period (January 1, 1998 – present).

3. Plaintiffs' claims arise from the failure of the Defendants, who are fiduciaries of the Plan, to act solely in the interest of the participants and beneficiaries of the Plan and to exercise the required care, skill, prudence, and diligence in administering the Plan and investing its assets. The Defendants violated their fiduciary obligations to the Plan under ERISA §§ 404 and 405, 29 U.S.C. §§ 1104 and 1105 by, among other things:

- (a) failing to prudently manage the assets of the Plan by maintaining investment in shares of HealthSouth stock for the Plan under circumstances in which Defendants could not possibly have believed that continued investment in HealthSouth stock was prudent;
- (b) failing to properly monitor the Plan's fiduciaries to ensure that they were prudently and loyally serving the interests of Plan participants and, in connection therewith, failing to remove and replace fiduciaries whom they knew or should have known were acting disloyally and imprudently with respect to the Plan and Plan assets; and
- (c) failing to provide fiduciaries who did not themselves participate in or know about the Company's illegal practices with material information that these fiduciaries obviously needed to effectively carry out their duties and responsibilities under the Plan and ERISA.

4. Plaintiffs allege that Defendants' breaches of fiduciary duty with respect to the Plan's holding and acquisition of HealthSouth stock resulted in losses to the Plan which the Defendants are personally liable to make good to the Plan pursuant to ERISA §§ 409 and 502(a)(2), 29 U.S.C. §§ 1109 and 1132(a)(2).

5. Because their claims apply to the Plan's participants and beneficiaries as a whole, and because ERISA authorizes Plan participants such as Plaintiffs to sue for plan-wide relief for

breaches of fiduciary duty, Plaintiffs bring this action on behalf of themselves and all participants and beneficiaries of the Plan during the Class Period.

6. Throughout the Consolidated Amended Complaint for Breach of Fiduciary Duty Under ERISA (“Complaint”), Plaintiffs refer to the fiduciary duties and responsibilities of Defendants as set forth in the Plan Documents and as required by ERISA. “Plan Documents,” as the term is used herein, refers to the Summary Plan Description (“SPD”), which under ERISA serves as the primary fiduciary communication with participants, and to the formal Plan Document and various Trust Agreements pertaining to the Plan.

7. The Plan Document has been revised and restated several times since the Plan was created. A new Plan Document was executed by the Board of Directors on February 27, 2002. However, this version purportedly was effective as of January 1, 1997 (“1997 Plan Document”).¹ To the extent the 1997 Plan Document was, in fact, effective as of that date, it has been operative throughout the Class Period. If, on the other hand, discovery establishes that the 1997 Plan Document was not effective until it was executed, then the prior version of the Plan, executed on January 1, 1994, also will be relevant to this litigation. Although the language of the 1994 and 1997 Plan Documents differs in a number of respects, unless otherwise indicated herein, the identity of the Plan fiduciaries, and the actual scope of fiduciary authority exercised by the fiduciaries, did not change materially as a result of the 1997 Plan Document.

II. JURISDICTION AND VENUE

8. This Court has subject matter jurisdiction over this action pursuant to 28 U.S.C. § 1331 and ERISA § 502(e)(1), 29 U.S.C. § 1132(e)(1).

9. Venue is proper in this district pursuant to ERISA § 502(e)(2), 29 U.S.C. § 1132(e)(2), because the Plan was administered in this district, some or all of the fiduciary breaches for which relief is sought occurred in this district, and/or some Defendants reside or maintain a place of business in this district.

¹ The 1997 Plan Document is attached hereto as Exhibit A.

10. Because the information and documents on which Plaintiffs' claims are based are for the most part solely in Defendants' possession and, despite requests, only partial disclosure of Plan Documents and other information has been provided, certain of Plaintiffs' allegations are by necessity upon information and belief. At such time as Plaintiffs have had the opportunity to conduct additional discovery, Plaintiffs will, to the extent necessary and appropriate seek leave to amend the Complaint to add such other additional facts as are discovered that further support their claims.

III. PARTIES

A. Plaintiffs.

11. Plaintiffs Coggins, French, Hunter, Priest, Lancaster, and Low worked for HealthSouth, are participants in the Plan pursuant to ERISA § 3(7), 29 U.S.C. § 1102(7), and held HealthSouth shares in their individual Plan retirement accounts during the Class Period.

B. Defendants.

1. HealthSouth.

12. Defendant HealthSouth Corporation is incorporated in the state of Delaware and maintains its corporate headquarters at One HealthSouth Parkway, Birmingham, Alabama, 35243. According to the Company's fiscal 2001 10-K, HealthSouth "is the nation's largest provider of outpatient diagnostic and rehabilitative healthcare services. [HealthSouth] provide[s] this service through [its] national network of in-patient and outpatient healthcare facilities, outpatient surgery centers, diagnostic centers, medical centers and other healthcare facilities....[As of] December 31, 2001, HealthSouth operated approximately 1,900 locations in all 50 states, Puerto Rico, the United Kingdom, Canada and Australia."

13. HealthSouth is the Plan Sponsor, a Plan Administrator, and the Named Fiduciary within the meaning of ERISA § 402(a)(2), 29 U.S.C. § 1102(a)(2). In addition, HealthSouth is a fiduciary within the meaning of ERISA § 3(21)(A)(i), 29 U.S.C. § 1002(21)(A)(i), in that it possesses and exercises discretionary authority and control with respect to the management and

administration of the Plan and authority and control with respect to management or disposition of the Plan's assets.

14. Additionally, at all relevant times, HealthSouth relied on its Board of Directors ("Board") to carry out its own Plan administrative and management functions. Furthermore, the officers and employees identified herein as Defendants acted at all times in the course and scope of their employment with respect to their fiduciary duties and obligations, and, thus, their actions are imputed to HealthSouth under agency principles and the doctrine of *respondeat superior*. Accordingly, HealthSouth is liable for these actions as well.

2. Members of the Board of Directors.

15. HealthSouth's Board of Directors is identified as a Plan Administrator in Plan Documents. The Board was responsible for the appointment, removal, and, thus, monitoring of Plan fiduciaries, including the Individual and Bank Trustees, and the Plan administrative committee ("ESOP Committee"). The Board also participated directly in the management and administration of the Plan by having final decision-making authority regarding all aspects of Plan administration and management, as reflected by its review and ratification of Board resolutions pertaining to the Plan, including resolutions regarding the purchase of HealthSouth stock by the Plan, and the management of Plan investments. The individual members of the Board, therefore, are fiduciaries of the Plan in that they exercised discretionary authority and control with respect to management and administration of the Plan and authority and control regarding management and disposition of the Plan's assets.

16. Defendant Richard Scrushy ("Scrushy"), a founder of the Company and its Chairman of the Board and Chief Executive Officer ("CEO") for most of the Class Period, wore multiple fiduciary hats during his tenure at HealthSouth. As explained more fully below, Scrushy was, during different and often overlapping time periods, a Plan Trustee, a member of the ESOP Committee, and a Board member fiduciary who was responsible for appointing, removing, and, thus, monitoring other fiduciaries appointed by the Board. Scrushy was a

fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

17. Defendant Aaron Beam, Jr. ("Beam"), a co-founder of the Company, served variously as a Company Director, Executive Vice President, and Chief Financial Officer ("CFO") during his tenure with HealthSouth. In addition to his fiduciary duties as a Director-Plan administrator, Beam served as a Trustee of the Plan and member of the ESOP Committee. Beam was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

18. Defendant Michael D. Martin ("Martin") was an Executive Vice President for Investments, CFO (on two different occasions), Treasurer, and a Director of HealthSouth during the Class Period. During his tenure with the Company, he was a member of the ESOP Committee and a Plan Trustee. In all of these various roles, Martin was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

19. Defendant Anthony J. Tanner ("Tanner") was an Executive Vice President of Administration, Company Secretary, and a Director of HealthSouth during the Class Period. During his tenure at HealthSouth, he was a member of the ESOP Committee and a Plan Trustee. He also was the Chairman of the Compliance Committee of the Board of Directors ("Compliance Committee"), as well as the Company's "Compliance Officer." In all of these various roles, Tanner was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

20. Defendant William T. Owens (“Owens”), a HealthSouth employee since 1986, was an Executive Vice President, President, CFO, and Chief Operating Officer (“COO”), as well as a Director, of HealthSouth during the Class Period. During his tenure with the Company, he was also a member of the ESOP Committee and a Plan Trustee. In all of these various roles, Owens was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets. Defendant Owens resigned from the Board on October 9, 2003.

21. Defendant Brandon O. Hale (“Hale”) is a former HealthSouth Vice President of Human Resources, was the Company’s Senior Vice President of Administration and Secretary during a portion of the Class Period, and was the Company’s “Compliance Officer” during the Class Period. Hale was a member of the ESOP Committee, the Compliance Committee, and also was designated as a Trustee of the ESOP in HealthSouth’s fiscal 1999, 2000, and 2001 10-K submissions. Hale, therefore, was fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets. Hale resigned from the Board on or about October 1, 2003, amidst criticism that the Company’s Compliance Officer was, to say the least, ineffective.

22. Defendant Richard F. Celeste (“Celeste”) was a director of HealthSouth during the Class Period. As a Director-Plan Administrator, Celeste was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets

23. Defendant Larry R. House (“House”) was a director of HealthSouth during the Class Period. As a Director-Plan Administrator, House was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of

the Plan and authority and control with respect to management and disposition of the Plan's assets.

24. Defendant Raymond J. Dunn, III ("Dunn") was a director of HealthSouth during the Class Period. As a Director-Plan Administrator, Dunn was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

25. Defendant James P. Bennett ("Bennett") was President and COO, as well as a Director, of HealthSouth during the Class Period and, during his tenure, a member of the Compliance Committee. As a Director-Plan Administrator, Bennett was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

26. Defendant Phillip C. Watkins ("Watkins") was a Director of HealthSouth during the Class Period and, during his tenure, a member of the Compliance Committee. As a Director-Plan Administrator, Watkins was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

27. Defendant George H. Strong ("Strong") is a Director of HealthSouth. As a Director-Plan Administrator, Strong was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets. A recent settlement of certain claims against HealthSouth brought by the Louisiana Teachers' Retirement System provided for the removal of Directors on whose watch HealthSouth engaged in highly illegal and improper business and accounting practices. In connection with this settlement, Strong will resign as a Director by August 30, 2004.

28. Defendant C. Sage Givins (“Givins”) is a Director of HealthSouth and has been, during her tenure, a member of the Compliance Committee. As a Director-Plan Administrator, Givins is a fiduciary of the Plan in that she exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets. As required by HealthSouth’s recent settlement with the Louisiana Teachers’ Retirement System, Givens will resign as a Director by August 30, 2004.

29. Defendant Charles W. Newhall, III (“Newhall”) is a Director of HealthSouth and has been, during his tenure, a member of the Compliance Committee. As a Director-Plan Administrator, Newhall is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets. As required by HealthSouth’s recent settlement with the Louisiana Teachers’ Retirement System, Newhall will resign as a Director by August 30, 2004.

30. Defendant P. Daryl Brown (“Brown”) was President of a primary operating unit of the Company and a Director of HealthSouth during the Class Period. As a Director-Plan Administrator, Brown was a fiduciary of the Plan in that he exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

31. Defendant John S. Chamberlin (“Chamberlin”) is a Director of HealthSouth during the Class Period and has been, during his tenure, a member of the Compliance Committee. As a Director-Plan Administrator, Chamberlin is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets. As required by HealthSouth’s recent settlement with the Louisiana Teachers’ Retirement System, Chamberlin will resign as a Director by August 30, 2004.

32. Defendant Joel C. Gordon (“Gordon”) is a Director of HealthSouth and has been, during his tenure, the Chairman of the Compliance Committee. As a Director-Plan Administrator, Gordon is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

33. Defendant Larry D. Striplin, Jr. (“Striplin”) is a Director of HealthSouth. As a Director-Plan Administrator, Striplin is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets. As required by HealthSouth’s recent settlement with the Louisiana Teachers’ Retirement System, Striplin will resign as a Director by August 30, 2004.

34. Defendant Jan L. Jones (“Jones”) was a Director of HealthSouth. As a Director-Plan Administrator, Jones was a fiduciary of the Plan in that she exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

35. Defendant Robert P. May (“May”) is a Director of HealthSouth. As a Director-Plan Administrator, May is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

36. Defendant Jon F. Hanson (“Hanson”) is a Director of HealthSouth. As a Director-Plan Administrator, Hanson is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

37. Defendant Lee S. Hillman (“Hillman”) is a Director of HealthSouth. As a Director-Plan Administrator, Hillman is a fiduciary of the Plan in that he exercises discretionary

authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

3. ESOP Committee Members.

38. According to the Plan Documents, the ESOP Committee assists the Company and Board in performing their fiduciary duties owed to the Plan. As is described in greater detail below, the ESOP Committee is selected and overseen by HealthSouth and the Board of Directors and is responsible for, among other things, assisting with the administration of the Plan and managing multiple aspects of Plan administration and management. The ESOP Committee and its individual members are fiduciaries of the Plan in that they exercise discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to the management and disposition of the Plan's assets.

