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**MY 16 DAYS ON THE
HEALTHSOUTH BOARD**

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My 16 Days on the HealthSouth Board

by Betsy Atkins



It's every director's nightmare: joining the board of a company just before it is hit by charges of massive criminal fraud, that's what happened to Betsy Atkins last March.

In this exclusive account—based on a diary she kept as events unfolded, e-mails she exchanged with other directors, and interviews with *Corporate Board Member's* Colin Leinster—Atkins reconstructs what the board discussed the day the FBI moved in, what she did to help the company stay in business, how she put together the professional backup the board needed in its time of crisis, and why she suddenly decided to RESIGN.

The allegations came right out of the blue. The SEC hadn't requested any information or data before filing its complaint, which I think it usually does in such cases. It had certainly done so before announcing its investigation into insider trading, and these new allegations were clearly very much more serious. We weren't just looking at manageable fines here; if anyone were to prove criminal fraud against the company, HealthSouth could be out of business.

As chair of the special litigation committee, I knew that the board had to make a series of immediate decisions to try and minimize the damage. And as the newest member of the board, and therefore the most objective, I took it upon myself to chair an emergency board meeting later that day, something we could do via a conference call.

I started to keep a diary of what I did and of what the board needed to do, sometimes making handwritten notes, sometimes dictating them. I see that I began March 19's entry with a typo, saying it "started as a regularly day." Then I noted that after I got word of the criminal allegations, I went to my computer to call up the Associated Press article, and printed it. "From there," I wrote, "things cascaded at a rapid pace." I listed some of the events of that day, breaking them down by the hour:

By 10:00 am EST, I had received phone calls from 5 of the board members.

By 11:00 am, I was on a telephone conference call, the first impromptu board meeting of the day with [board members] Sage Givens, Chuck Newhall, and George Strong.

By 12:00 noon, I had spoken to Joel Gordon, the largest shareholder and [a] board member who sold his surgery centers to HealthSouth.

By 1:00 pm I was on a Special Investigation Committee call with Wilson Sonsini's Bruce Vanyo [the lawyer I'd picked to represent the committee] discussing the SEC complaint, analyzing it, reviewing it, and determining the impact of this complaint.

By 5:00 pm EST, there was a board call of the entire board including Mr. Scrusby.

This last entry isn't quite accurate. One director, Bob May, was on a cruise and we couldn't get through to him in time. Jon Hanson was on a plane. He got through, but the static was so bad he drowned us all out and had to hang up. In addition, Bill Horton, HealthSouth's corporate lawyer, joined the conference call, as did a large number of other lawyers representing all kinds of interested parties, including HealthSouth itself, Mr. Scrusby, William Owens, the CFO, different individual directors, and various board committees, including my own. Even the corporate counsel had his counsel on the line. They all kept jumping in, and it was often impossible to know who was speaking for whom.

The one clear decision we made that afternoon was that the board would cooperate fully in the Justice Department's investigation. It was agreed I'd chair and host daily emergency board meetings for the foreseeable future. It was clear I would be very busy. As it was, I have six lines at my office in Coral Gables, and all of them were lit up from six in the morning until 11 at night from that point on.

At 7:30 p.m. that same day we had another board meeting, this one with just the outside directors. In other words, we met without the CEO or CFO being present.

Looking back over several pages of handwritten notes about what we needed to discuss at our second emergency board meeting that day, I see that I referred to one concern over and over, using different words to do so. Perhaps I got closest to the point when I wrote:

First thing to worry about is who drives the bus.

I stated this somewhat more officially in an e-mail I had sent the other board members by way of an agenda that outlined what I thought we needed to discuss when we met again at 7:30. I prioritized a number of issues, the top three being:

- 1) Should we remove Mr. Scrusby and put him on administrative leave?
- 2) Who would become the chairman?
- 3) Who would become the CEO?

We also needed to decide the future of our CFO. I said, because of the new allegations. We would have to decide whether to put them both on administrative leave or terminate them. To terminate Scrusby would trigger his \$15 million severance contract, however, because he hadn't been convicted of anything.

So at our meeting that night, we voted to put Mr. Scrusby on administrative leave rather than fire him. We made the same decision regarding Mr. Owens. Both had to leave the building, and neither was to be allowed back in, let alone anywhere near the computers. We also voted to bar them from company planes. The risk of their taking flight was something we had to consider.

Finding somebody to serve as chairman and CEO was clearly the issue on everybody's mind, and took up a lot of our discussion. In the end, we decided to split the jobs. Joel Gordon agreed to be chairman, and he was a good choice. He was the biggest individual shareholder, after all, and was familiar with the health-care business. For CEO, we zeroed in on Bob May, who agreed to take the job on an acting basis.

