IN THE CIRCUIT COURT OF JEFFERSON COUNTY, ALABAMA
HEALTHSOUTH CORPORATION 2002 DERIVATIVE LITIGATION

Filed in Open Court
This 18th day of June 2009
Allwin E. Horn III
Circuit Judge
By _____ DEPUTY CLERK

WADE TUCKER, ET AL.	)	
Plaintiff	)	
v.	)	**CV 02-5212 AEH**
RICHARD M. SCRUSHY, ET AL.	)	**(And All Consolidated Cases**
Defendants	)	**CV 03-3522, CV 03-2023,**
	)	**CV 03-2420 and CV 98-6592)**

FILED IN OFFICE
JUN 18 2009
ANNE-MARIE ADAMS
Clerk

MEMORANDUM OPINION REGARDING FINAL JUDGMENT ORDER AGAINST DEFENDANT RICHARD M. SCRUSHY UNDER ALABAMA RULES OF CIVIL PROCEDURE RULE 54 (b)

The last chapter in the HealthSouth/Scrushy saga in this Derivative Action is coming to closure. By agreement and consent of the Parties, this Court conducted an eleven day non-jury trial on all remaining claims against Richard M. Scrushy ("Scrushy") which ended with closing arguments on May 26, 2009.[1] Prior to the Bench Trial, Derivative Plaintiffs and Scrushy stipulated the remaining claims against Scrushy were all equitable in nature and governed by the substantive law of Delaware.

Prior to trial the Parties hereto submitted to this Court various submissions and pre trial briefs regarding their positions on the remaining issues for trial and legal support therefore. Significantly, the Parties entered into extensive stipulations which are Court's Exhibits 5-7 and which will be referenced throughout this opinion and the Parties jointly submitted *Derivative Plaintiffs' and Defendant Scrushy's Joint Succinct Statement Of Key Issues* (hereafter "*Joint Statement of Key Issues*"), the purpose of which was to define the key issues which would determine the outcome of these claims against Scrushy.

[1] Claim against Defendant Ernst & Young, LLC are in arbitration. Claims against directors and officers of HealthSouth who were not criminally accused of complicity in the fraud are settled subject to certain pending appeals from a settlement of securities fraud claims. Claims against UBS Securities, LLC have been settled. This leaves claims pending only against Defendants who pled guilty to crimes (the "Pleading Defendants") which will be heard at a later time.

As has been chronicled in prior Orders and opinions of this Court and decisions of the Alabama Supreme Court, from mid 1996 to early 2003 a massive accounting fraud was systematically and progressively perpetuated at HealthSouth which resulted in the falsification and fabrication of the true financial condition of HealthSouth (the "Fraud"). This Fraud resulted in the preparation and filing of false and fraudulent financial documents that publicly traded companies are required by law to file. Indeed, these Parties do not contest the fact, size and duration of the Fraud.[2]

As has been previously noted throughout this litigation Scrushy has not denied the existence of the Fraud during the years indicated. His position has been, and remains, that he did not know of, authorize or participate in the Fraud and that during his time as CEO he did not breach his fiduciary duties by failing to discover and prevent the Fraud. Based upon the record in this case, this Court rejects Scrushy's position and concludes, as will be hereinafter detailed, 1.) Scrushy knew of and participated in the Fraud and 2.) Scrushy consciously and willfully breached his fiduciary duties as CEO of HealthSouth.

CREDIBILITY OF THE SIX TESTIFYING FELONS

Aaron Beam ("Beam"), Michael D. Martin ("Martin"), William T. Owens ("Owens"), Weston Smith ("Smith") and Malcolm McVay ("McVay") (collectively the "Pleading Defendants") have all pled guilty to various and sundry criminal charges directly related to their active participation in the fabrication and falsification of HealthSouth's financial documents during the time period of the Fraud. As such they are all admitted felons. On the other side, Defendant Scrushy is a convicted felon having been convicted in the United Stated District Court for the Middle District of Alabama on several felony counts arising out of bribe payments to the Alabama Governor Don Siegleman in connection with Scrushy's

[2] See, e.g., Stips. 5,8,10,90,182 and 183-196. The Parties' stipulations, including those cited here, are in the record as Court's Exhibits 5-7.

appointment to the Alabama Certificate of Need Board. Scrushy's conviction was affirmed by the United States Court of Appeals for the Eleventh Circuit and rehearing has been denied.

In opening Statements, Scrushy's attorney admitted the Fraud occurred at HealthSouth. Indeed, these Parties have filed stipulations acknowledging the Fraud existed at HealthSouth from the summer of 1996 to March 18, 2003, the date the FBI raided HealthSouth.

All Pleading Defendants have given sworn, detailed testimony of Scrushy's knowledge of, authorization for and active participation in the Fraud. Scrushy has given sworn, detailed testimony directly denying the testimony of the Pleading Defendants, his testimony being that he did not know of, authorize or participate in the Fraud and he did not breach his fiduciary duties in failing to discover and prevent the Fraud that factually occurred on his watch as CEO of HealthSouth. This testimony presents to this Court the classic "he said/he said" scenario regarding accusations, denials and counter-accusations, all directed to each other, by and between six admitted/convicted felons. To reach the truth this Court is mindful of its duties to sift and weigh all the testimony and evidence, all to the view of arriving at the truth. This Court is also mindful of its discretion to disregard and give no weight to testimony and evidence which this Court determines to be false and untrue. Fortunately, this Court does not have to decide these claims solely on the testimony of the six felons.

THE FRAUD

As per the stipulations of these Parties, the Fraud commenced in the summer of 1996. The genesis of the Fraud arose out of the fact that HealthSouth's true financial earnings would not meet or exceed the expectations of Wall Street, which by necessity, would have a negative impact on HealthSouth and the price or value of its publicly traded stocks. In order to meet the expectations of Wall Street, it became necessary to falsify and fabricate internal financial

records so that HealthSouth could meet Wall Street expectations and announce financials that were in line with what Wall Street expected. This scheme, by necessity, then required the falsification and fabrication of financial documents, such as 10-Q's and 10-K's which publicly traded corporations are required to file, quarterly or annually.

Although this Court is not an expert in accounting, the evidence establishes that in order to determine what the final numbers would need to be in order to meet expectations, it was first necessary to determine HealthSouth's actual numbers, revenues, expenses, etc., in order to arrive at the number to be fabricated so that expectations could be met. Although Scrushy's trial testimony disputes this, the evidence establishes, on a weekly and monthly basis, all of the operating divisions of HealthSouth prepared what has been identified as consolidated income/tracking statements. Several of these documents were admitted into evidence. See PX. 262-269. These consolidated reports would reflect the true financial information, such as patient visits, expenses, revenues, etc., that HealthSouth was experiencing on a weekly and monthly basis. The evidence further establishes the participants in the Fraud used these monthly reports in order to know and determine the financial numbers that had to be concocted and fabricated in order to meet the expectations of Wall Street and keep HealthSouth's stock price stable. As previously stated, at trial Scrushy testified that although he knew the operating divisions prepared consolidated monthly reports, the Corporate level of HealthSouth, at which he resided, did not prepare these consolidated monthly reports and he did not see any such reports.[3] Furthermore, on cross examination, Scrushy admitted his handwriting appeared on several pages of monthly tracking reports that are in evidence in this case.[4] As to PX 262, which Scrushy also admitted contained his handwriting, Scrushy testified this tracking report was a one time only, experimental format

[3] Vol. 8, 2520: 14-2528:7 (Scrushy, testifying there were monthly financial statements at division level but not at corporate level); Vol. 9, 3200:3-18 (Scrushy)
[4] Vol. 10, 3455:20-3481:21 - Scrushy

and he was told by the employee who designed the report that the numbers contained therein were wrong and that he (Scrushy) should ignore the numbers.[5]

In summary, at trial Scrushy denied being advised by any of the Pleading Defendants of the Fraud, denied that he authorized or participated in the Fraud and further denied that at the Corporate level, he had access to or was provided with any consolidated financial reports, weekly or monthly, which would have caused a competent CEO, doing his job, to have discovered and stopped the Fraud. Scrushy's prior testimony in the MedPartners litigation tells a different story.

MEDPARTNERS

MedPartners, later called "Caremark RX", is a corporation founded in the early 1990s, formerly based in Birmingham AL, in which HealthSouth was an investor. Executives moved back and forth between the two companies, which had several common directors. Those who served on the boards of both HealthSouth and MedPartners at one time or another included Scrushy, Martin, Charles Newhall, Larry Striplin, and Larry House ("House"). The two companies had the same auditing firm, E & Y, and the same investment bankers, Ben Lorello and Bill McGahan. House was president and Chief Operating Officer of HealthSouth but moved to MedPartners to become its CEO in 1996. Scrushy had served on the Board of MedPartners for several years when an accounting fraud occurred at MedPartners; House was CEO when the fraud occurred. The fraud was uncovered by an acquisition target, a company called PhyCor, when PhyCor was doing due diligence on MedPartners. Scrushy urged House to resign as CEO of MedPartners, and House did so in January 1998, whereupon Scrushy

[5] Vol. 8, 2717:21:21; 2718:1-2; 2718:14-15; Vol. 8, 2718:16-19; Vol. 8, 2239:11-12.

assumed the role of acting CEO of MedPartners, and remained in that position for less than 90 days while MedPartners recruited a replacement, Mac Crawford.[6]

On the first day of trial, Plaintiffs played portions of a videotape deposition Scrushy gave on February 11, 2000 in the civil case involving the fraud at MedPartners. In his testimony Scrushy specifically testified as to the types of financial reports that would be provided on a monthly basis to the CEO and other top corporate officers. Scrushy testified as follows:

> "Let me explain it to you. The chief financial officer has the responsibility of gathering that data and giving those reports to both operations as well as the senior executive. And it comes out of the financial department and he has comptrollers and he has people reporting to him that gather data and that information is produced on a monthly basis... And its normally available to the CEO and you don't have to run around asking a bunch of people to gather it for you, its given to you."

When questioned about who at MedPartners would have to know about the fraud because of the size and length of time, Scrushy testified as follows:

> "... I know that – here's what I know: the information in those financial statements was incorrect and it was not in thousands but in billions.... And it had been done over a three-year period or a several year period, I don't know how many years but I do – we'd have to go back and refresh on that information, but that's what I know. And who all was involved, I don't know everybody that was involved but I was – I'm sure it was a large enough and there were enough people involving in putting all of that together that there had to be several people involved in it.
>
> Q. Who, in your mind, asking your belief, who comprises that management team that is responsible for the incorrect financial statements of MedPartners for 1996, 1997 and 1998.

[6] Vol. 9, 3061:15-3077:21 (Scrushy); 3081:15-3082:18 (Scrushy); Vol. 9, 3061:15-3197:19 (Scrushy); Vol. 10, 3288:12-3289:16 (Scrushy).