39. Defendants Scrushy, Beam, Martin, Tanner, Owens, and Hale each were members of the ESOP Committee during the Class Period.

4. Officer Trustee Defendants.

40. Defendants Scrushy, Beam, Martin, Tanner, Owens, and Hale each served as Officer Trustees of the Plan ("Officer Trustees") during the Class Period. As set forth in the Plan Documents, Officer Trustees also acted as administrators of the Plan. Upon information and belief, at such time as an ESOP Committee existed, the same three HealthSouth Officers/Directors who served as Officer Trustees also comprised the ESOP Committee. The Officer Trustee Defendants were fiduciaries of the Plan in that they exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

5. Daily Administrator Defendants.

41. Defendant Marca Pearson ("Pearson") was HealthSouth's Vice President of Benefits during the Class Period. Upon information and belief, Defendant Pearson served as the "Daily Administrator" of the Plan, as that term is defined in the Plan Documents, or the

functional equivalent thereof. Pearson was a fiduciary of the Plan in that she exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

42. Defendant Kimberly S. McCracken ("McCracken") was HealthSouth's Retirement Plan Manager during the Class Period. Upon information and belief, Defendant McCracken served as the "Daily Administrator" of the Plan, as that term is defined in the Plan Documents, or the functional equivalent thereof. McCracken was a fiduciary of the Plan in that she exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

43. Defendant Barbara Roper ("Roper") was HealthSouth's Senior Benefits Coordinator during the Class Period. Upon information and belief, Defendant Roper served as the "Daily Administrator" of the Plan, as that term is defined in the Plan Documents, or the functional equivalent thereof. Roper was a fiduciary of the Plan in that she exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

44. Defendant Dennis Wade ("Wade") is HealthSouth's Vice President of Human Resources. Upon information and belief, Defendant Wade serves as the "Daily Administrator" of the Plan, as that term is defined in the Plan Documents, or the functional equivalent thereof. Defendant Wade is a fiduciary of the Plan in that he exercises discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

6. Bank Trustees (not currently named as Defendants).

45. AmSouth Bank, formerly known as AmSouth Bank N.A., ("AmSouth") is designated as a Plan Trustee in numerous Plan regulatory filings and has allowed its representatives to sign such filings in a fiduciary capacity. While clearly a fiduciary of the Plan,

the extent of AmSouth's fiduciary activity, and whether it should be named as a defendant herein will only become clear after discovery. Therefore, AmSouth is not named as a defendant at this time.

46. During 2002, the Company changed Plan trustees from AmSouth to Wells Fargo Retirement Plan Services, Inc. ("Wells Fargo") and transferred the Plan's assets to the new trustees. As Wells Fargo acknowledges in its Services Agreement with HealthSouth, it is a fiduciary of the Plan within the meaning of ERISA. As with AmSouth, the extent of Wells Fargo's fiduciary activity, and whether it should be named as a defendant herein, will only become clear after discovery. Therefore, Wells Fargo is not named as a defendant at this time.

IV. APPROPRIATENESS OF CLASS ACTION

47. Plaintiffs bring this class action pursuant to Rule 23 of the Federal Rules of Civil Procedure in their representative capacity on behalf of themselves and a class ("Plan Class" or "Class") of all persons similarly situated, defined as follows:

All participants in the Plan and their beneficiaries, excluding the Defendants and their immediate family members, for whose accounts the fiduciaries of the Plan made or maintained investments in HealthSouth stock for the Plan between January 1, 1998, and the present (the "Class Period").

48. Plaintiffs meet the prerequisites to bring this action on behalf of the Class because:

Numerosity. The Class consists of thousands of individuals and is so numerous that joinder of all members as individual plaintiffs is impracticable.

Commonality. There are questions of law and fact common to the Class. Such common questions include, but are not limited to:

- (a) Whether Defendants breached their fiduciary duties under ERISA by failing to prudently manage the assets of the Plan by continuing to hold substantially all of the assets of the Plan in shares of HealthSouth stock under circumstances in which Defendants could

not have reasonably believed that such was in keeping with how a prudent trustee would operate;

- (b) Whether Defendants responsible for appointing other fiduciaries breached their fiduciary duties under ERISA by failing to properly monitor their appointees in order to ensure that, in carrying out their fiduciary responsibilities, the fiduciaries acted prudently, loyally, and for the exclusive purpose of providing benefits to the participants and beneficiaries of the Plan;
- (c) Whether Defendants breached their fiduciary obligations to the Plan and participants by providing incomplete and inaccurate information to other fiduciaries and participants regarding HealthSouth stock;
- (d) Whether Defendants, by failing to comply with their specific fiduciary responsibilities under ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1), enabled co-fiduciaries to commit violations of ERISA and, with knowledge of such breaches, failed to make reasonable efforts to remedy the breaches or participated in such breaches; and
- (e) Whether, as a result of fiduciary breaches engaged in by the Defendants, the Plan, and, indirectly, its participants and beneficiaries, suffered losses.

Typicality. Plaintiffs' claims are typical of the claims of the Class.

Adequacy. Plaintiffs will fairly and adequately protect the interests of the Class.

Plaintiffs have no interests that are antagonistic to or in conflict with the interests of the Class as a whole, and Plaintiffs have engaged competent counsel experienced in class actions and complex litigation.

49. This action is maintainable as a class action for the following independent reasons:

- (a) Given ERISA's imposition of a uniform standard of conduct on ERISA fiduciaries, the prosecution of separate actions by individual members of the Class would create the risk of inconsistent adjudications which would establish incompatible standards of conduct for the Defendants with respect to their obligations under the ESOPs. Fed. R. Civ. P. 23(b)(1)(A).
- (b) The prosecution of separate actions by members of the Class would create a risk of adjudications with respect to individual members of the Class which would, as a practical matter, be dispositive of the interests of the other members not parties to the adjudications, or substantially impair or impede their ability to protect their interests. Fed. R. Civ. P. 23(b)(1)(B).
- (c) The Defendants have acted or refused to act on grounds generally applicable to the Class, thereby making appropriate final injunctive, declaratory, or other appropriate equitable relief with respect to the Class as a whole. Fed. R. Civ. P. 23(b)(2).
- (d) Questions of law and fact common to members of the Class predominate over any questions affecting only individual members, and the class action is superior to other available methods for the fair and efficient adjudication of the controversy. Fed. R. Civ. P. 23(b)(3).

50. There are one or more putative or certified securities class action cases pending against HealthSouth and certain other Defendants. The claims herein are brought under ERISA and related principles of federal common law and are not being asserted by the plaintiffs in the securities class actions. Indeed, Plaintiffs' claims herein cannot be pursued in the securities actions, as the shares of HealthSouth stock in the Plan were not open market purchases. Accordingly, the named plaintiffs in those class actions do not adequately represent the Plaintiffs

or the Class herein with respect to ERISA claims. Moreover, the named plaintiffs in the securities actions may be subject to defenses, stays of discovery, heightened pleading requirements, and limitations of liability under the Private Securities Litigation Reform Act, 15 U.S.C. § 77z-1(b), and other statutes and rules that do not apply to the claims asserted herein. Furthermore, the shareholder plaintiffs in the securities actions lack standing under ERISA § 502(a), 29 U.S.C. § 1132(a), to bring an action on behalf of the participants of the Plan for allegations of fiduciary breaches.

V. THE PLAN

A. **The Plan Provides Broad Discretion Regarding the Range of Investment Options Available in the Event HealthSouth Stock Is Imprudent.**

51. The Plan was established by HealthSouth in 1991 purportedly “for the [dual] purpose of providing employees of the Company and affiliated entities the opportunity to save for their retirement and acquire a proprietary interest in the Company.”²

52. Thus, in addition to being an “employee pension benefit plan,” as defined by ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A), the Plan is an Employee Stock Ownership Plan (“ESOP”). An ESOP is an ERISA plan that may invest primarily in “qualifying employer securities.” 29 U.S.C. § 1107(d)(6)(A). Unlike other plans governed by ERISA, the duty to diversify plan assets *per se* does not apply to ESOPs. However, this does not mean that the Plan fiduciaries can invest blindly in HealthSouth stock regardless of the circumstances. On the contrary, the fiduciaries remain bound by the other core ERISA fiduciaries duties, including the duties to act loyally, prudently, and for the exclusive purpose of providing benefits to plan participants.

53. Hence, if the fiduciaries know or if an adequate investigation would reveal that HealthSouth stock no longer is a prudent investment, the fiduciaries must disregard the Plan

² 1997 Plan Document at 1, Exhibit A.

direction to invest in such stock and protect the Plan by investing the Plan assets in other suitable investments.

54. The Plan Documents incorporate these basic ERISA requirements, and, moreover, provide the fiduciaries with unusually broad discretion regarding the investment of Plan assets in the event HealthSouth stock becomes an imprudent investment for the Plan. As stated in the Summary Plan Description (“SPD”) provided to Plan participants:

To the extent Company stock is available for purchase *and the Administrator determines that it is prudent to purchase Company stock*, the Administrator will direct the Trustee to purchase Company stock. Otherwise, the Administrator will direct the Trustees to invest the Plan’s *funds in other investment media as the Administrator determines is in the best interests* of the Plan participants.³

55. Thus, unlike many ESOPs, which restrict investments to employer securities, cash or cash equivalents, the Plan does not in any manner limit the types of investments that the fiduciaries can make in the event that HealthSouth stock is not prudent.

B. The Plan’s Purchase of HealthSouth Stock.

56. Pursuant to the Plan Documents, the Plan is authorized to enter into non-recourse loans to purchase shares of HealthSouth stock, and did so on two occasions (“ESOP Loans”). First, in 1991 the Trustees (at the time, Scrushy, Beam, and Tanner), with the approval of the Board of Directors, obtained a \$10 million loan from HealthSouth, the proceeds of which were used to purchase 1,655,172 shares of HealthSouth common stock. The loan required the Plan to pay interest at the rate of 10 percent per annum. Similarly, in 1992, an additional \$10 million loan was made to the ESOP, which was used to purchase an additional 1,666,664 shares of HealthSouth common stock. This time the interest rate was set at 8.5 percent per annum.

57. At present, without the benefit of full discovery, the details of the first ESOP Loan are unknown to Plaintiffs. However, HealthSouth has produced information about the second ESOP Loan that raises concerns regarding whether the Plan fiduciaries ever had the

³ SPD at 6-7 (emphasis added), attached hereto as Exhibit B.

participants' best interests in mind, let alone administered the Plan with the "eye single" to the interests of participants as required by ERISA.

58. According to the Company's 1992 10-K SEC submission:

In November 1992, the Company's ESOP, using the proceeds of a \$10 million Loan from the Company, purchased an aggregate of 416,666 shares of [HealthSouth] Common Stock from **Richard M. Scrushy**, Chairman of the Board and Chief Executive Officer of the Company, for a total purchase price of \$10,000,000. The shares so sold by Mr. Scrushy were purchased by him upon exercise of stock options **utilizing \$2,822,530 loaned to him by the Company, which loan was immediately repaid out of the Proceeds** (emphasis added).

59. Thus, the Chairman and CEO helped approve a loan to himself to exercise options given to him by the Company so that a Company ESOP Plan, over which he had direct oversight and executive power as a member of the Board, a Plan Trustee, and an ESOP Committee member, could buy those shares from him at a price that not only would be sufficient for Scrushy to pay off his option-exercise loan, but also afford him millions in profit. In a Board resolution signed by, among others, Scrushy himself, the Board approved the transaction.

C. Loan Payments Paid by the Plan and Allocation of Shares to Participant Accounts.

60. Each year the Company was obligated by contract to make contributions in cash to the Plan which equaled the amount necessary to enable the Plan to make payments of principal and interest coming due on the ESOP Loans.

61. In essence, HealthSouth had a lien on the Plan's stock, a portion of which was "released" upon each annual loan payment. In the event of default, the seller's sole recourse was to recover the amount of stock securing the missed payment. A default in payment would not have led to acceleration of the entire loan, and only enough shares could have been foreclosed as the payment on the note would have released from the lien of the note – even if the shares proved to be insufficient to fully secure the loan.

62. In addition, the Plan Documents expressly allowed the Trustees in appropriate circumstances, as determined by the Plan Administrator, to sell HealthSouth stock held by the

Plan and use the proceeds to pay off the ESOP Loans.⁴ This is an important grant of authority, as it further reinforces that, in addition to the general duty under ERISA to invest Plan assets in HealthSouth stock only if prudent to do so, the Plan itself empowered the Trustees to liquidate the Plan's HealthSouth stock holdings.