The meeting lasted until 9:30, and by the time we hung up we had put together a press release that laid out the big changes at the top of the company. This demonstrated to outsiders, including the Justice Department, that the board was taking the crisis seriously. We said nothing about a replacement CFO; that was something we had yet to decide on. The release also identified the various directors who'd signed on to different committees.

I was careful to write down all the other things we never got around to but needed to discuss fast. As I noted after that meeting:

We need to do a lot of things in a short period of time.

I had known before I even joined the board that HealthSouth had legal problems, albeit relatively minor ones compared with what we now faced. In fact, that's why I'd been recruited in the first place. About six months previously, the SEC had begun an investigation of insider trading by Mr. Scrushy—specifically, that he knew Medicare was dropping reimbursement levels for various treatments and had unloaded some of his stock before the cutbacks became public knowledge and hurt the price of HealthSouth shares. The company was determined to face up to whatever lay ahead and wanted to find a new director who could also serve as the chair of the special litigation committee and help it through its legal issues. I seemed to fit the role because I had experience as a director of a number of companies, including Lucent Technologies, that had faced other legal difficulties.

The way I was recruited was an elaborate and highly transparent process—a very good example of the “best practices”. The recruiting firm, the screening committee, and the members of the nominating committee all made the same pitch, telling me that HealthSouth was a stable, profitable, high-growth outfit and the leader in its business sector.

Everybody I interviewed with tried to prepare me for Richard Scrushy. In particular, I was told about his strong and flamboyant “big” personality. I assured the nominating committee that I'd encountered several high-ego founders in my past, since I come out of the technology industry, where such characters are not unusual.

The job looked interesting and challenging. I had no doubts about HealthSouth's own state of health. Its approach to high-quality patient service, coupled with an integrated model of diagnostic facilities, surgery centers, and rehab centers, was unique, and the industry itself, of course, is a high-growth one.

I decided to accept HealthSouth's offer because I believed in the value and promise of its business. The opportunity to chair the special litigation committee was intellectually challenging and complex. It was obvious that I'd be signing up for a very significant amount of work, however, and I accordingly decided not to stand for reelection on two other boards. That way I would be able to dedicate all the time that I knew HealthSouth would need. I looked forward to the future.

I dove right into my new job. One of the first tasks I set myself was to take a hard look at all the dozen or so law firms that the company was paying—nationally known ones and what seemed to be a lot of local firms in Birmingham. Some of them, national and local, were billing like crazy. From the very start I had realized that the special litigation committee, of which I was the only member, would need its own legal counsel. I also realized that some of my fellow board members were perhaps overly influenced by Richard Scrushy. He'd handpicked them, after all.

In fact, Scrushy tried to turn his charm on me once I'd joined the board, probably to see how he might influence how I'd approach the insider-trading allegations. He called me at home on a couple of occasions to try to volunteer his version of history. But my conversations with him were very limited. I had the responsibility to investigate him, after all, and I did not want to taint my committee's independence. Remember, its predecessor had been condemned by the Delaware Court for just that reason. The committee had hired its own independent attorney, and I wanted him present when we interviewed Mr. Scrushy.

As things turned out, we never did have that meeting. The events of March 19 more or less took care of that.

March 20 wasn't any calmer. I spent the morning either at my computer or on the phone, much of it talking with or about professionals who could provide financial advice and crisis management. The board needed both, fast.

Over the course of the day, I sent a series of e-mails to the board members that underscored this conviction, faxing copies to George Strong, who didn't do e-mail. Here are some excerpts:

9:47 a.m. to Chuck Newhall et al.:

One of the first things the Special Investigation Committee needs to do is to hire a forensic accounting firm to immediately start to determine the status of the company's financials. I have identified the leading forensic investigator practitioners from PricewaterhouseCoopers, KPMG and Deloitte & Touche. I have calls in to all 3 and completed my first interview with [the] PricewaterhouseCoopers practice leader who has just completed the WorldCom, Adelphia and Xerox investigations. I've obtained a quotation range and confirmed his immediate availability.

I have asked PricewaterhouseCoopers to put out on their internal high level partner email list a request if they can identify any outstanding public company CFO candidates that could go in on an acting basis. Mike Kelly of the Directorship Search Group is also trying to identify high caliber proven credible public company CFOs who could go in on an acting basis.

Joel mentioned a previous long-time colleague he felt could step in, but I thought we ought to have some back up sources in case for some reason his colleague is unable to immediately step in to assist.

Just before noon, I heard from Joel Gordon and George Strong. They raised the issue of whether HealthSouth could stay solvent. I passed that concern on to the rest of the board, along with thoughts I had on that subject:

I think we may need to understand if we have free and clear assets that we can pledge, as well as obtain an adequate credit line to be able to go through a restructuring/refinancing. We're working on this with CS First Boston.

I used that same e-mail to repeat my belief that we needed to get a restatement/re-audit—and that we needed to look at the ramifications of taking the company into Chapter 11.