A. I think it would be the top operating guys, the top financial guys. It would be for example, the chief financial guys that ran the operation. It would be the top financial guys, which would involve comptrollers and the CFO, and it would be the CEO. And I think they would all have knowledge of what was going on in the company and whether or not their statements reflected accurately as to what was happening or not."

As to the importance of the monthly financial information given to the CEO as opposed to the quarterly statements given to Board members, Scrushy testified as follows:

"Point of clarification, we were given – I was given financial data, quarterly data as a Board member but I was not given monthly. And when I assumed the role of CEO, I started looking at more information, which would be monthly information, so I started looking at more information than I would as a board member but I had seen quarterly statements prior to that...

Q. When you heard from Sage Gibbons about these reports in December of 1997, did you go back at any time and start looking at the quarterly numbers that you had been provided as a board member?

A. What good would that have done? I didn't have the underlines. I mean, all I have is the gross top sheet. There is nothing that – you couldn't determine from these numbers anything so it would have been of no value to look at those numbers. You have got to have the stuff that made them up because the problem was all the stuff under them was inaccurate but there's no way that I had access as just a board member, an outside board member to any data or any information."

Scrushy's MedPartners testimony is diametrically at odds with his testimony in the instant case. Furthermore, his MedPartners testimony clearly demonstrates his knowledge 1.) that weekly and monthly financial reports are provided to the CEO and 2.) that a CEO has to have this information in order to determine that quarterly reports are true and accurate. MedPartners is a damning indictment to his sworn testimony in this case.

LEIF MURPHY AND HIS NOTEBOOK

Murphy joined HealthSouth in August 1996 as a treasury associate, reporting to Martin, and became Treasurer after Martin succeeded Beam as CFO at the end of 1997. Approximately early July, 1991, Martin asked Murphy to analyze the feasibility of splitting HealthSouth into two corporations, one for outpatient and one for inpatient, and asked Murphy to contact Ken Livesay in the Accounting Department to gather information. Livesay, a Pleading Defendant herein, gave Murphy the true operating results for the Second Quarter. After examining this information Murphy concluded that in the quarter ended June 30, 1999, the corporation had earned only Seven and One Half Cents ($0.075) per share versus the Twenty Seven Cents ($0.27) that management projected and Wall Street expected. Murphy, concerned about both the accuracy of prior earnings reports and the achievability of present and future earnings guidance, then met with General Counsel Bill Horton in Horton's office on July 23, 1999.[7] At the meeting, Horton advised Murphy to report all his concerns to Martin and Scrushy, and Horton's testimony corroborates Murphy's.[8]

On Sunday, July 25, 1999, Horton wrote Murphy a memorandum forwarding drafts of alternative communication strategies for advising the public and Wall Street of serious problems in revenue and earnings.[9] Horton's testimony pinpoints the date of this meeting at July 23, 1999, and, significantly, confirms that Horton told Murphy to take his concerns to Martin and Scrushy.[10] Both the Horton memorandum to Murphy (including the communications strategies it suggested) and Horton's testimony confirms that what Murphy

[7] Vol. 4, 1243:23-1244:14 (Murphy); Vol. 7, 2436:1-11 and 2500:1-13 (Horton).
[8] Vol. 7, 2500:1-13 (Horton); Vol.4, 1235:2-6 (Murphy).
[9] DX 65.
[10] Id.

communicated to Horton regarding revenue and earnings problems were negative and serious.[11]

Murphy prepared a notebook and took it to Martin (the "Murphy Notebook").[12] The Murphy notebook showed what percentage of earnings would have to be fabricated to reach the currently projected earnings level. This included the earnings announcement about to be released in early August. The word "fabricated" was typed into the Murphy Notebook in conjunction with some numbers shown therein in several places.[13] The Murphy Notebook reflected Murphy's conclusion that the company had not met earnings expectations for the Second Quarter of 1999 and his recommendation to reduce earnings expectations going forward.[14] Murphy concluded that the split of the company into two public companies was not feasible at the current real earnings level.[15]

Murphy took the Notebook first to Martin and the two went through it "page by page" and discussed it.[16] Martin took a black marker and struck out the word fabricated in several places,[17] but did not strike it out in one place that it appeared.[18] Murphy prepared only one copy of the Notebook.[19] Except for marking out "fabricated" on all but one page where the word appeared, Martin made no changes in the Murphy Notebook,[20] and Martin and

---

[11] Vol. 7, 2434:18- - 2443:3 (Horton); DE 0065.
[12] The Murphy Notebook is in evidence at PX 758 through 761. The Court is aware of a similar document admitted into evidence as DX 275. Scrushy has made much of the fact that the first page of DX 275 contains the word "Blue Sky" instead of the word "SHORTFALL," which is shown on PX 760. After carefully considering the evidence, the Court finds that this difference is immaterial, as DX 275 nonetheless contains much of the same information in the same format and conveys the clear message that HealthSouth would have to fabricate earnings to reach reported estimates for the Second Quarter of 1999 and for periods going forward.
[13] PX 759-760;
[14] PX 758-761.
[15] Vol. 4, 1246:16-23, 1278:3-10 (Murphy).
[16] Vol. 4, 1245:14-1246:2 (Murphy).
[17] Vol. 4, 1252:19-1253:17 (Murphy); Vol. 2, 445:5-9 (Martin).
[18] Vol. 4 1253:18-1254-2 (Murphy), Vol. 2, 444:15-446:18 (Martin). The word "fabricated" was not scratched out on the page marked PX 759.
[19] Vol. 4 1258:18-23 (Murphy), Vol. 2, 444:2-14 (Martin).
[20] Vol. 4, 1256:11-19 (Murphy); Vol. 2, 444:2-14 (Martin).

Murphy took it to Scrushy.[21] The word "fabricated" thus clearly appeared in the Murphy Notebook when Murphy showed it to Scrushy, and it showed what percentage of earnings would have to be "fabricated," over seventy percent, for the company to reach its earnings estimates.[22] Indeed, right on the first page of PX 759, Murphy showed Scrushy a table showing "Fabricated Earnings as a Percent of Total" for the quarter and year, with percentages in the 70s.

Martin, Murphy, and Scrushy, and no others, met in Scrushy's office. Murphy brought only one copy of Murphy's Notebook into the meeting.[23] Murphy told Scrushy that to reach the projected earnings for the Second Quarter and full year of 1999, earnings would have to be fabricated.[24] He recommended a sharp reduction in earnings guidance,[25] and advised Scrushy that no acquisition could be accretive enough to make up for the shortfall between Wall Street expectations and current real earnings.[26] After the meeting ended, Scrushy told Murphy that he wanted to think about the presentation. Murphy and Martin then walked back to Murphy's office, and shortly thereafter, with Murphy and Martin present, Scrushy swung the door open and yelled at Murphy: "Where do you get off telling me how to run my company. I've been running this company for fifteen years."[27] At that second meeting, which lasted five minutes or less, and consisted entirely of Scrushy yelling, Scrushy did not dispute what Murphy had provided him.[28]

Murphy decided then and there to leave the company, and on August 3, 1999, told Martin that he was leaving.[29] Martin asked Murphy to stay the day so that Murphy might

---

[21] Vol. 4, 1257:1-6 (Murphy).
[22] PX 759.
[23] Vol. 4, 1258:18-23 (Murphy); Vol. 2, 444:2-5, 244:9-14 (Martin).
[24] Vol. 4, 1277:4-12 (Murphy).
[25] Vol. 4, 1277:16-1278:10 (Murphy).
[26] Vol. 4, 1255:3-1256:10 (Murphy).
[27] Vol. 4, 1265:9-21 (Murphy).
[28] Vol. 4, 1265:22-1266-1 (Murphy).
[29] Vol. 4, 1267-17-1268:2 (Murphy).

attend an investor conference call. On that call, Scrushy deflected a question to Murphy regarding debt ratios, and Murphy reflexively answered the question based on official, false information.[30] Murphy left the company shortly thereafter.

Martin's version of these two meetings materially corroborates Murphy's. Scrushy remembered the three having a meeting, and even remembered that they urged him to reduce estimates,[31] but Scrushy said that he was upset because Murphy recommended that Scrushy fire the President and COO of the corporation, Bennett.[32] Although Murphy did admit he provided false information regarding HealthSouth's financials during the August 3, 1999 investors conference call, this Court concludes Murphy's testimony and notebook constitutes credible evidence. Thus, this is additional, credible evidence as to Scrushy's actual knowledge of the Fraud during the time period in question.

This Court could cite other testimony, events and documents which also contradict and call into question the credibility of Scrushy's testimony. However, this Court does not believe other examples are necessary. Leif Murphy's testimony and notebook constitute compelling credible evidence. Even more compelling are the words that came out of Scrushy's mouth during his sworn deposition given February 11, 2000 in the MedPartners case. That testimony clearly demonstrates Scrushy's understanding, as a CEO of a publicly traded company, of the need and necessity for accurate and reliable monthly financial reports. In his testimony Scrushy further opines, as a CEO, that for a fraud of even a billion dollars to occur over a period of years, **the CEO had to know of the fraud**. Even if this Court is wrong to conclude Scrushy knew of and participated in the Fraud, Scrushy's MedPartner's testimony constitutes an unwitting confession that by failing to review and know about

---

[30] Vol. 4, 1268:7-1273:2 (Murphy).
[31] Vol. 9, 2937:2-16 (Scrushy).
[32] Vol. 9, 2943:9-2946:5 (Scrushy).

monthly financials while CEO of HealthSouth, he consciously and willfully failed to perform his fiduciary duties as CEO. Scrushy's protestations of innocence and ignorance are not credible, are two times too convenient, and are rejected. Based upon the totality of evidence in this record, this Court concludes 1.) Scrushy knew of and actively participated in the Fraud and 2.) Scrushy consciously and willfully breached his fiduciary duties as CEO of HealthSouth, specifically including his duty of loyalty.

DERIVATIVE PLAINTIFFS' CLAIMS

A.) 1996 BONUS

By Judgment Order of January 3, 2006, affirmed. *Scrushy v. Tucker, 955 So2d 988 (Ala. 2006)* this Court determined, pursuant to HealthSouth's procedures as confirmed in its publicly filed documents, that annual bonuses to HealthSouth executives, including Scrushy, were only payable when annual net income exceeded budgeted net income. The Parties have now stipulated for the year 1996 HealthSouth's budgeted net income was $209.7 million and actual net income was $132 million. See Stips. 14(a) and 190.

As a matter of law, since actual net income did not exceed budgeted net income for 1996, no bonuses were properly payable to Scrushy for 1996. Therefore, Scrushy was unjustly enriched in the amount of $10.4 million, his 1996 bonus, and he must return this sum to HealthSouth.