63. The following chart documents the payments made by the Plan on the principal and interest of the ESOP Loans:

Payment Date	Payments	Totals
1/1/1992	\$ 725,000	\$ 725,000
1/1/1993	\$ 1,674,263	\$ 2,399,263
1/1/1994	\$ 3,272,858	\$ 5,672,121
1/1/1995	\$ 3,198,338	\$ 8,870,459
1/1/1996	\$ 3,198,338	\$12,068,797
1/1/1997	\$ 3,198,338	\$15,267,135
1/1/1998	\$ 3,198,338	\$18,465,473
1/1/1999	\$ 3,198,338	\$21,663,811
1/1/2000	\$ 3,198,338	\$24,862,149
1/1/2001	\$ 3,178,959	\$28,041,108
1/1/2002	\$ 1,524,075	\$29,565,183
1/1/2003	\$ 1,507,579	\$31,072,763

64. Thus, the Plan paid a total of \$31,072,763 for the shares of HealthSouth stock it held, much of which was purchased directly from Scrushy.

65. During some or all of the time that the Plan continued to make loan payments for the stock, the Officer Trustees, including, but not limited to, Scrushy, Beam, Martin, Tanner, Owens, and Hale, knew or should have known that the market price of HealthSouth stock was artificially inflated as a result of the Company's highly inappropriate and illegal accounting and business practices. As set forth more fully below, in light of these circumstances, the Officer

⁴ Amended and Restated Trust Agreement Under the HealthSouth Rehabilitation Corporation and Subsidiaries Employee Stock Benefit Plan, January 1, 1994 ("1994 Plan Trust Agreement") at § 4.1, attached hereto as Exhibit C.

Trustees and Plan Administrators should have made whatever disclosures to other fiduciaries, participants, and the public that were required by ERISA and the securities laws, suspended further loan payments, sold the allocated shares, and if and as necessary used the proceeds from the sale to pay off the remaining balance of the ESOP Loans so that appropriate alternate investments could have been made as contemplated by the Plan Documents.

66. The Plan Documents also set forth the process by which the Plan makes contributions to participants' Plan accounts. The dollar value of each participant's contribution is based on a ratio of his or her compensation compared to the compensation of all participants. Participants are then allocated shares of HealthSouth stock valued at the same amount based on the publicly traded price of the stock.

67. Thus, during the Class Period, at such time as the value of HealthSouth stock was artificially inflated by Defendants highly illegal and inappropriate business and accounting practices, participants were allocated shares of stock, the true value of which was significantly less than what was represented by Defendants. In effect, for every dollar of stock promised to participants, the fiduciaries, in fact, delivered less than a dollar of actual value.

D. Plan Restrictions Preventing Participants from Selling Shares of HealthSouth Stock.

68. Once allocated, participants' ability to sell the HealthSouth stock in their Plan accounts or diversify their holdings is severely restricted. Basically, participants cannot sell any of the stock until they are 55 years old and have completed 10 years of service.⁵ Thus, even after HealthSouth's debacle came to light, participants could not sell shares of HealthSouth stock in their Plan accounts. Conversely, the Plan fiduciaries could have sold the stock in the Plan, but they failed to do so.

⁵ ESOP participants who reach the age of 55 with 10 years of Plan participation may elect to diversify the assets in their Company stock account by directing the Plan administrator to transfer to HealthSouth's 401(k) Plan a portion of the account to be invested, at the participant's direction, in one or more of the 401(k) Plan's available investment options. 1997 Plan Document § 6.3, Exhibit A.

69. The losses to the Plan caused by Defendants' breaches of fiduciary duty are enormous. As of December 31, 1997, the Plan held approximately 3,320,000 shares of HealthSouth stock, valued at its market price of over \$89 million. Now, following revelations that HealthSouth and certain of its top executives, including Scrushy, Beam, Martin, and Owens – all Individual Plan Trustees – were involved in a vast scheme to inflate HealthSouth's earnings for their own benefit, HealthSouth stock is trading at approximately \$4.55 per share, representing a decline of approximately 83 percent of its value. The value of HealthSouth stock in the ESOP is now approximately \$15 million.

VI. DEFENDANTS' FIDUCIARY STATUS AND THE SCOPE OF THEIR FIDUCIARY DUTIES UNDER THE PLAN AND ERISA

70. *Named Fiduciaries.* ERISA requires every plan to provide for one or more "named fiduciaries" of the ESOP pursuant to ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1).

71. *De Facto Fiduciaries.* ERISA treats as fiduciaries not only persons explicitly named as fiduciaries under ERISA § 402(a)(1), but also any other persons who in fact perform fiduciary functions or hold fiduciary authority. *See* ERISA § 3(21)(A)(i), 29 U.S.C. § 1002(21)(A)(i) (stating that a person is a fiduciary "to the extent ... he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets ..."); and ERISA § 3(21)(A)(iii), 29 U.S.C. § 1002(21)(A)(iii) (stating that a person is a fiduciary if "he has any discretionary authority or discretionary responsibility in the administration of such plan.").

72. Instead of delegating fiduciary responsibility for the ESOP to external service providers, HealthSouth chose to comply with the requirements of ERISA § 402(a)(1) by internalizing the fiduciary function and by appointing its own directors, officers, and employees to manage and administer the Plan and the Plan assets.

73. As described herein, each of the Defendants was a fiduciary with respect to the Plan and owed fiduciary duties to the Plan and its participants under ERISA and in the manner

and to the extent set forth in the Plan Documents, as well as a result of their Plan-related fiduciary conduct.

A. HealthSouth.

74. At all times during the Class Period, HealthSouth was the Plan's Sponsor, Administrator, and Named Fiduciary. As stated in the 1997 Plan Document, "Responsibility for administration of this Plan shall be with the Company, which shall be the plan administrator and named fiduciary within the meaning of ERISA."⁶ In this capacity, HealthSouth has full authority to control and manage the operations of the Plan. *See* ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1). As a fiduciary, HealthSouth, like the other Plan fiduciaries, was required by ERISA §§ 404(a)(1)(A) and (B), 29 U.S.C. §§ 1104(a)(1)(A) and (B), to manage and oversee the Plan's investment in HealthSouth stock solely in the interest of the Plan's participants and beneficiaries and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

75. The Plan Documents could not be more clear in establishing HealthSouth's fiduciary duties as the Administrator and Named Fiduciary. Among other duties set forth therein, the 1997 Plan Document states:

The Company shall appoint a Committee consisting of at least three (3) persons who shall assist the Administrator in the administration of the Plan. All actions taken by the Committee shall be deemed actions taken by the Administrator and the Administrator shall alone have fiduciary responsibility in connection with such actions, except with respect to willful misconduct or gross negligence.⁷

76. While the effort to shield Committee members from fiduciary liability for their own actions is not permitted by ERISA, *see* ERISA § 410(a), 29 U.S.C. § 1110(a), the provision, nonetheless, clearly establishes that the actions of the ESOP Committee members are imputed to

⁶ 1997 Plan Document § 13.1, Exhibit A.

⁷ *Id.*

HealthSouth and, moreover, that HealthSouth exercised broad fiduciary responsibility for the Plan and Plan assets.

77. As the Plan Administrator, HealthSouth's specific duties include appointing and removing ESOP Committee members and Trustees and, thus, monitoring its appointees.

78. In addition, as reflected in Board resolutions and related documents, HealthSouth exercises discretionary authority and control by having final decision making authority over all aspects of the management and administration of the Plan and Plan Assets. With respect to assets in particular, HealthSouth is responsible for determining whether it is prudent for the Plan to purchase HealthSouth stock and, if so, directing the Trustees to do so. If the stock is not a prudent investment for the Plan, HealthSouth, as the Administrator, is responsible for directing "the Trustees to invest the Plan's funds in other investment media as it determines is in the best interests of the Plan participants."⁸

79. As the Administrator, during the Class Period, HealthSouth also is responsible for determining whether under the circumstances it is appropriate for the Plan to suspend making ESOP Loan payments or sell some or all of the HealthSouth stock held by the Plan and use the proceeds as necessary to pay off any remaining balance of the ESOP Loans.

80. In light of HealthSouth's status as a named fiduciary, and its broad exercise of discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to the management and disposition of the Plan's assets, HealthSouth is a fiduciary of the Plan within the meaning of ERISA.

81. HealthSouth, as a corporate entity, cannot act on its own without any human counterpart. In this regard, during the Class Period, HealthSouth relied and continues to rely directly on its Board of Directors to carry out its fiduciary responsibilities under the Plan and ERISA.

⁸ SPD at 6-7, Exhibit B.

82. In addition, as stated in the 1997 Plan Document, HealthSouth assigned to itself responsibility for the fiduciary actions of the ESOP Committee members. Moreover, by virtue of the indemnity provisions in the Plan Documents, HealthSouth agreed to indemnify and hold harmless any Director or employee for losses for which such persons are found liable as a result of any breach of fiduciary duty except willful or reckless conduct.

B. Board of Directors.

83. As stated above, HealthSouth relies on its Board of Directors to carry out its Plan-related fiduciary functions. As a result, the Director Defendants are functional fiduciaries under ERISA. However, the Board's role is not purely derivative of HealthSouth's. On the contrary, the Board itself is assigned and exercises – often negligently – broad fiduciary responsibility for the Plan and Plan assets.

84. Under the 1994 Plan Document, the Board was itself identified as the Plan Administrator and Named Fiduciary and assigned plenary responsibility for management and administration of the Plan.

85. Although the 1997 Plan Document substitutes the “Company” as the Administrator and Named Fiduciary, upon information and belief this was in practice a nominal substitution only: throughout the Class Period, the Board continued to operate in the same capacity as it did under the 1994 Plan Document.

86. Furthermore, the SPD identifies the Board as a Plan Administrator. The SPD states: “Type of Administration: Administered by the Board of Directors of HealthSouth Rehabilitation Corporation and by the Officer Trustees named in the Trust.”⁹

87. The Board resolutions produced to date by HealthSouth in preliminary discovery confirm the scope and extent of the Board's exercise of fiduciary functions for the Plan and Plan assets. From the inception of the Plan, the Board played a critical role. As a Plan Administrator, it reviewed and ratified resolutions regarding the ESOP Loans and the Plan's purchase of

⁹ SPD at 3, Exhibit B.

HealthSouth stock from Board member and CEO Scrushy in 1991. The Board also approved the Plan's second ESOP Loan and purchase of HealthSouth stock in 1992.

88. The Board also exercises ultimate decision-making authority for many other aspects of the Plan, including the amount of HealthSouth's contribution to the Plan and the appointment and removal of Plan fiduciaries, including the Individual and Bank Trustees and ESOP Committee members.

89. Lastly, certain members of the Board of Directors enhanced their fiduciary oversight responsibilities even further as members of the Compliance Committee of the Board. The Compliance Committee was an outgrowth of the Company's Corporate Compliance Program and was established on August 14, 1997.¹⁰ The Committee's task was to review the progress of the Corporate Compliance Program and "otherwise ensur[e] [that the Company] conduct[s] [its] operations in compliance with federal, state, and local laws and regulations," including, of course, ERISA.¹¹ Tanner was a Chair of the Committee during the Class Period, as well as the Company's designated Chief Compliance Officer. Gordon has also chaired the Committee, and Scrushy, Bennett, Chamberlin, Newhall, Watkins, Givins, and Hale have all been members of the Compliance Committee.

90. Accordingly, the Director Defendants are fiduciaries of the Plan in that they exercise or exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

C. Officer Trustee Defendants.

91. The same top-level officers who approved the creation of the Plan, and the Plan's purchase of HealthSouth Stock from Scrushy at a price that netted him millions of dollars of profit, also assigned to themselves the task of serving as the Plan Trustees. Thus, yet another

¹⁰ April 17, 1998 HealthSouth Proxy Statement

¹¹ *Id.*

level of fiduciary oversight of the Plan has been undermined by the presence of the same Directors/Officers who participated in the Company's illegal schemes.

92. During the Class Period, the following persons served as Officer Trustees for the Plan: (1) Richard Scrushy, former CEO and Chairman of the Board (sued by the SEC and indicted by a federal grand jury on 18 counts of securities fraud and related offenses); (2) Aaron Beam, Jr., former CFO and HealthSouth Director (pled guilty to securities fraud and related offenses); (3) Michael D. Martin, former CFO (pled guilty to securities fraud and related offenses); (4) William T. Owens, former CEO, President, and CFO (pled guilty to securities fraud and related offenses); (5) Brandon O. Hale, former Senior Vice President; and (6) Anthony Tanner, former Executive Vice President and Director. Tanner and Hale are the only Officer Trustees who have not been indicted or pled guilty to felonies in connection with their corporate practices.

93. The specific fiduciary responsibilities that the Officer Trustees assigned to themselves are set forth in the SPD, the 1997 Plan Document, and in the 1994 Trust Agreement.