I think it's essential to contact E&Y [Ernst & Young, the company's auditor] both in Birmingham and at their most senior level to get a commitment from them (if they will agree) to commence a re-audit. I will be investigating names of the most experienced financial advisory firms, i.e. Lazard was used at Adelphia. I'll find out who WorldCom used.

A key issue the board needs to be informed and decide on very shortly will be the trade-offs and issues associated with potentially going into bankruptcy. I will be pulling together a briefing on this for us so we can be informed and be able to make a thoughtful decision in a timely manner.

The SEC had suspended trading in HealthSouth, a ban that was to last four days—a record. But the stock was sure to take a big hit, and I worried that a good company might suddenly be very vulnerable. In other words, we needed to look not only at whether the company might end up insolvent—and at what that would mean to the directors personally—but also at whether we should set an entire meeting aside to discuss how to handle any unsolicited takeover bids.

I see that in the summary of notes I made to myself at this time that listed all the things I had to do, I wrote a short and perhaps desperate:

I need to get someone else on the Cmte with me.

Another e-mail I put together over the morning of the 20th contained my recommendation that the board hire two forms of specialized help, a crisis-management firm and one that could act as a financial adviser. I gave my reasoning:

In a serious situation where our liquidity and solvency is uncertain, we as a board need to engage the appropriate adviser team. Crisis managers have been used at Enron, WorldCom, etc. They are operating people who augment our Chairman and CEO. Their role is to run the business day to day and address near term liquidity issues and keep the company from hemorrhaging and melting down. They provide the financial institutions with comfort that someone untainted is there to protect their interest and help restore credibility. Financial advisers address the liquidity question and how to go about satisfying our liquidity needs. Financial advisers facilitate the access to capital and work with our lenders and bondholders as well as address the accuracy of reliable financial projects. [I supplied the names of both kinds of outfits, financial advisory firms and crisis-management firms, along with their phone numbers, so that my fellow board members could do whatever further checking they cared to do.]

Please think about the recommendation I have, which is we engage immediately a crisis management firm and a financial advisory firm. I would like your views on this.

I had also spoken with Harvey Kelly, a leader in the forensic accounting investigative practice at PricewaterhouseCoopers, and recommended that the board hire him as well. I passed along what he had to say about the conventional wisdom/best practice approach in a situation like ours, and gave the board his recommendation for the two best crisis-management firms.

Later I got back to the board with what I'd found out about the ability of KPMG to act as our forensic accountants. I'd asked KPMG the same questions I'd asked Pricewaterhouse, including "Should we retain a crisis-management firm to help manage the creditors?" (They said yes and offered some suggestions.) They said they were conflicted about recommending a financial adviser, because they wanted that work themselves. I used the same e-mail to urge the board to reach three important decisions at the 2 p.m. board meeting that now lay only an hour away.

Board Decisions:

- 1) We should review and hopefully approve the retention of a forensic accounting organization in today's board meeting.
- 2) We should review and hopefully approve a financial advisory firm.
- 3) We should review and hopefully approve a crisis management firm.

With two minutes to go before the board meeting, I sent another e-mail. It began and ended with a recommendation that I really hoped they'd go for:

May I suggest that for the first hour of the phone call, we have no attorneys on the call so we can sort out the key issues:

- 1) Liquidity—Specifically George can give us an update with E&Y regarding a re-audit on a potential credit line from CSFB.
- 2) Solvency Issues—Create a plan to determine if we can remain solvent and get counsel from Weil Gotshal.
- 3) Legal Issues—There are too many law firms. Our legal issues fall into 3 major categories:

* Investigative: Betsy to select.

* Insolvency/Restructuring Questions: The board to select. Weil Gotshal is the nation's leading firm and seems ready to jump in.

* Regulatory/SEC/Criminal/Civil Shareholder derivatives lawsuit: Here the criminal potential of RICO claims against the company could put us out of business.

Please let me know if you think this is the appropriate agenda. Do you have other suggested topics we should add to the agenda? Do you agree we should discourage having a wide range of attorneys dialing into this call? I believe it is not advisable at this juncture to have so many outside attorneys. Bill Horton will not be on this call. I'm anxious to hear your thoughts.

Obviously I wasn't the only one who wanted to cut back on the number of lawyers, because there were only two on the line for our next meeting: Bruce Vanyo and Michael Young of Willkie Farr & Gallagher, representing the audit committee. Even then it was a long meeting, but by the end of it we had selected Kelly and his PWC team to do our forensic accounting. The board also agreed on the need for a crisis-management firm. Joel Gordon and Bob May, in their new roles, agreed to interview the two finalists for the work the following day. Gordon agreed to take a company plane from his home in Nashville to Birmingham—a very necessary presence. The whole board was working very hard.