B.) INSIDER TRADING/"BROPHY" CLAIM

On November 6, 1997 and May 14, 2002 Scrushy exercised and sold 9,275,360 shares of HealthSouth stock at a net profit totaling $147,450,000.00 ($93,300,000.00 and $54,150,000.00 respectively) See Stips. 15-18.

The Parties agree Delaware law applies to this insider claim. Under Delaware law, a corporate fiduciary/insider, such as Scrushy, who uses inside information to profit from the sale of stock on the open market, at the expense of innocent buyers, holds the profit in

constructive trust for the corporation. *Brophy v. Cities Service Co., 70 A2d 5 (Del. Ch. 1949); In re American International Group, Inc. Deria, Litig., 965 A2d 763, 800-801 (Del. Ch. Feb. 10, 2009).* Additionally, these two stock sales occurred during the period of the fraud.

Although this Court believes the Federal Securities Litigation presently pending in District Court in Birmingham is an equally appropriate forum to adjudicate these claims, nevertheless Delaware law clearly provides derivative plaintiffs may recover these insider trading profits in a derivative action. Clearly profit was a motivating factor in these stock sales. Having been found to have knowledge of and been a participant in the fraud, and having breached his fiduciary duties, including loyalty, Derivative Plaintiffs are entitled to recover the total net profit Scrushy received from these two stock sales.

C. RESCISSION OF SCRUSHY'S EMPLOYMENT CONTRACTS

As pertinent hereto Scrushy and HealthSouth entered into an employment contract on July 23, 1986 which was amended and extended on occasion (the "1986 Employment Contract"). In April 1998 Scrushy and HealthSouth negotiated and entered into another employment contract (the "1998 Employment Contract") which purported to supersede and replace the 1986 Employment Contract. Attached to the 1998 Employment Contract is an unsigned document (the "Retirement Agreement") which purports to provide retirement benefits to Scrushy. Scrushy also contends he and HealthSouth entered into a new employment contract on September 17, 2002 (the "2002 Employment Contract"). With regard to this purported 2002 Employment Contract, the evidence establishes it was not approved by HealthSouth's Board of Directors as required by HealthSouth's corporate polices.

It is noted that all these employment contracts identified above covered periods of time involved in the Fraud. Indeed, the 1998 and 2002 contracts originated during the period of the Fraud. As to employees involved in the Fraud, the testimony establishes HealthSouth's

Board of Directors terminated all such employees when the Fraud was discovered. The Parties have also stipulated that HealthSouth's Board of Directors would not have approved any type agreement, whether an employment contract, indemnity agreement or otherwise, with any employee the Board knew was committing fraud. See Stips. 117.

Delaware and Alabama law allows rescission of contracts where a party has materially breached his contractual obligations. *Sheehan v. Hepbunn, 138 A2d 810 (Del. Ch. 1958); Demarie v. Neff, 2005 WL 90403 (Del. Ch. 2005); Strassburger v. Earley, 752 A2d 557 (Del. 2000); Gotham Partners, L.P. v, Holliwood Realty Partners, L.P., 817 A2d 160 (Del. 2002); Alabama Football, Inc. v. Stables, 319 So2d 678 (1975)* Delaware and Alabama law also allow rescission in circumstances where the contract is induced by fraud or fraud is concealed by one party from the other party. *Kenn v. NCD Industries, Inc.,* 316 A2d 576 (Del. Ch. 1973); *Putnam v. Byrd,* 632 So2d 961 (Ala. 1992).

Having been determined to be a knowing and active participant in the fraud, and been found to have breached his duty of loyalty to HealthSouth, Scrushy has forfeited any rights under the three employment contracts identified above and Derivative Plaintiffs are entitled to rescind said contracts.

D. THIRD PARTY/OTHER TRANSACTIONS

Tucker contends that Scrushy, while HealthSouth's CEO, approved and appeared on both sides of several transactions between HealthSouth, on the one hand, and Scrushy or his family or trusts on the other. Plaintiffs contend that Scrushy caused HealthSouth (a) to enter into contracts to purchase computing equipment from Scrushy's parents' entity, G.G. Enterprises, (b) to permit Scrushy's excessive personal use of corporate aircraft, (c) to divert assets to Capstone Capital Corp., a corporation in which Scrushy held an equity interest and to negotiate sale-and-leaseback transactions for both sides, and to divert HealthSouth assets to himself via Capstone, (d) to divert assets to First Cambridge, an entity in which Scrushy's

daughter was to receive an equity interest and an entity utilized to perpetuate the Fraud, (e) to purchase property adjacent to his home in Vestavia Hills and then convey it to himself, and (f) to divert assets to other entities in which Scrushy had an interest, including Source Medical, MedCenterDirect.com, MedPartners (later known as Caremark Rx), and the bands Proxy, Dallas County Line, and 3rd Faze. Under controlling Delaware law --

> There is no "safe harbor" for such divided loyalties in Delaware. When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. [Citations omitted.] The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.

Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983). Thus, as to each such transaction, Scrushy bears a heavy burden of establishing its "entire fairness" to HealthSouth. "Entire fairness" is not satisfied by approval by the Board standing alone – it requires a showing of both fair economics and fair process (often termed "fair price and fair dealing"). If he fails to meet that burden, Scrushy must return the fruits of his self-dealing transactions and pay the damages to HealthSouth. Of course, Scrushy was under a duty to make full disclosure to the Board before entering into any transaction with HealthSouth that could benefit him. This would include failure to disclose that he was committing fraud. Thus, Court's finding that Scrushy knew of the Fraud requires him to disgorge any unfair benefit he received and to pay HealthSouth any damages it suffered.

One theme is common to several of these transactions, – that Scrushy and HealthSouth shared the upside but not the downside. Scrushy held stock in all of these self-dealing entities. While HealthSouth also held stock in some of them, their risk was entirely different. HealthSouth put in assets to fund many of these entities and Scrushy did not; and HealthSouth put up loans or guaranteed loans to fund three of these entities, and Scrushy did not. Tucker contends that such arrangements, on which Scrushy is plainly on both sides, can never pass

muster under the exacting "entire fairness" standard, on which Scrushy bears a heavy burden of proof.

G. G. Enterprises ("G & G") was owned by Scrushy's father and mother and was a reseller of NCR computer equipment to HealthSouth. There is evidence in this record that Scrushy's brother, Gerald, negotiated with G.G. over the prices HealthSouth would pay and that HealthSouth paid over $5 million more than the same equipment could have been obtained elsewhere. There is no evidence that Gerald Scrushy was involved in the fraud. On the basis of this record, this Court cannot conclude the dealings with G.G. were not entirely fair to HealthSouth. Derivative Plaintiffs are not entitled to recover as to the G.G. dealings.

Capstone Capital Corporation ("Capstone") was a real estate investment trust organized and founded by Scrushy, Martin and a third investor, McRoberts. The shares of Capstone were owned by Scrushy (82,000 shares), Martin (8000 shares), McRoberts (18,000 shares) and HealthSouth (71,000 shares). Although Scrushy made millions of dollars as a result of his Capstone relationship, there is no credible evidence that the Capstone transaction was involved in the fraud as was detrimental to HealthSouth. Based on the record, HealthSouth has benefitted from the Capstone relationship. This Court cannot conclude Capstone was entirely unfair to HealthSouth.

Additionally, the Capstone transactions were timely and accurately reported in HealthSouth's publicly filed documents. No litigation was timely filed after the disclosure regarding Capstone. This Court further concludes recovery regarding Capstone is barred by the statute of limitations. Derivative Plaintiffs are not entitled to recover for Capstone.

As to Derivate Plaintiffs claims for excessive personal use of corporate aircraft, Scrushy's purchase of 19 acres of HealthSouth's property that adjoined Scrushy's personal residence, and HealthSouth's and Scrushy's involvement with the bands Proxy, Dallas County Line and 3rd Faze, again this Court, on this record cannot conclude these transactions were

entirely unfair. Scrushy paid substantial sums of money to HealthSouth for the use of corporate aircraft and the 19 acres of land. The bands appear to be promotional/advertising gimmicks for HealthSouth. Therefore, Derivative Plaintiffs are not entitled to recover damages for the use of aircraft, the 19 acres of land or the bands.

Source Medical Solution ("Source") was a company founded by HealthSouth, Scrushy and others in 2000. Prior to the founding of Source, HealthSouth had developed for its own use a clinical computer program, HCAP, which enabled doctors and other clinicians to automate and access patient data. HealthSouth wished to market this program to other companies and felt it could not successfully do so in its own name. Source was thus founded for the purpose of marketing this program in the competitive marketplace.

At founding, HealthSouth owned 35.75% of Source stock, Scrushy owned 13.64% and other HealthSouth officers owned 21.04% and other HealthSouth employees owned 20.5%. Although the evidence establishes HealthSouth has poured significant funds into Source, the record does not establish this relationship has been entirely unfair to HealthSouth. Derivative Plaintiffs are not entitled to recover with regard to the Source transaction.

MedCenterDirect.com ("MCDC"). MCDC was an e-commerce company that Scrushy tried to utilize to exploit the "dot com bubble." Scrushy caused HealthSouth to give MCDC an exclusive purchase agreement to be its e-commerce supplier to set MCDC up as an e-commerce middleman. The idea behind MCDC was (a) for HealthSouth to give MCDC substance through the purchase agreement, and then (b) for MCDC to do an initial public offering ("IPO") so that all MCDC's equity holders had a chance of making an enormous profit in the market conditions then prevailing.[33] Shares were purchased for nominal amounts, about Thirty Cents ($0.30) per share. On December 31, 1999, HealthSouth owned 29.8%, and Scrushy owned 28.3%. Scrushy cut in every member of the HealthSouth Board of

[33] Vol. 7, 2477:15-2482-6 (Horton).

Directors, who purchased lesser amounts. HealthSouth's purchases of equipment and supplies from MCDC amounted to $74.6 million in 2000, $100 million in 2001, and $89.4 million in 2002; MCDC took a 5% markup on these purchases, and later, beginning in November 2002, took a $5 million annual fee.[34] Throughout this period, MCDC operated with one large customer, HealthSouth.[35]

HealthSouth advanced MCDC $10 million in the form of a loan, and additionally guaranteed loans of $20 million from UBS. MCDC discontinued operations in 2003 and became insolvent.[36] HealthSouth eventually suffered a judgment on the guarantee for $31,949,155 including post-judgment interest.[37]

While the individual shareholders of MCDC, including Scrushy, invested their $0.30 per share on the same terms as HealthSouth, they shared the upside but not the downside. Scrushy and the other individual shareholders did not share in making the loan or loan guarantees.[38] On this record this Court concludes MCDC was materially unfair to HealthSouth and HealthSouth is entitle to recover its damages relating to MCDC. Even though HealthSouth's Board approved the MCDC transaction, their approval is tainted because they were in on the deal.