94. The SPD states that the Board of Directors, together with the "individual Trustees named under the Trust" administer the Plan. The SPD further states that the Trustees are responsible for, among other things, receiving and investing Plan contributions and purchasing HealthSouth stock if prudent at the direction of the Administrator or, if not prudent, investing the assets "in other investment media as the Administrator determines is in the best interests of the participants."¹²

95. The 1997 Plan Document adds to this the obligation to ensure that the Plan did not pay more than "adequate consideration" for HealthSouth stock purchased for the Plan.¹³

96. Finally, the 1994 Trust Agreement describes in great detail the specific powers of the Officer Trustees. Relevant provisions of the Trust Agreement include the power:

¹² SPD at 6-7, Exhibit B.

¹³ 1997 Plan Document § 4.2, Exhibit A.

(a) To purchase or subscribe for any securities or other property, including Company Stock, and to retain such securities or other property.

(b) To sell for cash or on credit, grant options with respect to, convert, redeem or exchange for other securities or other property, any securities or other property at any time held by it.

(g) To employ suitable agents . . . and counsel

(h) Subject to the limitations set forth in Article IV (regarding ESOP Loans and repayment), to transfer, at any time and from time to time, such part or all of the Funds as it shall deem advisable to any trust that is exempt from Federal income tax under section 501, or 584 of the Code and is maintained by the Trustee, in its capacity as trustee, as a medium for the collective investment of funds of pension, profit-sharing or other employee benefits trusts of which from time to time it may be acting as trustee

(i) To maintain custody and safekeeping over all securities and other property in the Funds

(p) *To perform all acts, whether or not expressly authorized, that a prudent fiduciary under ERISA would perform for the protection and safekeeping of the Funds.*¹⁴

97. The 1994 Trust Agreement also imposes on the Officer Trustees the high standard of care that is the hallmark of fiduciary status under ERISA, and which the Officer Trustees obviously completely disregarded during the Class Period. Specifically, the 1994 Trust Agreement provides:

5.2 Standard of Care. The Trustee shall discharge its duties with respect to the Trust solely in the interest of the Participants and their Beneficiaries and

(a) For the exclusive purpose of providing benefits to Participants and their Beneficiaries, and defraying reasonable expenses of administering the Plan;

¹⁴ 1994 Trust Agreement § 5.1 (emphasis added), Exhibit C.

(b) With the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and

(c) In accordance with the documents and instruments governing the Trust insofar as such documents and instruments are consistent with the provisions of Title I of ERISA.¹⁵

98. Although the 1994 Trust Agreement also contains a provision stating that “[t]he Trustee shall not be deemed to be the administrator, sponsor nor a Named Fiduciary of the Plan,” Trust Agreement § 1.3, this provision is, in effect, illusory. The same persons who served as Officer Trustees also served as Directors and ESOP Committee members, both of which are identified in Plan Documents as Plan Administrators. Furthermore, the SPD states that the Trustee administered the Plan with the Board of Directors.¹⁶

99. The Officer Trustees’ status as Plan Administrator fiduciaries has been confirmed by the Department of Labor (“DOL”). In a letter to HealthSouth informing the Company that it had determined that the fiduciaries for the Plan had breached their fiduciary duties in a number of respects not directly related to this litigation, the DOL identified the Officer Trustees as “constitut[ing] the ESOP Committee who also is named as Plan Administrator”¹⁷ Further, in that letter, the DOL specifically named Officer Trustees Scrushy, Tanner, Martin, and Beam, as “fiduciaries with respect to the Plan as defined in ERISA Section 3(21)(A).”¹⁸

100. Thus, based on the Plan Documents, Board Resolutions, and other materials produced in preliminary discovery, there is no question that the Officer Trustees were fiduciaries in that they exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

D. ESOP Committee Members.

¹⁵ *Id.* § 5.2, Exhibit C.

¹⁶ SPD at 3, Exhibit B.

¹⁷ Department of Labor letter dated October 28, 1999, HSESOP 01018, Exhibit D.

¹⁸ *Id.*, Exhibit D.

101. As stated in the 1997 Plan Document, HealthSouth is responsible for appointing an ESOP Committee that consists of at least three members. During the Class Period and before, HealthSouth acted through its Board in carrying out this responsibility.¹⁹

102. At such times as an ESOP Committee actually has been appointed as required by the Plan Documents, it comprised the same three Directors/Officers who served as Officer Trustees. Thus, Scrushy – and some combination of fellow Defendants Beam, Martin, Tanner, Owens, and Hale – served as ESOP Committee members. Consequently, notwithstanding the several layers of fiduciary oversight put in place by the Plan Documents, a triad of Company Directors/Officers, including CEO Scrushy, wielded practically unchecked authority over the Plan’s administration and operation during most of the Class Period.

103. The 1997 Plan Document outlines the role of the ESOP Committee. As a general matter, the ESOP Committee is tasked with “assist[ing] with the administration of the Plan.”²⁰

104. The ESOP Committee also is assigned a broad array of fiduciary power, duties, and responsibilities, including “*such powers as may be necessary to discharge its duties under the Plan,*” and the power:

- a. to appoint the Daily Administrator to handle the day-to-day administration of the Plan;
- b. to construe and interpret the Plan ...;
- c. to prescribe rules for the operation of the Plan;
- d. to receive from [HealthSouth] ... such information as shall be necessary for the proper administration of the Plan;
- e. to furnish each Employee and each Beneficiary receiving benefits under the Plan a summary plan description explaining the Plan;
- f. to delegate to one or more of the members of the Committee the right to act in its behalf in all matters connected with the administration of the Plan and Trust;

¹⁹ At present it is unclear whether there is an ESOP Committee. HealthSouth apparently does not know if it has complied with the Plan requirement to appoint an ESOP Committee.

²⁰ 1997 Plan Document §§ 1.8, 13.1, Exhibit A.

- g. to delegate to any individual such of the powers and duties as the Committee deems appropriate; and
- h. to appoint or employ for the Plan any agents it deems advisable, including, but not limited to, legal counsel.²¹

105. The ESOP Committee also is required by the 1997 Plan Document to elect one its members to serve as a chairman and also to elect a secretary who was supposed to keep a record of all meetings and forward all necessary communications to the Trustee. Although Plaintiffs' preliminary discovery requests asked HealthSouth for all documents pertaining to its administration of the Plan, no documents have been produced that indicate that the Committee appointed a chairman or a secretary, or kept any records of its meetings or whether any meetings were even held.

106. Based on the Plan Documents, and other materials produced in preliminary discovery, the ESOP Committee members were fiduciaries in that they exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan's assets.

E. Daily Administrator Defendants.

107. Pursuant to the 1997 Plan Document, the "Daily Administrator" is the "individual designated by the Committee to handle the day-to-day administration of the Plan..."²² Further, the Plan Document contemplates that "[i]n the event the Committee fails to appoint a Daily Administrator, the Committee shall be the Daily Administrator. As of July 1, 2001, the Daily Administrator is the Vice President of Human Resources."²³

108. The Daily Administrator is given the following powers, duties, and responsibilities under the Plan:

- (2) To direct the administration of the Plan [in accordance with the tenets of the Plan];

²¹ 1997 Plan Document §13.2 (emphasis added), Exhibit A.

²² 1997 Plan Document § 1.14, Exhibit A.

²³ *Id.*

- (3) To adopt rules of procedure and regulations necessary for the administration of the Plan...;

* * *

- (g) To engage the service of counsel..., actuaries, and agents whom it may deem advisable to assist it with the performance of its duties;
- (h) To receive from [HealthSouth]...such information as is necessary for the proper administration of the Plan;
- (i) To receive and review reports from the Trustee of the financial condition and receipts of and disbursements from the Trust Fund;

* * *

- (q) To comply with all applicable lawful reporting and disclosure requirements of ERISA;

* * *

- (s) To construe the Plan, in its sole and absolute discretion, and make equitable adjustments for any mistakes and errors made in the administration of the Plan.²⁴

109. Further, the Daily Administrator is required to “*exercise such other powers and perform such other duties as it may deem necessary, desirable, advisable or proper for the supervision and administration of the Plan.*”²⁵

110. Upon information and belief, during the Class Period, Wade, Pearson, McCracken, and Roper served in the capacity of “Daily Administrator,” as that term is defined by the 1997 Plan Document, or the functional equivalent thereof. Accordingly, the Daily Administrator Defendants were fiduciaries of the Plan in that they exercised discretionary authority and control with respect to management and administration of the Plan and authority and control with respect to management and disposition of the Plan’s assets.

²⁴ *Id.* at §13.4 (emphasis added).

²⁵ *Id.* (emphasis added).

VII. HEALTHSOUTH'S HIGHLY RISKY AND ILLEGAL ACCOUNTING AND BUSINESS PRACTICES

111. Although the Plan Documents clearly indicate that the Plan was to invest in HealthSouth stock only if it was prudent to do so, and ERISA requires the same, the Plan fiduciaries caused or allowed the Plan to hold all of its assets in HealthSouth stock even though they knew or should have known that the stock was an unduly risky and inappropriate investment as a result of HealthSouth's illegal accounting and business practices.

112. The Company's risky and illegal practices took two primary forms: (1) improper accounting, and (2) improper medical billing procedures. Each is summarized below.

A. Scheme One - "Cooking the Books."

1. Summary.

113. *TheStreet.com*, in a April 7, 2003, story,²⁶ quoted an anonymous HealthSouth employee who described the emerging Company story of long-term accounting fraud and top-down organized deceit as "the biggest high-profile corporate fraud in history." Stephen M. Cutler, the SEC's enforcement director has stated that "HealthSouth's fraud represents an appalling betrayal of investors.... [The] standard operating procedure was to manipulate the company's earnings to create the false impression that the company was meeting Wall Street's expectations."

114. According to a suit filed by the SEC in March 2003, shortly after the Company became publicly traded in 1986, and at Scrushy's instruction, the Company began to artificially inflate its earnings to match Wall Street analysts' expectations and maintain the market price for HealthSouth's stock. Between 1999 and the second quarter of 2002, HealthSouth intentionally overstated its earnings, identified as "Income Before Income Taxes and Minority Interests," by at least \$1.4 billion in reports filed with the SEC. Former Directors, Officers, and high-level employees who have pled guilty to aiding Scrushy's unlawful accounting schemes put the amounts and timeframe involved as bigger and longer, potentially adding another \$1.1 billion in

²⁶ Available at <http://www.thestreet.com/pf/stocks/melissadavid/10078539.html>.

inflated figures for just 1997-98. In July 2003, the Company's newly hired auditor, PricewaterhouseCoopers corroborated the total \$2.5 billion figure.

115. Although, incredibly, Scrusy claims that the entire HealthSouth fraudulent scheme – which involved every CFO who ever worked for the company – was perpetrated behind his back and without his knowledge, on October 29, 2003, a federal grand jury returned an 18-count indictment against Scrusy (“Scrusy Indictment”) alleging securities fraud and related offenses. The Scrusy Indictment alleges that the scheme to defraud began on or about 1996, and that beginning as of that date, the scheme resulted in the inclusion of huge amounts of “fictitious income” to be included in HealthSouth annual reports. The purpose of the scheme was to enable Scrusy and his cronies to reap huge profits at the expense of the Company's shareholders.

116. The scheme hit its full stride in 1997 when HealthSouth reported \$700 million of fabricated earnings in that year alone. In total, the Scrusy Indictment alleges that the total amount of false income reported between 1996 and 2002 was \$2.74 billion.

117. In the wake of the Scrusy Indictment, and the litany of prior indictments already resulting in guilty pleas from at least fifteen Directors, Officers, and high-level executives, Defendants cannot genuinely dispute the fact that HealthSouth stock become an imprudent investment for HealthSouth's employees' retirement savings.

118. Although HealthSouth represented to employees in the SPD and other Plan Documents that the Plan was a means of retirement savings for them, in fact, as a result of the Company's illicit practices, it has been, at best, a risky gamble that served no other purpose than personally enriching Scrusy and others to the tune of millions of dollars.

2. Details of the Scheme.

119. According to factual information presented in various Defendants' guilty pleas, and the SEC's complaint against HealthSouth and Scrusy, on a quarterly basis, HealthSouth's senior officers, including Scrusy's right-hand man and most-trusted aide, Defendant Owens,

would present Scrusby with an analysis of HealthSouth’s actual, but as yet unreported, earnings for the quarter as compared to Wall Street’s expected earnings for the Company. If HealthSouth’s actual results fell short of expectations, Scrusby would tell HealthSouth’s management to “fix it” by recording false earnings on HealthSouth’s accounting records to make up the shortfall.

120. HealthSouth’s senior accounting personnel then convened a meeting to “fix” the earnings shortfall. By 1997 the attendees referred to these meetings as “family meetings” and referred themselves as “family members.”