Even before that meeting had begun, I was putting together another agenda for our meeting the following day, the 21st. This primarily addressed the company's need for strong legal representation. I'd already done considerable homework on what we should be looking for, and outlined the characteristics I and the lawyers I'd consulted thought such firms should have:

- a) SEC experience
- b) The ability to manage massive sets of litigations, and derivative and shareholder lawsuits
- c) Knowledge of insolvency and bankruptcy
- d) Experience with public company securities law
- e) Employment law experience.

The attorneys I'd spoken to recommended two firms in particular that met these requirements. They agreed, too, on which firms had to go—a group that included many of the Birmingham outfits.

Overview

In thinking about the counsel issue, I divide our legal needs into three “baskets”: (i) general corporate and insolvency counsel, to assist the board on a going-forward basis as it considers the general business and fiduciary issues facing us over the near term; (ii) regulatory counsel, to respond to the inquiries and investigations from the SEC and U.S. Attorney's offices and possibly other governmental agencies; and (iii) counsel to investigate and issue a report on the allegations of past misconduct.

It is my inclination to get new counsel for all of these roles. I am concerned about the appearance of conflict that any of our prior counsel may have, as well as the possibility that actual conflicts exist. In addition, I am of the view that the gravity of our situation demands that we have the best possible counsel for all of these positions.

I summarized how I felt about a half-dozen leading law firms, and specified what I thought were their strengths and weaknesses and how they met the criteria I'd outlined above. Under their strengths, I included the firms' ability to advise the board on its fiduciary duties in this situation, and to ensure that the steps the board and the individual directors might take were protected under the business-judgment rule. Potential weaknesses included whether or not individual law firms had previous or ongoing associations with HealthSouth.

I made my recommendation, but said I believed the final decision belonged to the board. Then I addressed another legal specialty that we'd be needing, a law firm with experience in criminal affairs to help us respond to the government's various investigations.

I think we really need to select new counsel. Again, my criteria are simply to find the best firm and people available, though an issue to consider is whether the key issues are civil liability (in which case we want a firm skilled in working with the SEC) or criminal (in which case we may want a different skill set).

Then I turned back to what I saw was another legal problem, though one of a different stripe:

Conclusions About the Role of Counsel at Board Meetings

Once we have selected counsel to fill this role, I think it is important that we all agree going forward about the role for lawyers at board meetings. I recognize that board members or groups of board members will retain counsel to advise them personally about the issues being faced; the number of lawyers and propriety of multiple counsel is a matter for another day. But I do not believe we can function effectively if every board member has his or her own personal lawyer at every meeting. And I do not believe it is proper for the board to consider the views of each member's personal lawyer.

Therefore, I believe that the only counsel who routinely should attend our board meetings is our corporate, insolvency and fiduciary counsel. I believe we frequently will call on our regulatory and criminal counsel as well as our investigative counsel to attend all or part of board meetings.

The board had all these e-mails to consider overnight, once the meeting of the 20th was over. The directors were highly focused.

At that night's meeting (March 21st), I'm glad to say, the board did insist that the choice of a crisis-management team be put back on track, and one was selected soon after that. We also elected a lead law firm.

March 22 turned out to be my last day on the HealthSouth board. Strange though it seems, considering how important it was, I can't recall who gave me the information that led me to resign. In any event, I heard that Chubb, the insurance company that provided our D&O insurance, had returned HealthSouth's check and was canceling coverage. A phone call to the company confirmed that I was without coverage.

This was unacceptable, and various lawyers I called confirmed that I was putting all my personal assets at risk if I continued on the board. I had only one course of action, and called George Strong in his role as chair of the audit committee to say I was resigning, effective immediately. I called each of the directors that day to give my decision in person, and my reason for leaving. All the other directors felt they had to stay, the lack of D&O coverage notwithstanding. And all of them urged me to change my mind. When they saw that my decision was final, they thanked me for all I'd done.

I knew my departure would raise questions, or possibly be interpreted as a negative judgment on the company. But the risk and personal liability of continuing without insurance coverage was overwhelming. In fact, I've already been served with multiple lawsuits resulting from my brief time on the HealthSouth board.

I do take satisfaction from having made a contribution in that critical time by chairing the meetings and leading the agenda, collecting the information, and researching the alternatives for the decision-making process. Identifying the key steps and resources needed to stabilize the company, driving the decision to retain forensic accounting experts so we could get an accurate picture of HealthSouth's finances, and locating good crisis-management firms to facilitate and manage the key liquidity issues were valuable.

Some seven months later, things seem to be more stable. The investigations are continuing. Presumably the board still meets all the time and continues to work hard. Scrusby and Owens have been formally terminated. I see that Lee Hillman, former chairman and CEO of Bally Total Fitness, has joined the board and Richard Koppes a director of outstanding judgment and analytical skills has joined. I wish them, and all the other board members, the very best.