First Cambridge. First Cambridge was a real estate investment trust primarily started with HealthSouth's real estate, and the template was Capstone.[39] Scrushy dictated the ownership percentages, but this time HealthSouth was not to receive any ownership at all.[40] A real estate investment trust called HCI entered into an agreement with HealthSouth in December 2001 to purchase and lease back land and improvements constituting 13

[34] HealthSouth's "Super 10-K" at 151-152, in evidence as PX 46; Vol. 7, 2477:15-2484:13 (Horton).
[35] Stip. 97.
[36] HealthSouth's "Super 10-K" at 151-152, in evidence as PX 46.
[37] Stip. 99.
[38] Vol. 7, 2484:8-13 (Horton).
[39] Vol. 4, 1177:18-1178-13 (McVay, deposition testimony read into the record).
[40] Id. at 1179:1-1180:2.

HealthSouth facilities for a purchase price of $81.5 million, whereupon HCI assigned all rights and duties to First Cambridge, which leased the properties back to HealthSouth. HealthSouth did not receive full benefit of the purchase price for the properties, as it guaranteed an $82.5 loan from UBS to First Cambridge to finance the sale; the loan was payable December 26, 2002. In the ensuing year, HealthSouth paid First Cambridge $9.5 million in lease payments.

Scrushy took a 20% ownership position in First Cambridge in his daughter's name.[41] Under Scrushy's leadership as CEO, HealthSouth did not make public disclosure of the loan guarantee until after revelation of the Fraud; Horton testified that he now regards the guarantee as having been material, which it obviously was.[42]

The loan defaulted, and HealthSouth had to make good on its guarantee on which Scrushy (or his daughter) was not at risk. In late 2002, it became obvious that First Cambridge could not repay the $82.5 million loan, leaving HealthSouth exposed on the guarantee. HealthSouth arranged for an extension in the loan due date of four business days, so that it came due on January 2, 2003, and paid UBS $1 million to grant that extension. With First Cambridge failing to meet its obligations, the sale-leaseback transaction was unwound, with the properties being re-conveyed to HealthSouth at an additional loss of $8.8 million.[43]

The First Cambridge transactions were plainly unfair to HealthSouth.

Other Transactions

Digital Hospital. In 2001, HealthSouth began construction of a $400 million hospital facility on Highway 280, next to the corporate headquarters, called the "Digital Hospital." HealthSouth paid $191 million in construction and maintenance on the Digital Hospital before

[41] HealthSouth's "Super 10-K" at 155, in evidence as PX 46.
[42] Vol. 7, 2490:21-2492-9 (Horton).
[43] HealthSouth's "Super 10-K" at 155, in evidence as PX 46.

construction ceased. HealthSouth sold the partially-built facility in 2008 for $1.5 million plus a 40% contingency interest, on which it has not received any payment.[44] This Court credits Grinney's testimony that the project could not be justified on any economic basis even if HealthSouth had the cash to complete it.[45] Scrushy concedes that the decision to build it made no sense for a company that did not have the cash to complete it, that one would have to be a "complete bumbling idiot" to do so. As Scrushy knew that the cash was not there to complete the project, he is liable for all of HealthSouth's damages concerning the Digital Hospital.

FRAUD DAMAGES

Plaintiffs presented evidence of damages through stipulated facts, supporting documents, deposition testimony, and live witnesses, including extensive expert reports admitted into evidence through a live expert witness, Neill Freeman. ***Scrushy offered no evidence seeking to limit the damages claimed, with one exception:*** from the witness stand, Scrushy challenged as excessive HealthSouth's claimed damages for reconstruction and remediation of financial statements; Scrushy said he recalled that in the MedPartners fraud, such costs were not more than $20 million. But Scrushy did not attempt to show what was or was not done at MedPartners, or the similarities or differences in the two frauds. Scrushy admitted that he left MedPartners within 90 days after assuming the role as CEO. He thus is not competent to testify as to what may or may not have had to be done in the ensuing years at MedPartners to correct, reconstruct, or remediate its accounting. ***This Court finds Mr. Freeman a credible witness whose testimony and extensive work product submitted to this Court stand materially uncontradicted.*** The parties stipulated to both the authenticity of his

[44] Stips. 85-88.
[45] Vol. 3, 871:7-873:8 (Grinney).

documents (as to remediation costs)[46] and most of the sums he specifies as damages (as to various categories of damages).[47]

As to the general Breach of Fiduciary Duty claim, Plaintiffs have proven damages as follows:

A. Reconstruction and Remediation of Financial Statements. Between April 2003 and December 2007, HealthSouth paid $692,000,000 to twenty vendors providing services related to remediation, reconstruction, and/or restatement.[48] Of this sum, at least $457,629,000, plus prejudgment interest constitutes quantifiable damages proximately caused by the Fraud.[49]

B. Excess Debt Costs. HealthSouth incurred excess debt costs of $742,496,000 in interest on long-term debt that is directly attributable to and proximately caused by the Fraud.[50] Additionally, in 2004 & 2006, HealthSouth paid $404,516,000 in consent fees, bond and credit premiums, and arrangement fees that were necessitated by the Fraud and constitute damage resulting from the Fraud.[51] Through December 2008, total quantifiable damages from the Fraud associated with excess debt costs total more than $1,147,012,000, plus prejudgment interest.[52]

C. Stock Repurchases. HealthSouth spent over $324 million between 1998 and 2002 to repurchase, in the open market, shares of its own stock that were inflated by the fraudulently reported financial statements. However, there is no evidence in this record as to

---

[46] Stip. 81.
[47] Damages listed herein enumerate only those that are being claimed in this case. In addition to these damages, there is at least $1.2 billion in damages that were incurred but are not claimed against Scrushy. Included among those amounts are settlements related to the fraud, legal fees in relation to the fraud, additional vendor fees, numerous internal HealthSouth costs for reconstruction and remediation, among other costs.
[48] Stip. 80; PX 1015; PX 488.
[49] Vol. 4, 1371:10-1372:3; 1375:21-1376:13 (Freeman); PX 1014 at (I)(A); PX 488.
[50] Vol. 4, 1386:23-1387-17; 1393:7-1394-1 (Freeman); PX 1014 at (I)(B)(4); PX 1009; PX 488.
[51] Vol. 4, 1386:3-18 (Freeman); PX 1014 (I)(B)(1-3); PX 488.
[52] Stips. 71-77, 83-84; PX 1014 at (I)(B); PX 488.

the actual value of the stocks at the time of repurchase nor is there any evidence in this record as to the excess amount over actual value that HealthSouth paid to repurchase its stock. While this Court could conclude HealthSouth overpaid for the stocks, it would be pure speculation and conjecture on the part of this Court to arrive at the actual amount HealthSouth overpaid for its stock. Therefore, this Court is forced to conclude it has no factual basis on which to award damages to HealthSouth regarding these stock purchases.

D. Excess Salaries and Bonuses. HealthSouth paid $80,689,000 in salaries and bonuses (excluding Scrushy's 1996 bonus) to disloyal employees who participated in the Fraud. After deducting the $47,828,000 in bonuses to Scrushy already collected, and considering additional applicable offsets, present quantifiable damages to the Company resulting from the Fraud for payments to participants therein total $26,725,000, plus prejudgment interest.[53]

E. Taxes Paid on Fictitious Assets or Earnings. From 1996 to 2003, HealthSouth overpaid taxes on fictitious assets and revenues. HealthSouth overpaid by $81,334,000 personal property taxes on fictitious assets for which it is unlikely to recover any future refunds.[54] HealthSouth's overpaid federal income taxes (with interest) from 1996 to 2003 totaling $614,146,000, of which it has been able to recover $527,770,000, including interest, as of March 31, 2009.[55] HealthSouth estimates receiving future federal tax refunds (with interest) aggregating $35,349,000. Total cash out-of-pocket (net of excess interest costs and refunds obtained or expected) as a result of overpaid federal income taxes on fictitious income from 1996 to 2003 totals $51,027,000.[56] HealthSouth overpaid state income taxes (with

[53] Stips. 51, 89, 180; Vol. 4, 1398:1-1399:15 (Freeman); PX 1014 at (D)(3) (the $26,725,000 amount is arrived at after subtracting Scrushy's bonus for 1996, which is covered elsewhere in Plaintiffs' damage calculation); PX 488.
[54] Vol. 4, 1402:16-1404:13 (Freeman); PX 1014 at (D)(5); PX 488.
[55] PX 1010; PX 488.
[56] Vol. 4, 1407-23-1408:11 (Freeman); PX 1014 at (I)(D)(7); PX 1010; PX 488.

interest) on fictitious income between 1996 and 2003 totaling $105,218,000, of which it has been able to recover $44,389,000 including interest, as of March 31, 2009.[57] HealthSouth estimates receiving future state tax refunds (with interest) aggregating $23,505,000. Total cash out-of-pocket (net of excess interest costs and refunds obtained or expected) as a result of overpaid state income taxes on fictitious income between 1996 and 2003 totals $37,324,000.[58] Damages as a result of the Fraud from wrongfully paid taxes total $169,685,000 plus prejudgment interest.[59]

Damages from related party, self-dealing, and other transactions are shown below as part of the Findings of Fact and Conclusions of Law. For all damages on all claims outlined herein, Plaintiffs are entitled to recover from Scrushy, for and on behalf of HealthSouth, prejudgment interest.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This Court makes the following findings of fact and conclusions of law:

A. Findings of Fact.

1. A massive fraud in the financial statements of HealthSouth Corporation ("HealthSouth") began with the reporting of the 1996 2nd Quarter results (the three-month accounting period ended June 30, 1996) and continued until the public disclosure of the Fraud on or about March 18, 2003.

2. The Fraud was remarkable and perhaps unique in its duration, size, and scope. The following compares Net Income reported during the Fraud to actual Net Income:

[57] PX 1010; PX 488.
[58] Vol. 4, 1404:14-1407:22 (Freeman); PX 1014 at (I)(D)(6); PX 1010; PX 488.
[59] Stips. 78-79, 90-92, 93-94, 95-96,

HealthSouth Corporation Net Income

YEAR	SOURCE	ORIGINALLY REPORTED	ACTUAL	VARIANCE FROM ORIGINALLY REPORTED
2002 (1)	10Q, 11/14/02 (fraud) 10K, 6/27/05 (now)	$135,704,000	$(466,824,000)	$(602,528,000)
2001	10K, 3/27/02 (fraud) 10K, 6/27/05 at F-5 (now)	$202,387,000	$(191,225,000)	$(393,612,000)
2000	10K, 3/30/01 (fraud) 10K, 6/27/05 (now)	$278,465,000	$(364,243,000)	$(651,708,000)
1999	10K, 3/30/00 (fraud) Same minus adjustments reported by SARC (actual)	$76,517,000	$(326,443,000)	$(402,960,000)
1998 (2)	10K, 4/2/99 (fraud) Same minus adjustments reported by SARC (actual)	$46,558,000	$(556,482,000)	$(603,040,000)
1997	10K, 3/31/98 (fraud) Same minus adjustments reported by SARC (actual)	$330,608,000	$(65,432,000)	$(396,040,000)
1996	10K, 3/27/97 (fraud) Same minus adjustments reported by SARC (actual)	$220,818,000	$132,458,000	$(88,360,000)

Note (1) – Originally reported Net Income numbers from 2002 are nine month unaudited figures, as no 10K or final audited figures were released for 2002 until June 27, 2005. All numbers for 2000, 2001, and 2002 marked "now" are as restated and audited after the discovery of the fraud.
Note (2) – Actual Net Income numbers from 1996 through 1999 are those Originally Reported in the Fraud minus fraudulent adjustments to income reported by a "Special Audit Committee Report" ("SARC" or "SARC Report") by a Special Audit Committee of the Board of Directors of HealthSouth, dated June 1, 2004. The SARC Report was done in conjunction with PriceWaterhouseCoopers ("PWC").