121. While the scheme to manipulate earnings was ongoing, HealthSouth’s senior officers and accounting personnel periodically discussed with Scrusby the burgeoning false financial statements, and tried to persuade him to abandon the scheme.

122. Scrusby insisted that the scheme continue because he did not want HealthSouth’s stock price to suffer. Indeed, in the fall of 1997, when HealthSouth’s accounting personnel advised Scrusby to abandon the earnings manipulation scheme, Scrusby refused, stating in substance, “not until I sell my stock.” Despite it being clear that Scrusby had no intention of managing HealthSouth appropriately and lawfully, accounting personnel and other top-level executives took no action to alert appropriate state or federal authorities regarding the improper practices, nor did they undertake any serious efforts to accurately report the Company’s financial condition.

HealthSouth officers, including several of the Plan’s Officer Trustees and ESOP Committee members, personally profited from the scheme to artificially inflate earnings. Following is a summary of the insider sales by the Plan Trustees and ESOP Committee members since late 1997:

NAME	DATE OF SALE(S)	PROCEEDS OF SALE(S)
Scrusby	11/6/97	\$ 108,000,000
	5/14/02 (option sales)	\$ 74,118,808

Martin	11/6/97 (option sale)	\$ 3,375,000
Beam	11/4/97 (option sale)	\$ 2,759,000
Tanner	11/18-11/28/97 (all option sales)	\$ 4,922,366

123. Moreover, according to HealthSouth's 2001 Form 10-K, Scrusby *alone* received at least \$6.5 million from HealthSouth during 2001 in "Bonus/Annual Incentive Awards." This bonus payment was based on HealthSouth's artificially inflated earnings. Further, according to HealthSouth's 2001 Form 10-K, from 1999 through 2001, HealthSouth paid Scrusby \$9.2 million in salary. Approximately \$5.3 million of this salary was based on HealthSouth's achievement of certain budget targets. HealthSouth attained these budget targets through its scheme(s) of artificially inflating earnings.

124. In the Scrusby Indictment, the United States Department of Justice ("DOJ") estimates that HealthSouth's accounting fraud resulted in the inclusion of fictitious income in HealthSouth's annual reports in the following amounts by year:

Year	Amount of Fictitious Income
1996	\$70 million
1997	\$700 million
1998	\$550 million
1999	\$390 million
2000	\$350 million
2001	\$450 million
2002	\$230 million
Total	\$2.74 billion

125. Several months earlier, in connection with its complaint against HealthSouth and Scrusby, the SEC found that the approximate amounts of overstated "Income Before Income Taxes and Minority Interests" since 1999 in Forms 10-K and 10-Q were as follows:

Income (Loss) before Income Taxes and Minority Interests (In \$ millions)	1999 Form 10-K	2000 Form 10-K	2001 Form 10-K	For six months ended June 2002

Actual	\$ (191)	\$ 194	\$ 9	\$ 157
Reported	230	559	434	340
Misstated Amount	421	365	425	183
Misstated Percentage	220%	188%	4722%	119%

126. Whether the DOJ’s or the SEC’s numbers are found to most accurately reflect the true extent of Defendants’ overstatement of HealthSouth’s income, the fact remains that, under either scenario, the Company was nowhere near as profitable as it claimed it was and, rather than being a well-managed and financially sound investment, it was a highly risky and inappropriate investment, particularly for an ERISA-governed retirement Plan.

B. Scheme Two - “Milking Medicare.”

1. Summary.

127. In addition to the Company’s egregious accounting practices, HealthSouth engaged in improper Medicare-related billing practices which resulted in several internal complaints by employees, at least four *qui tam* actions under the federal False Claims Act, and an ongoing civil fraud investigation by the DOJ. The Company’s unlawful billing practices, and complaints pertaining thereto, were well known by Company executives.²⁷

128. Medicare, a federal health benefit program for the elderly, was responsible for much of the revenue taken in by the Company’s in-patient business which was, in turn, responsible for about half of all HealthSouth revenues. Thus, HealthSouth’s improper Medicare-related billing practices are yet another indication of egregious mismanagement by HealthSouth Directors and Officers that potentially imperil the future success and survival of HealthSouth.

2. Details of the Scheme.

129. In order to artificially inflate the reported revenues and profits of HealthSouth, Defendants caused the Company’s employees to systematically overcharge the Government by,

²⁷ In 2001, HealthSouth agreed to pay \$7.9 million to settle Medicare fraud allegations. The federal government had alleged that the Company had overcharged for computers and other equipment bought from a business owned by Scrushy, his mother, and his brother.

among other wrongful acts, “upcoding” the billing – altering the invoices – for group therapy sessions as individual sessions. Indeed, the Company’s billing system did not even enable HealthSouth’s employees to record charges for group – as opposed to individual – therapy sessions.

130. Offended by Defendants’ wrongful conduct, HealthSouth supervisory employees repeatedly complained to their colleagues and superiors that they were “stonewalled” when attempting to obtain correct billing guidance, compelled to participate in a Medicare fraud, and put at risk of disciplinary or other action by the Government. Those complaints were ignored by HealthSouth and its senior executives, including the Plan Trustees and ESOP Committee members, who never investigated these complaints or undertook any effort to determine the impact the practices had on the HealthSouth stock held in trust by the Plan.

131. Further, Kimberly Landry, a former HealthSouth employee and target of a Company defamation suit (which the Company has since announced it is dropping), reported that, at HealthSouth hospital facilities, employees were instructed to accept patients covered under Medicare even if the facility was not properly equipped to treat their maladies. She stated that if employees did not keep relevant “numbers up, they would lose their jobs.”²⁸

132. In addition to the questionable billing practices raised internally by HealthSouth’s employees, over at least the past five years, the Company has been a Defendant in at least four *qui tam* actions alleging that HealthSouth had improperly overcharged Medicare for therapy services provided to patients at the Company’s facilities. These actions are briefly summarized below:

²⁸ On September 8, 2003, a Montgomery County, Alabama jury decided HealthSouth must pay Dr. Helen Schilling \$1.4 million in damages. Dr. Schilling is a former Director of the HealthSouth Houston Rehabilitation Institute, and she claimed that HealthSouth fired her after she refused to keep patients hospitalized at the Institute when they were medically ready for discharge or to admit patients who, in truth, needed no treatment – both violations of federal and state laws and, upon information and belief, representative of the ongoing, endemic efforts of the Company to inflate income figures by any means necessary. Federal law enforcement officials are currently investigating the extent and expanse of this type of unlawful booking and non-releasing of patients and how it may tie into other Medicare payment-related abuses currently alleged against the Company.

(a) The Devage Action.

133. On April 24, 1998, James Devage, a former HealthSouth patient, filed an action in the United States District Court for the Western District of Texas, San Antonio Division, *U.S., ex rel. Devage v. HealthSouth Corp., et al.*, Civil Action No. SA-98-CA-0372 (DWS) (“*Devage*”).

134. In *Devage*, the plaintiff alleged, that HealthSouth among other unlawful acts, knowingly and fraudulently overcharged Medicare by falsely describing the services provided to patients.

135. According to Mr. Devage, HealthSouth also misrepresented to Medicare the location where his outpatient therapeutic services had been performed in order to receive the higher reimbursement rates allowed in certain geographic areas.

136. In May 2002, the United States intervened in *Devage* as a plaintiff. The Government complaint (the “U.S. Compl.”) alleged that between January 1, 1996, and May 23, 2002 (the date the Government complaint was filed), HealthSouth improperly submitted claims to Government payors for therapy services provided at outpatient physical therapy facilities without a properly certified plan of care, as required by Medicare regulations. The Government further alleged that HealthSouth improperly billed Government payors for services not provided or for services provided by unqualified personnel. *Id.*

137. Since early 1995, the Cahaba Government Benefits Administration (“Cahaba”), a division of Blue Cross Blue Shield of Alabama, has served as national fiscal intermediary/carrier for HealthSouth. U.S. Compl. ¶ 5. In this capacity, Cahaba processed most Medicare claims submitted by HealthSouth. *Id.* In 1996 and 1997, during a routine analysis of outpatient claims, Cahaba noticed certain aberrations in claims submitted by HealthSouth. U.S. Compl. ¶ 16. Accordingly, Cahaba began a full investigation of HealthSouth’s Medicare billing practices. *Id.*

138. According to the government disclosures, the Cahaba investigation included a review of more than 5,000 Medicare claims for services rendered at 60 HealthSouth outpatient facilities. U.S. Compl. ¶ 17. The consultants who reviewed the records found similar instances

of HealthSouth's failure to obtain properly certified plans of care in connection with a substantial percentage of the Medicare claims reviewed, including facilities where the failure to comply with the plan of care requirements was nearly 100 percent. U.S. Compl. ¶ 26. In addition, Cahaba conducted pre-payment audits of Medicare claims submitted by HealthSouth outpatient physical therapy facilities during 1999. *Id.* The audits revealed a similarly high claims denial rate based on HealthSouth's failure to obtain a properly certified plan of care for the physical therapy services rendered to the beneficiary. *Id.* In fact, from January 1, 1996, until the date the Government complaint was filed in May 2002, HealthSouth routinely sought reimbursement for outpatient physical therapy services provided in the absence of a certified or recertified plan of care.²⁹ U.S. Compl. ¶ 23.

139. The Government also charged HealthSouth with billing for services provided by unqualified personnel. For example, the Medicare program only pays for outpatient physical therapy services that are provided by qualified personnel. U.S. Compl. ¶ 30. Specifically, personnel qualified to provide outpatient physical therapy services are limited to licensed physical therapists and licensed physical therapy assistants who are acting under the supervision of a licensed physical therapist. *Id.* The Medicare program does not pay for physical therapy services provided by supportive personnel, such as physical therapy aides, athletic trainers, or student trainees. U.S. Compl. ¶ 31. Nevertheless, in an effort to boost its Medicare claims and revenues, HealthSouth adopted and implemented a corporate policy permitting and encouraging the use of supportive personnel to provide physical therapy services to Medicare beneficiaries. U.S. Compl. ¶ 32. This policy was sometimes referred to as "Team Treatment." *Id.* Upon implementation of the "Team Treatment" policy, HealthSouth facilities systematically submitted Medicare claims for reimbursement for physical therapy services provided by supportive personnel. *Id.*

²⁹ The Government alleged numerous specific examples, provided by confidential sources, of HealthSouth's submission of claims to Medicare despite a failure to comply with the plan of care requirements. U.S. Compl. ¶ 25 a-d.

140. The Government further alleged that the practice of filing for services provided by unqualified personnel occurred throughout HealthSouth facilities nationwide. For example:

- (a) At a HealthSouth outpatient physical therapy clinic in St. Petersburg, Florida, supportive personnel often had full patient schedules. U.S. Compl. ¶ 34(a);
- (b) At a HealthSouth outpatient rehabilitation facility in Des Moines, Iowa, HealthSouth physical therapists at the facility were told that it was expected that they would team with one supportive person and together they would see 24 patients in an 8-hour day, billing between \$150-200 (or 4 units of direct, one-on-one care) per patient visit. The only way this goal could be met was to have the supportive personnel provide services directly to the patient and to bill those services as if the physical therapist had provided the care. *Id.* ¶ 34(b);
- (c) At a HealthSouth outpatient facility in Scottsdale, Arizona, physical therapy was provided to a patient by a certified athletic trainer. HealthSouth submitted Medicare claims for interim payments to Cahaba for the physical therapy as if it had been performed by a physical therapist. *Id.* ¶ 34(b);
- (d) At a HealthSouth outpatient facility in Glen Burnie, Maryland, on multiple occasions in June 1995, the physical therapy was rendered by a student physical therapist. HealthSouth submitted Medicare claims for interim payments to Cahaba for the physical therapy as if it had been performed by a physical therapist. *Id.* ¶ 34(c).

141. The Cahaba investigation of HealthSouth's Medicare billing practices outlined above found similar instances of billings for services provided by supportive personnel in a substantial percentage of cases. In fact, Cahaba's review team observed many instances of

supportive personnel rendering physical “therapy services to patients during the on-site visits to the 60 facilities.” U.S. Compl. ¶ 36.

142. According to the Government’s complaint, HealthSouth also routinely sought reimbursement for outpatient physical therapy services which in fact were not provided. For example, after January 1, 1999, HealthSouth billed for direct care (one-on-one) services when such services were not provided. U.S. Compl. ¶ 46, This allegation was corroborated by the Cahaba investigation. *Id.*

143. In addition, the Government charged HealthSouth with billing for unskilled services as if they were skilled services. HealthSouth also systematically billed Medicare for unskilled services that were not reimbursable under Medicare. U.S. Compl. ¶ 47.

144. Finally, the Government alleged that there were numerous meetings, telephone conversations, and other contacts between Cahaba and HealthSouth at which various Medicare regulations and billing issues were discussed since HealthSouth selected Cahaba to be its national fiscal intermediary/carrier in 1995. Despite these contacts, however, HealthSouth never sought guidance from Cahaba concerning whether the Company’s corporate billing practices conflicted with Medicare reimbursement regulations. U.S. Compl. ¶ 38.