3. Asset items on HealthSouth's balance sheet were comparably and concomitantly overstated. During the fraud, actual cash was a small fraction of reported cash.

4. At all times during the Fraud, i.e., the summer of 1996 until March 18, 2003, Defendant Scrushy ("Scrushy") was a member of the Board of Directors of HealthSouth and its Chairman. Throughout this period, he was also Chief Executive Officer ("CEO") of HealthSouth except that he was not CEO between August 28, 2002, and January 6, 2003.

5. The purpose of the Fraud was to overstate earnings to meet or exceed Wall Street expectations so as to artificially inflate the price of HealthSouth stock.

6. Scrushy knew of the Fraud, approved it, and participated with the Pleading Defendants to perpetuate it, from the Fraud's inception in mid-1996 until its public disclosure in March 2003. ***Scrushy was the CEO of the fraud.***

7. Throughout the history of HealthSouth, until the discovery of the Fraud in March 2003, five and only five individuals served as Chief Financial Officer ("CFO") of HealthSouth. The five were –

(a) Aaron Beam, a CPA, who served as CFO from the founding of HealthSouth in 1984 until his resignation in about September 1997 ("Beam");

(b) Michael D. Martin, not a CPA, who joined HealthSouth in 1991 as Treasurer, served as Treasurer (receiving various promotions while still remaining Treasurer of the corporation) until he succeeded Beam as CFO in Oct. 1997, and served as CFO until resignation in February 2000 ("Martin");

(c) William T. Owens, a CPA, who served as Controller from 1986 until February 2000 (receiving various promotions between 1986 and February 2000 while still remaining Controller of the corporation), when he succeeded Martin as CFO, served as CFO until August 2001, served as President and Chief Operating Officer ("COO") between August 2001, and August 28, 2002, served as Chief Executive Officer ("CEO") between August 28, 2002, and January 6, 2003, and returned to the CFO position between January 6, 2003, until the discovery of the Fraud on March 18, 2003 ("Owens");

(d) Weston Smith, a CPA, who headed the reimbursements function from the late 1980s until he succeeded Owens as Controller in February or March 2000, succeeded Owens as CFO in August 2001, remained in CFO position until August 2002, and remained employed by HealthSouth in other capacities until the Fraud was discovered in March 2003 ("Smith"); and

(e) Malcolm McVay, not a CPA, who joined HealthSouth in 1999 and served as Treasurer from Feb. 2000 to Aug. 28, 2002, when he was promoted to CFO, served as CFO until he was demoted back to Treasurer from Jan. 3, 2003 until discovery of Fraud ("McVay").

8. All five CFO's (Beam, Martin, Owens, Smith and McVay) have pleaded guilty to crimes resulting from their participation in the Fraud. These five CFOs, plus two other defendants herein who also pleaded guilty to crimes connected with the Fraud, Kenneth Livesay ("Livesay") and Emery Harris, are sometimes collectively referred to hereinafter as the "Pleading Defendants."

9. Scrushy knew that the financial statements of HealthSouth materially overstated Net Income from and after the Second Quarter of 1996 and continued to materially overstate Net Income until the discovery of the Fraud on March 18, 2003.

10. Scrushy signed each and every annual report to the Securities and Exchange Commission ("SEC") on Form 10K, from the report for 1996 through 2001, and each and every quarterly report on Form 10Q, from the report for the Second Quarter 1996, to the report for the Second Quarter 2002, despite knowing that they contained fraudulent financial statements materially exaggerating the financial health of the corporation.

11. Murphy, who has never been accused of complicity in the Fraud, was Treasurer of HealthSouth from 1997 to August 3, 1999. In July 1999, Martin gave Murphy the assignment of studying the feasibility of a proposed split-off of HealthSouth's outpatient and inpatient businesses into two separate corporations. In the course of this assignment, in July 1999, Murphy obtained from Livesay the consolidated income statement for the Second Quarter of 1999; what Livesay gave Murphy did not contain fraudulent adjustments and showed Net Income of only Seven and One Half Cents ($0.075) per share for the Second Quarter, a quarter that had been completed but for which earnings were not yet announced. Wall Street's expectations for the Second Quarter of 1999 were Twenty Seven Cents ($0.27) per share. Murphy concluded both that the company had been falsely overstating earnings and that the current earnings level would not support the proposed split-off. Upon seeing the numbers provided by Livesay, Murphy immediately, on July 23, 1999, sought the advice of HealthSouth's chief legal officer, William Wiley Horton, Esq. Horton advised Murphy to take his concerns to Martin and Scrushy. Murphy followed this advice. Murphy put together a notebook presentation and showed it to Martin (the "Murphy Notebook"). The Murphy Notebook included the word "fabricated" in at least three places, showing how much of earnings would have to be "fabricated" for HealthSouth and its divisions to achieve its

projected earnings. Martin took a black marker and crossed out the word "fabricated" in two places but did not cross it out in a third place. Martin made no other changes in Murphy's Notebook. Martin and Murphy then met with Scrushy and Murphy presented the Murphy Notebook in book form to Scrushy at a meeting held toward the end of July 1997, attended by Murphy, Martin and Scrushy. Murphy's Notebook shows "Fabricated Earnings as a Percentage of Total" reported earnings for the Second Quarter and annualized for the full year. Murphy clearly demonstrated to Scrushy that the earnings had been fabricated, and would have to be fabricated to achieve Wall Street expectations for the Second Quarter and going forward. Murphy also recommended that earnings guidance be lowered. Right after the meeting ended, Scrushy followed Murphy and Martin into Martin's office and yelled at Murphy that he could not tell Scrushy how to run the company. Murphy promptly decided to resign and tendered his resignation to Martin, and left HealthSouth on August 3, 1999. This Court believes this compelling evidence that Scrushy knew of the Fraud and consciously disregarded his responsibilities to HealthSouth, and this Court so finds.

12. Despite having been shown by Murphy in late July the true earnings for the Second Quarter of 1999, i.e., Seven and One Half Cents ($0.075) per share, Scrushy told stock analysts during the August 3, 1999 conference call that HealthSouth had made Twenty Seven Cents ($0.27) per share in Net Income for the quarter. And again, on August 16, 1999, Scrushy fraudulently signed, and caused HealthSouth to file, an SEC Form 10Q reporting that HealthSouth had earned $0.27 per share, almost four times the true earnings.

13. On November 6, 1997, with guilty insider knowledge of the Fraud that vastly overstated Net Income, cash, and other assets, Scrushy exercised stock options in HealthSouth stock and sold 4,000,000 shares into the market the same day at the market price of $27.00 per share, clearing a pre-tax profit that exceeded $93,300,000. This transaction was of course motivated at least in part by a desire to make a profit.

14. On May 14, 2002, with guilty insider knowledge of the Fraud that vastly overstated Net Income, cash, and other assets, Scrushy exercised stock options totaling 5,275,360 shares of HealthSouth stock and sold all such shares into the market the same day at the market price of $14.05 per share, clearing a pre-tax profit that exceeded $54,150,000. This transaction was of course motivated at least in part by a desire to make a profit.

15. This Court finds it inherently incredible that a CEO could fail to know of or discover a fraud of this magnitude over almost seven years. This is true of the unimaginable size of the discrepancy between real earnings and reported earnings shown in the table above, and it is also true as to balance sheet items such as cash. See Scrushy's MedPartners testimony.

16. HealthSouth did monthly consolidations of financial results, producing a monthly profit and loss statement. During the Fraud, each quarter, quarter after quarter, the first two months would be relatively weak as compared with Wall Street expectations. In the third month of every quarter, quarter after quarter, the Accounting Department would prepare a "first run" consolidation, containing numbers without fraudulent adjustments, and Scrushy would review it; those implementing the Fraud, including Scrushy, would then decide how much fabricated Net Income to add to the real Net Income numbers and this would be done by making false entries. Thus, anyone who was knowledgeable with HealthSouth's operation and was watching the repetitive spikes in earnings in the third month of every quarter should have quickly discovered the Fraud. As Scrushy monitored monthly consolidated financial statements, he necessarily knew of the Fraud.

17. Scrushy reviewed monthly tracking reports at HealthSouth that contained similar spikes in patient visits in the third month of every quarter, spikes that can only be explained by fraud.

18. False adjustments to raise earnings to meet Wall Street expectations were made at the end of the third month of every quarter. Scrushy saw the real results after each quarter. After seeing the first-run consolidated results, those implementing the Fraud, including Scrushy, would add fraudulent entries to get earnings up to Wall Street expectations and reissue the quarterly consolidated reports containing the Fraud. Scrushy then reviewed them again and signed the quarterly reports to the SEC that contained the fraudulent financial statements. This took place between the Second Quarter of 1996 through at least the Second Quarter of 2002.

19. Scrushy received incentive bonuses totaling $10,400,000 for 1996.

20. The Board of Directors approved a budget that included Net Income of $209,700,000 for 1996. Real Net Income was $132,000,000 for 1996. Under HealthSouth's policy published repeatedly in filings with the SEC, this level of Net Income did not produce a bonus pool out of which a bonus could properly be paid to or received by Scrushy. It would be unconscionable for Scrushy to retain his bonus for 1996.

21. HealthSouth was forced to expend substantial sums on remediation, reconstruction, and/or restatement of its financial records. Between April 2003 and December 2007, HealthSouth paid more than $692,000,000 to twenty vendors providing services related to remediation, reconstruction, and/or restatement; however, Plaintiffs have not claimed this full amount as damage in this action. Rather, for this category of damages they have claimed a total of $457,629,000, which constitutes quantifiable damages resulting from the Fraud. Included in these damages are payments to the following, which were the seven major non-legal vendors employed by HealthSouth after the Fraud to remediate the effects of the fraud on HealthSouth's accounting and financial systems, to reconstruct HealthSouth's accounting records, and to restate HealthSouth's financials:

$120,074,000 to Callaway Partners, expended no later than August 31, 2007.

$101,088,000 to PWC, expended no later than August 31, 2007. This amount is net of reasonably anticipated annual audit costs absent the Fraud.

$77,798,000 to Grant Thornton, expended no later than August 31, 2007.

$57,894,000 to Deloitte entities, including Deloitte & Touche LLP and Deloitte Consulting LLP. This amount is net of reasonably anticipated consulting costs concerning compliance with the Sarbanes-Oxley Law.

$35,123,000 to KPMG LLP, expended no later than August 31, 2007.

$28,559,000 to Alvarez & Marsal, Inc., expended no later than December 31, 2005. This amount is net of anticipated ongoing management compensation.

Additional amounts, aggregating $37,092,000 were paid to the following vendors, no later than December 31, 2006: American Appraisal, Vaco Resources, A&M Tax Advisory Services, Tidwell DeWitt, Tatum CFO Partners, Houlihan Lokey, Joel Frank Wilkinson, Credit Suisse/First Boston, Loughlin Meghji & Co., Resources Global, The Siegfried Group, Spencer Stuart, and Candlewood Suites.

22. HealthSouth incurred substantial excess debt costs of $742,496,000 in interest on long-term debt that is directly attributable to the Fraud. Additionally, in 2004 and 2006, HealthSouth paid $404,516,000 in consent fees, bond and credit premiums, and arrangement fees that were a natural consequence of the Fraud and constitute damage resulting from the Fraud. Total quantifiable damages from the Fraud associated with excess debt costs total at least $1,147,012,000, plus prejudgment interest.

23. HealthSouth paid $80,689,000 in salaries and bonuses (excluding Scrushy's 1996 bonus) to disloyal employees who participated in the Fraud. After deducting the $47,828,000 in bonuses to Scrushy already collected, and considering additional applicable offsets, present quantifiable damages to the Company resulting from the Fraud for payments to participants therein total $26,525,000, plus prejudgment interest.

24. This Court finds the facts regarding MCDC to be as previously stated in this Memorandum Opinion. Total damages to HealthSouth arising from transactions concerning MCDC transactions are $53,808,000, plus prejudgment interest.

25. This Court finds the facts regarding First Cambridge to be as previously stated in this Memorandum Opinion. Total damages to HealthSouth arising from transactions concerning First Cambridge are at least $15,500,000, plus prejudgment interest.

26. From 1996 to 2003, as a proximate result of the Fraud, HealthSouth overpaid taxes on fictitious assets and revenues. Overpaid and unrefunded personal property taxes total $81,334,000. Overpaid and unrefunded state income taxes total $37,324,000. Overpaid and unrefunded federal income taxes total $51,027,000. Thus, the total damages to HealthSouth for taxes overpaid as a result of the Fraud are $169,685,000, plus prejudgment interest.

27. Scrushy concealed a highly material fact from HealthSouth, the existence of the Fraud, when he and HealthSouth entered into, or amended, or extended the various employment and employment related contracts, and extensions thereof. In particular, the (a) 1998 Employment Agreement, and the Retirement Agreement attached thereto and purportedly made a part thereof, was materially induced by Scrushy's fraud, and (b) the purported 2002 Employment Agreement and Retirement Agreement were materially induced by Scrushy's fraud.

28. At all times from and after August 1996, HealthSouth relied to its detriment on the misrepresentations (including those embodied in the false financial statements and false SEC filings) that Scrushy made in extending the term of his employment, and in entering into new employment and employment-related agreements.

29. Scrushy materially breached all of his employment agreements in effect at any time after mid-1996, or entered into, or amended, or extended after that date and his fiduciary duties to HealthSouth by knowing of, failing to report, consciously disregarding, and/or participating in the Fraud, and by failing to perform duties normally incident to the position of CEO. All three employment agreements are hereby voided on these alternative grounds.

30. The Fraud by its nature was concealed from outside shareholders of HealthSouth until the fraud was revealed in March 2003.

31. Scrushy refused to resign as a director of HealthSouth until December 5, 2005. Scrushy thus remained a director and a fiduciary of HealthSouth until his departure from the Board on December 5, 2005.

32. As a matter of equity, this Court notes that HealthSouth suffered damages that its expert, Mr. Freeman calculates at $1.25 billion, as a proximate result of the Fraud, but that HealthSouth is not claiming in this litigation. This includes costs to HealthSouth of settling various other suits and regulatory actions that resulted from the Fraud.

33. During his tenure as CEO, Scrushy engaged in felonious conduct to make an illegal bribe payment to the Alabama Education Lottery Fund in exchange for his appointment to the Alabama Certificate of Need Board. In 1999, while CEO of HealthSouth, Scrushy caused HealthSouth to pay $250,000 of the bribe money. Scrushy was convicted in the United States District Court for the Middle District of Alabama on several felony counts arising from these illegal contributions. His conviction was affirmed by the United States Court of Appeals for the Eleventh Circuit and rehearing has been denied.

34. With regard to the transaction involving G.G., Capstone, use of Corporate aircraft, Source, the stock repurchases and the three bands, Derivative Plaintiffs have not met their burden of proof and are not entitled to recover damages for these transactions.

B. <u>Conclusions of Law and Applications of Law to Facts</u>

1. Between July or August 1996 and his departure from the Board in 2005, Scrushy breached his fiduciary duty of loyalty to HealthSouth by knowing of, failing to report, or participating in and failing to report the Fraud.

2. Between mid-1996 and March 19, 2003, Scrushy breached his fiduciary duty to HealthSouth, proximately causing injury to HealthSouth for which Scrushy must answer in

damages. The breaches of fiduciary duty arise out of each of the following: his participation in the Fraud in the accounting statements at HealthSouth, his conscious disregard of his duties as CEO, his participation in the self-dealing transactions that benefited Scrushy to the detriment of HealthSouth, and his criminal conduct in connection with the bribe payment to the Governor of Alabama.

> A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties. There may be other examples of bad faith yet to be proven or alleged, but these three are the most salient.

Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006), *quoting and citing* In re Walt Disney Deriv. Litig., 906 A.2d 27, 67 (Del. 2006). The Stone v. Ritter Court explained that a fiduciary's action or inaction in bad faith constitutes a breach of the duty of loyalty:

> . . . the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.

911 A.2d at 370.

3. Through his participation in the accounting fraud at HealthSouth, Scrushy defrauded HealthSouth, its Board of Directors, its shareholders, the investing public, and many others by making fraudulent misrepresentations regarding HealthSouth's financial condition. HealthSouth and its Board relied upon the material fraudulent misrepresentations by Scrushy each time the Board approved an extension of any of Scrushy's employment contracts, or allowed any such contract's term to be extended, or approved new employment contracts for Scrushy, or approved Scrushy's retirement contracts for Scrushy, from the commencement of the Fraud in mid-1996 until Scrushy was removed as CEO on March 19, 2003.

4. Either a fiduciary's action in bad faith or breach of the duty of loyalty renders inoperative the exculpation clause in HealthSouth's corporate charter. 8 Del.C. § 102(b)(7) (charter provision under § 102(b)(7) provides no protection for breach of the "duty of loyalty," for "acts of omissions not in good faith," for "intentional misconduct," for "knowing violation of law," or for a transaction involving an "improper personal benefit"). Id. Scrushy cannot avoid liability under the exculpation clause in HealthSouth's charter or under 8 Del.C. § 102(b)(7).

5. It is clearly the controlling law of Delaware that intentional illegal activity, or causing one's corporation to act illegally, is a breach of the duty of loyalty, as follows:

> In short, by consciously causing the corporation to violate the law, a director would be disloyal to the corporation and could be forced to answer for the harm he has caused. Although directors have wide authority to take lawful action on behalf of the corporation, they have no authority knowingly to cause the corporation to become a rogue, exposing the corporation to penalties from criminal and civil regulators. Delaware corporate law has long been clear on this rather obvious notion; namely, that it is utterly inconsistent with one's duty of fidelity to the corporation to consciously cause the corporation to act unlawfully. The knowing use of illegal means to pursue profit for the corporation is director misconduct . . .

Desimone v. Barrows, 924 A.2d 908, 934-935 (Del. Ch. 2007). The Supreme Court of Delaware has also made clear that the intentional failure to uphold one's duty of care amounts to a breach of the duty of loyalty. Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006). Scrushy engaged in intentional illegal activity in several respects, including his participation in the Fraud and his use of HealthSouth funds to bribe the Governor of Alabama.

6. A "conscious disregard of one's responsibilities" or "deliberate indifference and inaction in the face of a duty to act" is the appropriate standard for determining if a fiduciary has acted in bad faith. In re Disney Co. Derivative Litig., 906 A.2d 27, 62-63 (Del. 2006). Thus, an intentional disregard of one's duty of care amounts to bad faith and a breach

of the duty of loyalty. Desimone, 924 A.2d at 935 (director liable for bad faith breach of duty of loyalty if he acted with "indolence [that] was so persistent that it could not be ascribed to anything other than a knowing decision not to even try to make sure the corporation's officers had developed and were implementing a prudent approach to ensuring law compliance"); Stone v. Ritter, 911 A.2d at 370 ("Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."). "Under Delaware Law, a fiduciary may not manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity." Metro Comm. BVI v. Advanced Mobilecomm., 854 A.2d 121, 131 (Del. Ch. 2004).

7. Even if this Court is wrong in its firm and confident conclusion that Scrushy knew of and participated in the Fraud from and after the summer of 1996, Scrushy clearly breached his fiduciary duty of loyalty by consciously disregarding his responsibilities to HealthSouth.

8. Thus, since Scrushy knowingly caused his corporation to violate the law by filing false financial statements between the Second Quarter of 1996 and the discovery of the Fraud on March 18, 2003, he acted throughout this period in bad faith and in breach of the duty of loyalty, whether or not he was motivated by a desire to help the corporation, which he was not. Scrushy also acted in conscious disregard of his obligations to HealthSouth throughout the same period.

9. Because he knew of the Fraud on and before November 6, 1997, under the doctrine of Brophy v. Cities Service Co., 70 A.2d 5 (Del.Ch. 1949), Scrushy holds in constructive trust for HealthSouth the profit he made on his sale of stock executed on November 6, 1997, amounting to $93,300,000. He must return this sum to HealthSouth plus prejudgment interest. The Brophy rule was very recently applied in Delaware, upholding an

insider trading claim in a derivative suit over a motion to dismiss, in In re American International Group, Inc. Deriv. Litig., 965 A.2d 763, 800-801 (Del.Ch., Feb.10, 2009) ("AIG Derivative"). As the Delaware Court of Chancery held in AIG Derivative –

> Under Delaware law, "directors who misuse company information to profit at the expense of innocent buyers of their stock should disgorge their profits." A breach of fiduciary duty claim premised on insider trading, also known as a Brophy claim, arises where "1) the corporate fiduciary possessed material, nonpublic company information; and 2) the corporate fiduciary used that information improperly by making trades because she was motivated, in whole or in part, by the substance of that information."