(b) The Darling Action.

145. In February of 2000, John Darling, another former HealthSouth patient, filed an action (the “Darling Compl.”) against HealthSouth in the United States District Court for the Middle District of Florida, Tampa Division, *U.S., ex rel. Darling v. HealthSouth Sports Medicine & Rehabilitation Center of Clearwater LP*, Civil Action No. 8:00-cv-416-T-26B (“*Darling*”), for improperly billing Medicare for physical therapy. The allegations by Mr. Darling, which are based on his personal experience and similar to those made by Devage, charge that a HealthSouth facility in Clearwater, Florida, wrongfully upcoded Darling’s Medicare billings. Darling Compl. ¶ 22.

(c) The Mandel Action.

146. On or about October 1, 1999, another action (the “Mandel Compl.”) alleging similar misconduct was filed in the United States District Court for the Southern District of New York entitled *U.S. ex. rel Mark D. Mandel v. HealthSouth d/b/a HealthSouth Network Services of NY IPA, Inc.*, Civil Action No. 99 Civ. 10184 (JSM) (“*Mandel*”).

(d) The Manning Action.

147. On August 18, 1999, an action was filed (the “Manning Compl.”) in the United States District Court for the Northern District of Alabama entitled *U.S. ex. rel. Dewayne Manning v. HealthSouth Corp.*, Civil Action No. CV-99-B-2150-S (“*Manning*”). In his complaint, Manning averred that he began employment with HealthSouth as a physical therapist technician in May 1996 and that the Company, among other wrongful acts, billed Government payors for physical therapy services performed by unlicensed personnel at outpatient rehabilitation facilities.

148. HealthSouth’s Medicare scheme has now begun to unravel. In late April 2003, HealthSouth announced an internal inquiry into potential Medicare-related problems such as those recounted above. Moreover, on April 21, 2003, the *Wall Street Journal* reported that HealthSouth had offered to pay as much as \$150 million to the DOJ in order to settle all allegations of Medicare-related illegalities. According to the story, the DOJ found the figure insufficient considering the alleged violations of federal law.

149. In addition, on April 22, 2003, the House of Representatives Energy and Commerce Committee announced it was launching its own investigative probe into accounting and Medicare-related allegations of wrongdoing by the Company. A Committee spokesman stated on September 10, 2003, that the Committee had specifically sent three investigators to HealthSouth headquarters to look for Medicare fraud and other related violations of federal law.

150. In July 2003, Alvarez & Marsal, a corporate restructuring specialist firm hired by HealthSouth to help stave off bankruptcy, noted that it could not rule out the possibility that the DOJ will charge the Company criminally in connection with the corporate crimes committed by

its Directors, Officers, and other employees, including Medicare-related offenses. Further, the restructuring specialists could not accurately predict the amount of fines potentially owed by the Company resulting from the government's civil investigations of alleged Medicare improprieties and violations of the securities laws.

C. Aftermath - "Smoke, Mirrors, & Medicare."

151. In the wake of the Enron and WorldCom corporate disgraces during the summer of 2002, and facing a tough new corporate governance law in the Sarbanes-Oxley Act, senior executives convinced Scrushy to stop doctoring the Company's financials. Yet, instead of explaining to employees and the market that HealthSouth's earnings guidance would need to be reduced substantially as a result of the Company's decision to stop cooking its books, Scrushy and other top-level Director/Officer Defendants sought to conceal their prior illegal acts by concocting yet another scheme.

152. The Company falsely represented that the Medicare rules on outpatient individual and group therapy billing had been changed by the Government and that, as a result, it was necessary for the Company to reduce its earnings guidance by \$175 million annually and to discontinue and disavow the earnings guidance to investors for 2002 and 2003. This explanation was immediately discredited by government and industry experts. For example, on August 27, 2002, CMS Administrator Tom Scully was quoted by Reuters as follows: "I know those guys well, I'm astounded by (their claims). We made that decision in May and they never called me. If this were such a big problem for them, why am I just hearing about this now?"³⁰

153. Similarly, Frank Mallon, chief executive of the American Physical Therapy Association, confirmed in the September 6, 2002, edition of the *New York Times* that the group billing rule had been accepted practice for many years: "[Mallon] said the group billing rule had

³⁰ Scrushy and other HealthSouth Directors and Officers also attempted to, upon information and belief, utilize a proposed Company restructuring/spin-off ("Project Crimson") of its most lucrative business assets (its 203 surgery centers) in order to hide the true state of its underlying corporate health. The spin-off of its highly profitable surgery centers touted in August 2002 was soon called off in the wake of the market's reaction to the Company's Medicare revelations.

been accepted practice by the association since Medicare first announced it in The Federal Register in 1994 and repeated the ruling in 1996.”

154. The reaction by securities analysts was equally skeptical. An article in the August 28, 2002, edition of *The Wall Street Journal* reported that analysts were “shocked” at the Company’s belated disclosures and that the Company had lost its credibility. The story went on to report that: “Analysts said they were shocked, particularly since the company didn’t mention the Medicare issue in either its earnings conference call earlier this month, or in its quarterly financial filing...HealthSouth...has ‘lost credibility.’”

155. In response to the adverse disclosures and loss of credibility, a large number of securities analysts downgraded their recommendations on HealthSouth shares on August 27, 2002. The brokerage firms issuing those downgrades included: Lehman Brothers; Jeffries & Company; U.S. Bancorp Piper Jaffray; Salomon Smith Barney; UBS Warburg LLC, which had just been retained by HealthSouth for advice in connection with the potential divestitures; and H&R Block Financial Advisors.

156. Investors, who unlike Plan participants could actually sell their holdings of HealthSouth stock, also responded swiftly to the plethora of negative information regarding HealthSouth and its leader, Scrushy. The Company’s shares fell 44 percent the day the announcement was released. The SEC also began to investigate the odd timing of the announcement, in light of Scrushy’s recent stock sale.

157. On September 19, 2002, HealthSouth announced that it was the target of a SEC investigation. Following the announcement of the SEC investigation, Standard & Poor’s (“S&P”), the ratings agency, slashed its ratings on HealthSouth bonds to junk status and said it might lower the ratings even further. Specifically, S&P lowered HealthSouth senior unsecured debt two notches to “BB,” its second-highest junk grade, from “BBB-.” The Company had approximately \$3.3 billion of debt at the end of June.

158. As has now been revealed, the Company explanation for its earnings revisions was merely a ruse hatched by Scrushy and other executives in order to lower Wall Street's expectations and decrease the "need" to artificially inflate earnings in the future.

159. Although the true extent of the Company's misrepresentations since going public in 1986 may never be known, the effect of these activities on HealthSouth stock is all too easy to measure. Once trading as high as \$30.56 a share on May 1, 1998, and even \$15.69 in 2002, the stock price at closing on March 18, 2003, was \$3.91 per share. In response to the foregoing adverse disclosures and others concerning HealthSouth and its executives, Company shares declined to as low as \$0.10 per share in the months following the indictments and guilty pleas.

160. HealthSouth stock has been "de-listed" from the NYSE, and any value of the Company's outstanding shares has been cast in doubt by the specter of potential bankruptcy as a result of the Company's mismanagement and long-term corporate malfeasance.

VIII. DEFENDANTS' BREACHES OF FIDUCIARY DUTY UNDER ERISA

A. Defendants Breached Their Fiduciary Duties under ERISA by Failing to Loyal and Prudently Manage and Administer the Plan and Plan assets.

1. HealthSouth, Bean, Martin, Owens, and Scrushy Knew That HealthSouth Stock Was an Imprudent Investment for the Plan.

161. During the Class Period, Beam, Martin, Owens, and Scrushy were fiduciaries of the Plan as Officer Trustees, ESOP Committee Members, and, with the exception of Owens, Directors, and were expressly responsible for the prudent management of Plan assets. Each of these Defendants knew that HealthSouth was engaged in the improper accounting and business practices described above and, thus, that HealthSouth stock was an unduly risky and inappropriate investment for the Plan. As the Named Fiduciary that acted through, among others, these same individuals, HealthSouth also possessed such knowledge, and was responsible for overseeing the Plan and ensuring that its assets were prudently invested. Yet, these Defendants did nothing to protect the Plan from the huge losses that their schemes inevitably

caused. The Plan suffered obvious and undeniable losses as a result of these Defendants' negligent disregard of their fiduciary obligations.

162. Beam, Martin, and Owens cannot deny actual knowledge of the corporate practices that caused HealthSouth stock to become an imprudent Plan investment, as they each have pled guilty to securities fraud and/or related criminal offenses pertaining to these practices. Relevant details of the guilty pleas of each are as follows:

163. **Aaron Beam, Jr.**, company co-founder and former CFO from 1984 until 1997, pled guilty to bank fraud for making false representations to HealthSouth's lenders. In his guilty plea, Beam admitted that he lied in April 1996 when he used HealthSouth financial statements to secure loans, totaling \$1.25 billion, from banks and lenders. Thus, Beam possessed actual knowledge of HealthSouth's improper and illegal practices no later than 1996.

164. **Michael D. Martin**, former CFO from October 1997 to March 2000, pled guilty to conspiracy to commit wire and securities fraud and filing false information with the SEC. Martin attended meetings with members of the accounting department in which there were discussions regarding how financial statements could be altered so as to meet the earnings-per-share projection. Martin signed the Company's SEC filings, even though he knew that they contained materially false and misleading information about the Company's financials. Martin admits in his guilty plea that he became aware of and began participating in HealthSouth's accounting manipulations when he became the CFO in October 1997. Thus, Martin possessed actual knowledge of HealthSouth's improper and illegal practices as of October 1997.

165. **William T. Owens**, former CFO from February 2000 to August 2001 and Board member until October 9, 2003, pled guilty in connection with the accounting fraud. Owens directed members of HealthSouth's accounting staff to find ways to ensure the Company's earnings-per-share numbers would meet or exceed Wall Street projections. Owens then filed with the SEC quarterly and annual reports that materially overstated the Company's earnings-per-share, income, revenue, assets, and liabilities. In order to cover up the false financial

information filed with the SEC, Owens met with co-conspirator Weston Smith and convinced him to file with the SEC a statement certifying the accuracy of the 10-Q for the second quarter of 2002. Owens, thus, had actual knowledge of HealthSouth's illegal accounting practices no later than February 2000.

166. Although Scrusby denies the allegations in the Indictment and the SEC's civil charges against him, in light of his co-conspirators admissions in their guilty plea describing Scrusby's role, it would be surprising, to say the least, for Scrusby not to have been a participant, or at least to have known what was going on. Yet, even if Scrusby is able to demonstrate his innocence, his liability under ERISA would be the same: as an Officer Trustee and ESOP Committee member, not to mention the CEO, Scrusby should have known what was going on at the Company. Thus, whether he was involved in HealthSouth's illegal scheme or not, Scrusby negligently disregarded his duties under the Plan and ERISA.³¹

167. Had any one of these individual Defendants satisfied his fiduciary obligations under the Plan Documents and ERISA to loyally and prudently serve the interests of Plan participants and taken action to protect the Plan at the point he gained actual knowledge of the imprudence of the stock, he could have prevented the Plan from losing millions of dollars of its value.

2. HealthSouth, Beam, Martin, Owens, and Scrusby Suffered from Direct Conflicts of Interest.

168. HealthSouth Directors and Officers who participated in, had knowledge of, or benefited from the Company's improper and unlawful practices on the one hand, and served as

³¹ As of yet, it is uncertain when Scrusby first began or became aware of the Company's illegal practices. Although the Scrusby Indictment alleges that his conspiracy to cook the books started "in or about" 1996, the SEC complaint suggests that Scrusby's artificial inflation of earnings began when the stock first went public in 1986. If the latter proves true, then Scrusby knew at the time that the Plan originally purchased \$20 million dollars of HealthSouth stock (at least \$10 million of which was from him) in 1991 and 1992, and that the price paid for the stock was artificially inflated by the Company's fraud. In that case, the purchase was a prohibited transaction under ERISA §§ 406 and 408, in that more than "adequate consideration" was paid by the Plan for the stock. As such, the Plan would be entitled to rescission of the purchases, plus interest and other damages. Plaintiffs will seek leave from the Court to add a prohibited transaction claim if discovery substantiates the claim.

fiduciaries for the Plan on the other, had an obvious conflict of interest that was inconsistent with their duty of loyalty under ERISA.

169. Such fiduciaries, who at the very least included Beam, Martin, Owens, and Scrushy, had an obvious incentive to keep the Plan's assets in HealthSouth stock and to continue allocating shares of HealthSouth stock to participants, so as not to draw attention to any problems within the Company. In addition, they, and other officer and director fiduciaries had a strong incentive to maintain the artificial inflation of HealthSouth stock so that they could continue to personally enrich themselves at the shareholders' and Plan participants' expense by selling their own HealthSouth stock and stock options at high prices that otherwise would not have been available. The effect of this incentive cannot be underestimated in this case: when Owens attempted to persuade Scrushy to stop cooking the books, according to the SEC, Scrushy responded, "Not until I sell my stock."