Id. at 800-801 [Internal citations omitted].

10. Because he knew of the Fraud on and before May 14, 2002, under the Brophy doctrine, Scrushy similarly holds in constructive trust for HealthSouth the profit he made on his sale of stock executed on May 14, 2002, amounting to $54,150,000. He must return this sum to HealthSouth plus prejudgment interest. Brophy, *supra*; AIG Derivative, *supra*.

11. Scrushy was in material breach of his employment and employment-related contracts with HealthSouth in that they required him to exercise responsibilities normally associated with the position of CEO and Chairman. Scrushy breached these contracts by engaging in massive fraud and by consciously disregarding his responsibilities to HealthSouth. These contracts are rescinded on this ground, and HealthSouth is entitled to recover all sums paid to Scrushy or on Scrushy's behalf thereunder, as all such sums constitute damages for his breach of the duty of loyalty. HealthSouth shall have no further obligations to Scrushy under any of the employment-related contracts, including, without limitation, Scrushy's various employment contracts, retirement contracts, or the so-called "Split Dollar Agreement." Material breach mandates rescission at the option of the party against whom the breach is committed. Scrushy's knowledge of the Fraud, or the failure to discover it through conscious disregard of his responsibilities, constitutes a material breach of his employment contracts, and such breach also supports rescission, both in Delaware and

Alabama. Sheehan v. Hepburn, 138 A.2d 810, 812 (Del. Ch. 1958) (recognizing that "failure to perform basic terms of a contract warrant rescission"); Demarie v. Neff, 2005 WL 90403, Del.Ch. 2005 ("A party may terminate or rescind the contract because of substantial non-performance or breach by the other party."); Alabama Football, Inc. v. Stabler, 319 So.2d 698 (Ala. 1975) (affirming rescission remedy based on defendant's non-performance of contract). ***Scrushy had a contractual obligation to uphold the responsibilities of a CEO; for example, his 1998 Employment Agreement stated that he had "the powers, authorities, duties and responsibilities usually incident to the positions and offices of Chief Executive Officer and Chairman of the Board of the Company."*** As a matter of law, those "duties incident to the position of CEO" include ensuring preparation of materially accurate financial statements, and the courts of Delaware so held in In re HealthSouth Corp. Securities Litig., 845 A.2d 1096 (Del. Ch. 2003), *affd.* 847 A.2d 1141 (Del. 2004) (the "Buyback Case"). Even more obviously, if Scrushy engaged in material accounting fraud, or knew of it and signed SEC filings anyway, or consciously disregarded his responsibilities to HealthSouth, then he was in material breach of that agreement and each employment-related agreement because he did not perform "his responsibilities normally incident to the positions and offices of Chief Executive Officer . . ." as required in all his employment contracts. In addition, Scrushy's conscious disregard of his duties to HealthSouth as CEO constitute breaches of his fiduciary duty of loyalty to HealthSouth and justify rescission of his employment and employment-related contracts and excuse any further performance by HealthSouth thereunder.[60]

12. Scrushy now appears to argue that a previous arbitration of his right to indemnification of the costs of his successful criminal defense forecloses Derivative

[60] *See Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 817 A.2d 160, 175 (Del. 2002) (noting that a "breach [of the duty of loyalty] permits broad, discretionary, and equitable remedies"); *Strassburger v. Earley*, 752 A.2d 557, 578 (Del. 2000) (concluding that complete rescission was preferred remedy for stock purchase transactions tainted by breach of fiduciary duty of loyalty); *United States v. Graham*, 2007 WL 1806174, *2 (E.D. Mich.) (holding that breach of duty of loyalty justifies rescission of employment contract).

Plaintiffs' argument that the employment contracts are ineffective. Scrushy's argument is erroneous for three reasons. First, the arbitration in question involved only the Indemnification Agreement, not Scrushy's employment agreements as updated and extended from time to time. Second, the Indemnification Agreement specifically provides that Scrushy is not to be indemnified thereunder to the extent that he is adjudicated to have committed fraud; Derivative Plaintiffs seek such adjudication here.[61] Third, as a matter of Delaware law, adjudicated breaches of the duty of loyalty and bad faith resulting from participation in a fraud cannot be indemnified, even where there is a contract purporting to do so. 8 Del. C. § 145.

13. Scrushy fraudulently induced HealthSouth to enter into, or extend, or allow to be extended, any employment or employment-related contract between HealthSouth and Scrushy. Scrushy's employment contracts are rescinded on this ground, and Plaintiffs are entitled to recover on behalf of HealthSouth all sums paid to Scrushy or on Scrushy's behalf thereunder, all of which sums also constitute damages for his breach of the duty of loyalty. The law of both Delaware and Alabama firmly support the proposition that fraud in the inducement mandates rescission. *See* Kern v. NCD Industries, Inc., 316 A.2d 576, 582 (Del. Ch. 1973) ("Fraud is the misrepresentation or concealment of a material fact and when proved calls for rescission of a thus tainted contract."); Putnam v. Byrd, 632 So.2d 961 (Ala. 1992) (affirming remedy of rescission of commercial real estate sale in favor or plaintiff buyer where defendant seller had concealed from buyer knowledge that important tenant intended to vacate). *See also* Restatement (Second) of Contracts § 164 (contracts voidable where

[61] Scrushy also appears to argue that the offset of his arbitration award for the defense of his Birmingham criminal suit against the bonus judgment somehow validates his employment agreements. This is erroneous for numerous reasons. First, any judgment held by one party against a second can be offset against the second party's judgment against the first, even if the judgments have absolutely nothing to do with one another. Second, only the Indemnity Agreement was at issue in the arbitration; his employment and retirement agreements were not.

innocent party induced by fraud or material misrepresentation). Thus, Scrushy's knowledge of the Fraud at HealthSouth supports the remedy of rescission.[62]

14. Because of the findings of fraud and trading on inside information in this case, Scrushy must make restitution to HealthSouth of all monies advanced to Scrushy by HealthSouth in this matter.

15. The 2002 Employment Agreement was never validly entered into or effective. It required full Board approval, but the full Board never approved it. It was also induced by Scrushy's fraud, and even if it ever went into effect (and it did not), Scrushy materially breached it by not performing duties normally associated with his position. HealthSouth has no obligations thereunder.

16. Scrushy is required to return to HealthSouth monies paid under the Split-Dollar Agreement, which premiums were required under his now-rescinded employment contracts.

17. HealthSouth owes no further contractual obligations to Scrushy, under any of the employment or employment-related contracts.

18. As CEO, Scrushy is the individual and officer charged with ensuring preparation and reporting of materially accurate financial statements. In re HealthSouth Corp. Securities Litig., 845 A.2d 1096 (Del. Ch. 2003), *affd.* 847 A.2d 1141 (Del. 2004) (the "Buyback Case"). The Buyback Case repeatedly states and restates that the CEO is the officer primarily responsible for ensuring the accurate reporting of financial statements, and he cannot be allowed to profit because he failed in this duty. The Buyback Case was cited favorably by the Supreme Court of Alabama in Scrushy v. Tucker, 955 So. 2d 988 (Ala. 2006), declaring that the law of Delaware and of Alabama as to unjust enrichment is

[62] There can be no serious dispute that HealthSouth relied to its detriment on Scrushy's fraudulent misrepresentations regarding the financial condition of the company. Scrushy has stipulated that the non-management members of the Board did not know of the Fraud, and had they known of Scrushy's participation in it, they would have terminated him forthwith (which they indeed did once the fraud was revealed). Even if he did not know of the Fraud (which he did), the Board would never have entered into an employment agreement with the CEO on whose watch the massive fraud occurred.

essentially the same. This also provides an alternative ground, standing alone, for rescission of all of Scrushy's employment and employment-related contracts, as Scrushy failed spectacularly in his primary duty.

19. Scrushy must repay to HealthSouth the incentive bonus Scrushy received for 1996, or $10,400,000, plus prejudgment interest, under any of the alternative theories of unjust enrichment, or misrepresentation, or breach of the fiduciary duty of loyalty. Per the parties' stipulations, HealthSouth's actual results did not generate a legitimate executive bonus pool for 1996 from which Scrushy could legitimately have been paid a bonus for that year. As adjudicated in this Court's Judgment Order of January 3, 2006, *affd.* Scrushy v. Tucker, 955 So. 2d 988 (Ala. 2006), if no bonus pool was generated under rules HealthSouth announced to the public, then any bonus paid to Scrushy for that year must be returned.

20. Amounts spent on remediation, reconstruction, and/or restatement of HealthSouth financial records were directly and proximately caused by the Fraud. Scrushy is liable for $457,629,000 in damages relating to remediation, reconstruction, and restatement of HealthSouth financial accounts, plus prejudgment interest.

21. Amounts spent on excess debt costs were directly and proximately caused by the Fraud. Further, HealthSouth's 2004 and 2006 consent fees, bond and credit premiums, and arrangement fees were directly and proximately caused by the fraud. Scrushy is liable for $1,147,012,000 in such costs, plus prejudgment interest.

22. Amounts spent on salaries and bonuses to participants in the Fraud were directly and proximately caused by the Fraud. Scrushy is liable for $26,525,000 in damages relating to salaries and bonuses to participants in the Fraud (excluding Scrushy's 1996 bonus), plus prejudgment interest.

23. Excess payments and loans to MCDC incurred by HealthSouth were directly and proximately caused by Scrushy's misconduct, self-dealing, and breach of his duty of

loyalty. Scrushy appeared on both sides of the transactions with MCDC and failed to meet his burden of proving that the transaction was entirely fair to HealthSouth. Scrushy is liable for $21,859,000 in damages relating to MCDC, plus an additional $31,949,000 in a judgment which HealthSouth suffered and satisfied regarding HealthSouth guarantee of a loan to MCDC. Scrushy is accordingly liable for a total of $53,808,000 in damages relating to MCDC, plus prejudgment interest.

24. HealthSouth's payments related to First Cambridge were a damage directly and proximately caused by Scrushy's misconduct, self-dealing, and breach of the duty of loyalty. Scrushy appeared on both sides of the transactions with First Cambridge and failed to meet his burden of proving that the transaction was entirely fair to HealthSouth. Scrushy is liable for $15,500,000 in damages relating to First Cambridge, plus prejudgment interest.

25. Amounts spent on the Digital Hospital facility were directly and proximately caused by the Fraud. Scrushy is liable for $190,883,000 in damages relating to Digital Hospital expenditures, plus prejudgment interest.

26. HealthSouth's overpayment of taxes based upon fictitious revenues and assets is a direct and proximate result of the Fraud. Scrushy is legally responsible for any excess overpayments not recovered by the company, as well as all expenses related to efforts to secure overpayment refunds. The total damages relating to overpayment of personal property and federal and state income taxes is at least $169,685,000, plus prejudgment interest.

27. Scrushy argues that Plaintiffs have no standing to assert any claims accruing before August 18, 1998, the date the original shareholder plaintiff herein, Wade C. Tucker, acquired his shares. Scrushy's defenses based on Plaintiffs' shareholding (which Scrushy terms "standing") have no merit for all the reasons stated in this Court's Final Judgment Order of January 3, 2006, at 15-17, *affd.*, Scrushy v. Tucker, 955 So. 2d 988 (Ala. 2006), which is hereby made part of the syllabus and record herein. Additionally, Scrushy litigated and lost

this issue, having raised it in his answering brief dated September 12, 2005, to Tucker's motion for summary judgment. Scrushy raised it again in a cross motion for partial summary judgment and supporting brief filed September 21, 2005. Both these motions were decided against Scrushy, and this Court specifically rejected the "standing" argument based on Mr. Tucker's shareholding for six separate alternative reasons. Scrushy did not thereafter pursue the issue, either in his unsuccessful motion to Alter, Amend, or Vacate, filed January 20, 2006, or in his subsequent unsuccessful appeal. If Plaintiffs had no standing, they could not have prevailed on recovering Scrushy's bonus for 1997. Thus, Scrushy's defense has no merit for the additional reasons that he litigated and lost on these very same grounds, waived the issue by failing to raise it on appeal, and the matter stands as *res judicata* and the law of the case.

28. Scrushy's "unclean hands" defense has no merit and this Court exercises its discretion not to apply it, for all the reasons stated *supra*. The defense simply does not apply to an insider seeking to shield himself from liability to his own corporation. In re HealthSouth Corp. Sec. Litig., 845 A.2d 1096 (Del. Ch. 2003), *affd* 847 A.2d 1141 (Del. 2004). The innocent, continuing shareholders of HealthSouth do not have "unclean hands," and Scrushy, who does, cannot use them to strum the harp of equity.

29. As to the transactions involving G.G., Capstone, use of corporate aircraft, Source, the three bands, and the stock repurchases, and the land transaction, Derivative Plaintiffs are not entitled to recover damages and Judgment will be rendered in favor of Scrushy as to these transactions.

30. This disposes of all claims by Tucker against Scrushy. This Court explicitly finds that there is no just reason for delay, and the judgment issued this day is final under Alabama Rule of Civil Procedure, Rule 54(b).

31. Both parties have advised the Court that as all claims herein are based on Delaware law, that the Delaware law of damages should be applied. In American General Corp. v. Continental Airlines Corp., 622 A.2d 1 (Del. Ch. 1992), following a judgment of over $44 million for plaintiff for breach of its rights under warrants of a loan agreement in connection with a merger, Vice Chancellor Hartnett held:

> Prejudgment interest is available in Delaware ***as a matter of right.*** Such interest is normally computed from the date of the breach, but the Court of Chancery "is empowered to grant such relief 'as the facts of a particular case may dictate.'"

Id. at 13 (citations omitted) [Emphasis supplied]. In Delaware, prejudgment interest is generally viewed as a component of damages. Trans World Airlines Inc. v. Summa Corp., Del. Ch., C.A. No. 1607, Walsh, J. (Jan. 21, 1987), aff'd, 540 A.2d 403 (Del. 1988), cert. denied, 488 U.S. 853. As stated in Trans World Airlines, slip op. at 39, "Interest is simply a component of the fair compensation allowable for loss of principal." There is broad discretion in the Delaware Court of Chancery in all matters relating to pre-judgment interest, but in all but the most unusual cases, prejudgment interest is awarded.

32. In Delaware, pre-judgment interest runs on all claims, and is calculated at the legal rate of five percentage points above the Federal Reserve Discount Rate. 6 Del. C. §2301(a). Prejudgment interest generally begins to accrue on the date of the breach or when the damages were inflicted, but the trial judge has broad discretion. American General, 622 A.2d at 13. This Court will accordingly apply prejudgment interest as to damages (or restitution) on all claims. Once interest begins accruing, the rate is generally fixed as to any claim, and does not float with interim changes in the discount rate. Rollins Environmental Services Inc. v. WSMS Industries, Inc., 426 A.2d 1363, 1368 (Del. Super. 1980)

33. This Court has calculated and awarded prejudgment interest only up to May 31, 2009. The applicable prejudgment interest rate in Delaware on May 31 of the year shown is as follows:

Year	Fed. Rsrv. Discount Rate[63]	Legal Interest Rate, DE
1996	5.00%	10.00%
1997	5.00%	10.00%
1998	5.00%	10.00%
1999	4.50%	9.50%
2000	6.00%	11.00%
2001	3.50%	8.50%
2002	1.25%	6.25%
2003	2.25%	7.25%
2004	2.25%	7.25%
2005	4.00%	9.00%
2006	6.00%	11.00%
2007	6.25%	11.25%
2008	2.25%	7.25%

ACCOMPANYING FINAL JUDGMENT PURSUANT TO ALA. R. CIV. P., RULE 54(b) AGAINST DEFENDANT RICHARD M. SCRUSHY

Following trial on the merits, held May 11, 2009, through May 26, 2009, of this derivative suit brought by Plaintiffs Wade C. Tucker and another derivative shareholder plaintiff (collectively, "Tucker"), for and on behalf of HealthSouth Corporation, and it appearing to this Court that Tucker is entitled to judgment for the reasons stated in the Memorandum Opinion herein, and based on the record, the transcript, stipulations, and

[63] *See* http://www.federalreserve.gov/releases/h15/data/Daily/discontinued_DWB_NA.txt.

documents and evidence presented herein, and there appearing no just reason to delay the finality of the order and judgment entered herein, THIS COURT HEREBY CERTIFIES AS FINAL THE ACCOMPANYING FINAL JUDGMENT WHICH THIS COURT HAS ENTERED THIS DAY PURSUANT TO THE ALABAMA RULES OF CIVIL PROCEDURE, RULE 54(b) AGAINST RICHARD M. SCRUSHY. The sums comprising the said FINAL JUDGMENT are as follows:

(a) $10,400,000 plus prejudgment interest of $12,480,000 on the bonus Scrushy received for 1996, the interest on this bonus being calculated at 10.00% per annum from and after May 31, 1997 until May 31, 2009, or 12 years simple interest, for a total of $22,880,000.00.

(b) $93,300,000 plus prejudgment interest of $102,630,000 for the insider trade Scrushy made on November 6, 1997, the interest being calculated at 10.00% per annum from and after May 31, 1998, or 11 years simple interest, for a total of $195,930,000.

(c) $54,150,000 plus prejudgment interest of $23,691,000 for the insider trade Scrushy made on May 14, 2002, the interest being calculated at 6.25% per annum from and after May 31, 2002, until May 31, 2009, or 7 years interest, for a total of $77,841,000.

(d) $457,629,000 plus prejudgment interest of $164,746,000 for reconstruction and remediation costs, the interest being calculated at 9.00% per annum from and after May 31, 2005, until May 31, 2009, or 4 years simple interest, for a total of $622,375,000.

(e) $1,147,012,000 plus prejudgment interest of $412,924,000 for excess debt costs incurred between 2003 and 2006, the interest being calculated at 9.00% per annum from and after May 31, 2005 until May 31, 2009, or 4 years simple interest, for a total of $1,559,936,000.

(f) $169,685,000 plus prejudgment interest of $74,237,000 for damages from taxes overpaid as a result of the fraud, the interest being calculated at 6.25% per annum from and after May 31, 2002, or 7 years simple interest, for a total of $243,922,000.

(g) $53,808,000 plus prejudgment interest of $3,901,000 for damages from transactions relating to MedCenterDirect.com, the interest being calculated at 7.25% per annum from and after May 31, 2008, or 1 year simple interest, for a total of $57,709,000.00.

(h) $15,500,000 plus prejudgment interest of $6,743,000 for damages from transactions relating to First Cambridge, the interest being calculated at 7.25% per annum from and after May 31, 2003, or 6 years simple interest, for a total of $22,243,000.

(i) $190,883,000 plus prejudgment interest of $83,034,000 for damages from wrongful expenditure for the Digital Hospital, the interest being calculated at 7.25% per annum, from and after May 31, 2003, or 6 years simple interest, for a total of $273,917,000.

(j) $26,725,000 plus prejudgment interest of $11,625,000 for compensation paid to participants in the Fraud and not previously recovered (excluding Scrushy's 1996 Bonus), the interest being calculated at 7.25% per annum, from and after May 31, 2003, or 6 years simple interest, for a total of $38,350,000.

3. The total amount of the judgment this day entered by separate judgment, before application of a judgment credit, is $3,115,103,000.00 constituting the sum of the above.

4. Scrushy is entitled to a judgment credit of $239,000,000 based on orders of this Court previously entered which consists of the 100 million settlement made by non pleading officers and directors, the 133 million settlement with UBS, the 5 million settlement with Capstone and the 1 million settlement with Source Medical.

5. ACCORDINGLY, THE FINAL JUDGMENT HEREBY ENTERED FOR WADE C. TUCKER, FOR AND ON BEHALF OF HEALTHSOUTH CORPORATION

AGAINST RICHARD M. SCRUSHY, IS $2,876,103,000.00 AS SET FORTH IN THE SAID SEPARATE JUDGMENT ORDER. COSTS ARE TAXED TO THE DEFENDANT.

6. Furthermore, this Court in the said Judgment Order rules and declares that all employment agreements between Richard M. Scrushy and HealthSouth Corporation are void, and HealthSouth shall have no further obligations thereunder, including, without limitation, the following: (a) 1986 Employment Agreement; (b) 1998 Employment Agreement, including Retirement Agreement attached thereto; and (c) 2002 Employment Agreement, including Retirement Agreement attached thereto.

7. Judgment is rendered in favor of Scrushy with regard to the G.G., Capstone, Use of Aircraft, Source, the three bands, the stock repurchases and the land transactions.

8. It is ORDERED that this memorandum opinion regarding final judgment order against defendant Richard M. Scrushy under Ala. R. Civ. P., Rule 54(b), be filed in this matter as part of the open public record herein.

June 18, 2009.

ALLWIN E. HORN, III
CIRCUIT JUDGE

AEH/km

Distribution: Copies of this Order are being provided to all Steering Committee Counsel with directions that said counsel further distribute this Order to all Parties in their respective Groups.

cc: Honorable Karen O. Bowdre
U. S. Federal Judge
Hugo Black U. S. Courthouse
1729 5th Avenue North
Birmingham, AL 35203