170. These conflicts of interest put Defendants in the position of having to choose between their own interests as executives, stockholders, and co-conspirators, and the interests of the Plan participants and beneficiaries to whom Defendants owed "an unwavering" duty of loyalty. Instead of putting the participants' interests first, or resigning as fiduciaries so others could be appointed who would do so, Defendants, in particular Beam, Martin, Owens, and Scrushy, chose to put their own personal interests ahead of all others.

3. The Plan Fiduciaries Failed to Consider the Prudence of Continued Investment in HealthSouth Stock.

171. Upon information and belief, no Defendant conducted an appropriate investigation into whether HealthSouth stock was and continued to be a prudent investment for the Plan, as required by the Plan Documents and ERISA. Consequently, the fiduciaries failed to fulfill their obligation under the Plan Documents and ERISA to ensure that Plan assets were invested prudently.

172. Among fiduciaries who were themselves participants in HealthSouth's illegal practices, and HealthSouth itself, obviously no investigation at all was necessary in order to obtain information that a prudent fiduciary acting under similar circumstances would need in order to protect the Plan as required by ERISA. For the other Defendants named herein, including Trustees Tanner and Hale, the Director Defendants who have not been indicted, and the Daily Administrator Defendants, an adequate investigation certainly would have revealed that investment by the Plan in HealthSouth stock, under these circumstances, was imprudent, and that certain Individual Trustees, ESOP Committee members, and Director Defendants were acting contrary to the interests of the persons whose assets they managed and controlled as Plan fiduciaries. Based on the duties each possessed under the Plan and ERISA, each of these fiduciaries had the authority, and the obligation, to conduct such an investigation, and generally to ensure the prudent administration of the Plan and Plan assets.

173. Given the ease with which federal investigators were able to uncover the Company's massive fraud, there should be little doubt that an adequate investigation would have uncovered the true state of affairs at the Company.

174. In addition, there were a number of red flags that should have at the very least triggered an investigation by the Plan fiduciaries. These red flags include the Individual Trustees' sales of their own holdings of HealthSouth stock at the same time that they were touting the stock publicly and encouraging employees and others to purchase the stock. At the very least, these sales should have caused other Plan fiduciaries to consider why the persons responsible for ensuring that Plan assets were invested prudently were themselves *dumping* their own holdings of HealthSouth stock. It is difficult to conceive of a more obvious sign that the Individual Trustees were not loyally serving the interests of participants. Scrusby's massive insider sales, which exceeded \$180 million and coincided with his repeated representations of the strength of the Company, should, in particular, have caused alarm among the Plan's other fiduciaries.

175. In addition, (1) the multiple *qui tam* actions filed against the Company beginning in 1998; (2) the securities fraud action in 1998, naming among others the very same Plan Trustees who sold millions of dollars of their own holdings in HealthSouth stock; (3) the DOL investigation initiated in 1998 and concluding in 1999 that determined that these same fiduciaries had failed to comply with Plan requirements in several respects; and (4) the fact that HealthSouth stock declined precipitously during the Class Period, notwithstanding the Company's repeated rosy representations of its financial condition and performance are additional red flags that should have triggered a more thorough investigation into whether the assets of the Plan were being prudently managed for the exclusive benefit of Plan participants, and whether the Plan was being properly administered according to its terms.³²

176. A prudent fiduciary dedicated, as ERISA requires, to fairly evaluating the Plan's investment in HealthSouth stock, certainly would have concluded that it was not prudent to invest employees' retirement savings in a company that was engaged in a massive scheme to defraud the investing public, federal authorities, and its own employees. Such a fiduciary would have discerned these circumstances – and the risks they posed – and taken appropriate steps to limit the Plan's investment in HealthSouth stock.

177. Defendants had available to them several different options for satisfying this duty, including making appropriate public disclosures as necessary; divesting the Plan of HealthSouth stock; investing the Plan in other investment media as the fiduciaries determined was in the best interests of Plan participants; consulting independent fiduciaries regarding appropriate measures to take in order to prudently and loyally serve the participants of the Plan; using Plan contributions to purchase new investments rather than paying down debt on HealthSouth stock that likely exceeded the value of the stock securing the debt, or resigning as Plan fiduciaries to

³² Only limited discovery has occurred and given the breadth and extent of the HealthSouth scandal, Plaintiffs anticipate learning of many other red flags that were or should have been apparent to Plan fiduciaries charged with the responsibility for ensuring that the Plan was properly administered, and the assets prudently invested.

the extent that as a result of their conflicts of interest they could not loyally serve Plan participants in connection with the Plan's management of its investment in HealthSouth stock.

178. Despite the availability of these and other options, Defendants failed to take any action to protect participants from losses as a result of the Plan's investment in HealthSouth stock. Instead, they turned a blind eye to their duties and responsibilities under the Plan and ERISA.

4. The Daily Administrator Defendants Failed to Ensure that the Plan Was Properly Administered According to its Terms.

179. As stated above, the Daily Administrator Defendants were responsible for supervising the Plan and ensuring its proper administration. In this regard, the Plan Documents require the Daily Administrator Defendants to, *inter alia*, direct the administration of the Plan, receive information from HealthSouth as necessary for the proper administration of the Plan, engage the services of counsel or other agents as it deems advisable to assist it with the performance of its duties, and "exercise such other powers and perform such other duties as it may deem necessary, desirable, advisable or proper for the supervision and administration of the Plan."³³

180. Yet, in the face of circumstances clearly suggesting the Plan was not being properly administered by the other Defendant fiduciaries, the Daily Administrator Defendants did not undertake any effort to protect the Plan or the participants. For example, the Daily Administrator Defendants did not seek "necessary" information from HealthSouth, engage the services of counsel to assist it with the performance of its duties, or satisfy its duty under the Plan to "exercise such other powers or perform such other duties" as necessary or proper for the supervision and administration of the Plan.

181. Moreover, upon information and belief, the Daily Administrator Defendants did not so much as raise an objection to the Plan holding substantially all of its assets in HealthSouth

³³ 1997 Plan Document, § 13.4, Exhibit A.

stock even as the value of the stock declined precipitously, and HealthSouth, the Officer Trustees, ESOP Committee members, and Directors Defendants did nothing to stem the losses. Nor does it appear that the Daily Administrator Defendants raised objection to any other failures by the fiduciaries to comply with the terms of the Plan, including, by way of example, HealthSouth's apparent failure even to appoint an ESOP Committee during at least some of the Class Period.

182. Thus, upon information belief, the Daily Administrator Defendants ignored their fiduciary duties under the Plan Documents, and stood mutely and idly by as their co-fiduciaries breached their duties of loyalty and prudence under the Plan and ERISA. Accordingly, the Daily Administrator Defendants failed to ensure the Plan was properly administered, and violated their duty under ERISA to act with the degree of care, skill, diligence, and prudence of a prudent fiduciary in like circumstances.

B. Defendants' Breached Their Fiduciary Duties under ERISA by Failing to Properly Monitor Plan Fiduciaries and Provide Them with Material Information.

183. HealthSouth and the Director Defendants exercised fiduciary responsibility for appointing and removing Individual and Bank Trustees and ESOP Committee members. In addition, the ESOP Committee members were responsible for appointing and removing the Daily Administrator Defendants. As appointing fiduciaries, these Defendants owed a fiduciary duty with respect to the selection and retention of those appointees. 29 C.F.R. § 2509.75-8, at D-4.

184. Among other things, this fiduciary duty requires the appointing fiduciaries at reasonable intervals to review the performance of their appointees in such a manner as to reasonably ensure that the appointees perform their duties in compliance with the terms of the Plan and statutory standards and in satisfaction of the needs of the Plan. 29 C.F.R. § 2509.75-8 at FR-17. In addition, this duty requires the appointing fiduciaries to provide their appointees with information that they know or should know would have an extreme impact on the Plan and, thus, is necessary for the appointees to effectively discharge their fiduciary obligations.

185. Upon information and belief, HealthSouth and the Director Defendants did not undertake any effort to in any way monitor the conduct of the Officer Trustees and ESOP Committee Defendants. Moreover, the Officer Trustee and ESOP Committee Defendants who possessed actual knowledge of the Company's illegal schemes did not communicate that information to other Plan fiduciaries they appointed, as their monitoring duty required.

186. Indeed, Scrushy and other top-level Directors and Officers who participated in the Company's illegal practices did just the opposite by repeatedly assuring employees – both directly in internal company meetings and indirectly through public disclosures and SEC filings – that the Company was highly successful and profitable.

187. Scrushy was particularly brazen when it came to misleading his employees. For example, in a March 1999 videotape featuring Scrushy, he specifically encourages employees to accumulate personal holdings in HealthSouth stock, pointing to a glowing balance sheet and strong cash flow. During June 2000, Scrushy starred in a HealthSouth "State of the Company" videotape made for employee consumption. In the tape, Scrushy remarks that HealthSouth and its management "have remained committed to prudent fiscal policy and the integrity of our balance sheet," adding that the Company had an "outstanding balance sheet." Finally, as late as March 2003, Scrushy boasted to a crowd of more than 1,000 employees that the Company had met the earnings expectations of Wall Street analysts every quarter for more than a decade. Thus, instead of satisfying his fiduciary duty as an appointing fiduciary to provide other fiduciaries with information that he knew or should have known would have an extreme impact on the Plan, Scrushy, and the other Director/Officer Defendants who also participated in the Company's illegal schemes, further obfuscated the truth.

IX. CLAIMS FOR RELIEF – THE LAW UNDER ERISA

188. ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2), provides, in pertinent part, that a civil action may be brought by a participant for relief under ERISA § 409, 29 U.S.C. § 1109.

189. ERISA § 409(a), 29 U.S.C. § 1109(a), “Liability for breach of fiduciary duty,” provides, in pertinent part, that any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by ERISA shall be personally liable to make good to such plan any losses to the plan resulting from each such breach; to restore to such plan any profits which have been made through use of assets of the plan by the fiduciary; and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.

190. ERISA § 404(a)(1)(A) and (B), 29 U.S.C. § 1104(a)(1)(A) and (B), provide that a fiduciary shall discharge his duties with respect to a plan *solely in the interest of the participants* and beneficiaries, for the *exclusive purpose of providing benefits to participants* and their beneficiaries, and *with the care, skill, prudence, and diligence* under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

191. These fiduciary duties under ERISA § 404(a)(1)(A) and (B) are referred to as the *duties of loyalty, exclusive purpose, and prudence* and are the “highest known to the law.”

192. ERISA § 405(a), 29 U.S.C. § 1105(a), “Liability for breach by co-fiduciary,” provides, in pertinent part, that:

...[i]n addition to any liability which he may have under any other provision of this part, a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances: (A) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach; (B) if, by his failure to comply with section 404(a)(1), 29 U.S.C. § 1104(a)(1), in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or (C) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

193. Plaintiffs therefore bring this action under the authority of ERISA § 502(a)(2) for, *inter alia*, Plan-wide relief under ERISA § 409(a) to recover losses sustained by the Plan arising

out of the breaches of fiduciary duties by the Defendants for violations under ERISA § 404(a)(1) and ERISA § 405(a), and for other appropriate equitable relief.

COUNT I

Failure to Loyal and Prudently Manage and Administer the Plan and Plan Assets (Breaches of Fiduciary Duties in Violation of ERISA §§ 404 and 405 By All Defendants)

194. Plaintiffs incorporate the allegations contained in the previous paragraphs of this Complaint as if fully set forth herein.

195. At all relevant times, as alleged above, Defendants were ERISA fiduciaries. Thus, they were bound by the duties of loyalty, exclusive purpose, and prudence.

196. At all relevant times, as alleged above, the scope of Defendants' fiduciary responsibilities included managing the Plan and Plan assets for the sole and exclusive benefit of plan participants, and with the care, skill, diligence, and prudence required by ERISA. In connection therewith, HealthSouth, the Officer Trustee, ESOP Committee and Director Defendants were directly responsible for, among other things, ensuring that Plan assets were invested prudently. Their duties in this regard are particularly apparent in this case in light of the provision in the SPD requiring the Trustee and Plan Administrator to invest in HealthSouth stock *only if it is prudent to do so* and, if not, to invest in "other investment media as the Administrator determines is in the best interests of the Plan participants."³⁴ The Daily Administrator Defendants were responsible for ensuring that the Plan was properly administered according to its terms, and, like the other Defendants, were required to exercise such other powers and duties as necessary for the proper supervision and administration of the Plan.

197. Yet, contrary to their duties and obligations under the Plan Documents and ERISA, Defendants failed to loyally and prudently manage the Plan and the Plan's assets. Specifically, during the Class Period, Defendants knew or should have known that HealthSouth stock was not a suitable and appropriate investment for the Plan. Nonetheless, during the Class

³⁴ SPD at 6-7, Exhibit B.

Period, Defendants continued to allow the Plan to hold substantially all of its assets in HealthSouth stock, and to allocate shares of the stock to participants' Plan accounts at artificially inflated values. They did so despite the stock's precipitous decline in value during the Class Period, and evidence that that the Company was being seriously mismanaged and that its future prospects were jeopardized as a result.

198. In addition, Defendants failed to conduct an appropriate investigation of the merits of continued investment in HealthSouth stock even in the face of red flags that, at a minimum, raised questions regarding the risks of continued investment in HealthSouth stock, and the conduct of the Plan Trustees and ESOP Committee members.

199. Under the circumstances, Defendants should have taken steps to protect the Plan from unnecessary losses. As discussed above, *see infra* ¶ 178, such steps should have included, among other actions, investing Plan assets in investment media other than HealthSouth stock, making appropriate disclosures, as necessary, appointing independent fiduciaries, and reporting the circumstances to the DOL. Moreover, Defendants should have used the authority each possessed to take such others action as necessary and appropriate under the circumstances to ensure that the Plan was properly managed and administered according to its terms. By, instead, doing absolutely nothing to protect the Plan from massive losses, Defendants breached their duties of loyalty and prudence under ERISA.

200. The fiduciary duty of loyalty also entails a duty to avoid conflicts of interest and to resolve them promptly when they occur. A fiduciary must always administer a plan with single-minded devotion to the interests of the participants and beneficiaries, regardless of the interests of the fiduciaries themselves or the plan sponsor.

201. HealthSouth, Beam, Martin, Owens, and Scrushy, breached their duty to avoid conflicts of interest and to promptly resolve them by, *inter alia*, failing to engage independent fiduciaries who could make independent judgments concerning the Plan's investment in HealthSouth stock; failing to notify appropriate federal agencies, including the DOL, of the facts

and transactions which made HealthSouth stock an unsuitable investment for the Plan; failing to take such other steps as were necessary to ensure that participants' interests were loyally and prudently served; with respect to *each of these above failures*, doing so in order to prevent drawing attention to the Company's inappropriate practices; and by otherwise placing the interests of the Company and themselves above the interests of the participants with respect to the Plan's investment in HealthSouth stock.

202. As a direct result of their disloyal scheme to enrich themselves, the Officer Trustee Defendants earned in excess of \$195 million during the same time period that the Plan, which they were duty-bound by ERISA to protect, lost over 80 percent of its value.

203. Defendants also breached their co-fiduciary obligations by, among other failures, knowingly participating in or knowingly undertaking to conceal the failure of their fellow fiduciaries to prudently and loyally manage investment of Plan assets and by enabling others to breach their fiduciary duties as a result of their own breaches.

204. Specifically, the Officer Trustee and ESOP Committee Defendants knowingly participated in each other's imprudent management of Plan assets and conflicts of interest, knew of such breaches, but failed to undertake any effort to remedy them. Moreover, the Director Defendants, some of whom claim they did not even know they were fiduciaries and, apparently, had not ever read the Plan Documents, enabled the Officer Trustees' and ESOP Committee members' breaches of fiduciary duty by failing to determine whether HealthSouth stock was a prudent investment for the Plan, or to direct the Trustees and ESOP Committee members to invest in other investment media that were in the bests interest of the Plan participants as required by the Plan Documents.

205. As a consequence of the Defendants' breaches of fiduciary duty, the Plan suffered tremendous losses. If the Defendants had discharged their fiduciary duties to prudently invest the Plan's assets, the losses suffered by the Plan would have been minimized or avoided. Therefore, as a direct and proximate result of the breaches of fiduciary and co-fiduciary duties

alleged herein, the Plan, and indirectly Plaintiffs and the other Class members, lost millions of dollars of retirement savings.

206. Pursuant to ERISA §§ 409 and 502(a), 29 U.S.C. §§ 1109(a) and 1132(a), Defendants in this Count are liable to restore the losses to the Plan caused by their breaches of fiduciary duties alleged in this Count and to provide other equitable relief as appropriate.

COUNT II

Failure to Monitor Fiduciary Appointees and Provide Critical Information to Them (Breaches of Fiduciary Duties in Violation of ERISA §§ 404 and 405 by HealthSouth, the Board of Director Defendants, and the ESOP Committee Defendants)

207. Plaintiffs incorporate the allegations contained in the previous paragraphs of this Complaint as if fully set forth herein.

208. At all relevant times, as alleged above, HealthSouth, the Board of Director Defendants, and the ESOP Committee Defendants were ERISA fiduciaries. Thus, they were bound by the duties of loyalty, exclusive purpose, and prudence.

209. At all relevant times, as alleged above, the scope of the fiduciary responsibility of HealthSouth, the Board of Director Defendants, and the ESOP Committee Defendants included the responsibility to select, monitor, and, when and if necessary, remove other Plan fiduciaries.

210. In connection with this duty, HealthSouth and the Director Defendants appointed Individual and Bank Trustees and ESOP Committee members. ESOP Committee members, in turn, on information and belief, appointed the Daily Administrator Defendants.

211. Under ERISA, a monitoring fiduciary must ensure that the fiduciaries he or she appoints are performing their fiduciary obligations, including those with respect to the investment of plan assets, and must take prompt and effective action to protect the plan and participants when they are not. In addition, a monitoring fiduciary must provide his or her appointees with complete and accurate information in their possession that they know or reasonably should know the monitored fiduciaries must have in order to prudently to manage the

plan and plan assets. At a minimum, such information includes facts or circumstances that a reasonably prudent fiduciary would know would have an extreme impact on participants' retirement savings in the plan.

212. HealthSouth and the Director Defendants breached their fiduciary monitoring duties by failing to undertake any effort whatsoever to monitor the performance of the Officer Trustee and ESOP Committee members they appointed. They also failed to adequately monitor their appointees' implementation of the terms of the Plan, including, but not limited to the investment of the Plan's assets, the establishment of an investment policy, and the ongoing monitoring of that policy and the Plan's investments.

213. Furthermore, HealthSouth and the Director Defendants failed to remove their appointees, in particular, Scrushy, Beam, Martin, Tanner, Owens, and Hale, despite clear indications that these appointees were acting directly contrary to the best interests of Plan participants or, at the very least, wholly disregarding their duties and obligations under the Plan Documents and ERISA. By all accounts, HealthSouth and the Director Defendants turned a blind eye to the failures and abuses of their appointees.

214. Had HealthSouth and the Director Defendants at all times carried out their fiduciary duties to monitor the Plan's fiduciaries, including removing those engaged in breaches of fiduciary duties and those with conflicts of interest (and replacing the discharged fiduciaries with qualified fiduciaries), the losses suffered by the Plan would have been minimized or avoided.

215. In addition, as fiduciaries with knowledge that Plan assets were invested in HealthSouth stock, HealthSouth, Scrushy, Beam, Martin, Tanner, and Owens had an affirmative obligation under ERISA to disclose to their appointees such material facts about the financial condition of the Company that they knew or should have known their appointees needed in order to protect the Plan and make sufficiently informed decisions, based on accurate information, concerning the Plan's investment in HealthSouth stock.

216. Had the Defendants named in this Count satisfied their fiduciary duty to provide their fiduciary appointees with information they knew or should have known their appointees needed in order to carry out their responsibilities under the Plan and ERISA, some or all of the Plan's loss could have been avoided.

217. Defendants also breached their co-fiduciary obligations by, among other failures, knowingly participating in or knowingly undertaking to conceal the failure of their fellow fiduciaries to satisfy their monitoring duties as appointing fiduciaries, and by enabling others to breach their fiduciary duties as a result of their own failure to monitor.

218. Specifically, Defendants named in this Count are liable as ERISA co-fiduciaries because:

- (a) HealthSouth and the Director Defendants participated in and undertook to conceal the Officer Trustees' and ESOP Committee Defendants' failure to provide critical information to their appointees by not appropriately calling attention to the breaches and by not taking any action to alert any other fiduciaries, participants, or appropriate regulatory agencies of the improper practices that imperiled the Plan assets;
- (b) HealthSouth and the Director Defendants enabled the Officer Trustee and ESOP Committee Defendants to imprudently manage the Plan's investment in HealthSouth stock, failed to provide complete and accurate information regarding HealthSouth stock to other fiduciaries and participants, and have impermissible conflicts of interest by failing to appropriately monitor the Officer Trustee and ESOP Committee Defendants; and
- (c) HealthSouth and the Director Defendants, including, at a minimum, Scrushy, Beam, Martin, Tanner, and Owens had knowledge of each other's failure to prudently manage the Plan's investment in HealthSouth stock and conflicts of interest, yet failed to make reasonable or any efforts to remedy the breaches.

219. Therefore, as a direct and proximate result of the breaches of fiduciary duties alleged herein, the Plan, and indirectly Plaintiffs and the other Class members, lost millions of dollars, and the breaching fiduciaries are liable to make good those losses to the Plan.

220. Pursuant to ERISA §§ 409(a) and 502(a)(2), 29 U.S.C. §§ 1109(a) and 1132(a)(2), Defendants in this Count are liable to restore the losses to the ESOP caused by their breaches of fiduciary duties alleged in this Count, and for such other equitable relief as is appropriate.

X. CAUSATION

221. The Plan suffered tens of millions of dollars in losses because substantially all of the assets of the Plan were imprudently invested, or allowed to be invested, by Defendants in HealthSouth stock during the Class Period, in breach of Defendants' fiduciary duties.

222. Had the Defendants properly discharged their fiduciary and/or co-fiduciary duties by divesting the Plan of some or all of its imprudent holdings of HealthSouth stock and investing the assets in other investment media as the Plan Administrators should have determined was in the best interest of Plan participants, by appropriately monitoring the actions of the Plan fiduciaries, and by replacing breaching fiduciaries with prudent fiduciaries, some or all of the Plan's losses caused by Defendants' breaches of fiduciary duty would have been avoided.

XI. REMEDY FOR BREACHES OF FIDUCIARY DUTY

223. The Defendants breached their fiduciary duties in that they knew or should have known the facts as alleged above, and therefore knew or should have known that the Plan's assets should not have been exclusively invested in HealthSouth stock.

224. As a consequence of the Defendants' breaches, the Plan suffered significant losses.

225. ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2) authorizes a plan participant to bring a civil action for appropriate relief under ERISA § 409, 29 U.S.C. § 1109. Section 409 requires "any person who is a fiduciary...who breaches any of the...duties imposed upon fiduciaries...to

make good to such plan any losses to the plan....” Section 409 also authorizes “such other equitable or remedial relief as the court may deem appropriate....”

226. With respect to calculation of the losses to a plan, breaches of fiduciary duty result in a presumption that, but for the breaches of fiduciary duty, the Plan would not have made or maintained its investments in the challenged investment and, instead, prudent fiduciaries would have invested the Plan assets in the most profitable alternative investment available to them. In this way, the remedy restores the Plan’s lost value and puts the participants in the position they would have been in if the Plan had been properly administered.

PRAYER FOR RELIEF

WHEREFORE, Plaintiffs pray for:

A. A Declaration that the Defendants, and each of them, have breached their ERISA fiduciary duties to the participants;

B. An Order compelling the Defendants to make good to the Plan all losses to the Plan resulting from Defendants’ breaches of their fiduciary duties, including losses to the Plan resulting from imprudent investment of the Plan’s assets; to restore to the Plan all profits the Defendants made through use of the Plan’s assets; and to restore to the Plan all profits that the Plan would have made if the Defendants had fulfilled their fiduciary obligations;

C. Imposition of a Constructive Trust on any amounts by which any Defendant was unjustly enriched at the expense of the Plan as the result of breaches of fiduciary duty;

D. An Order enjoining Defendants, and each of them, from any further violations of their ERISA fiduciary obligations;

E. Actual damages in the amount of any losses the Plan suffered;

F. An Order awarding costs pursuant to 29 U.S.C. § 1132(g);

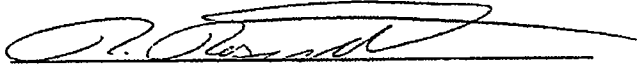
G. An Order awarding attorneys’ fees pursuant to 29 U.S.C. § 1132(g) and the common fund doctrine;

H. An Order for equitable restitution and other appropriate equitable monetary relief against the Defendants; and

I. Other appropriate injunctive relief, including appropriate modifications to the Plan to ensure against further violations of ERISA.

DATED this 19th day of December, 2003.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that on December ¹²/~~9~~, 2003, a copy of the above and foregoing pleading was served upon each and all of the parties listed below by depositing a true and correct copy of the same in the United States Mail with adequate first class postage affixed thereon, addressed as follows:

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