

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

SECURITIES AND EXCHANGE COMMISSION,)	
)	
Plaintiff,)	
)	
)	Civil Action No.
)	CV-03-J-0615-S
vs.)	
)	
HEALTHSOUTH CORPORATION and RICHARD M. SCRUSHY,)	
)	
Defendants.)	
)	

COMMISSION'S RESPONSE TO ORDER TO SHOW CAUSE

The Securities and Exchange Commission ("Commission" or "SEC") hereby respectfully responds to the Order of June 28, 2005, requiring the parties to show cause why this matter should not be dismissed.

The June 28 Order does not identify the issues of concern to the Court, other than noting the Scrushy acquittal. The Commission shows below that the acquittal has no collateral estoppel effect in this civil matter and that the denial of preliminary relief in 2003 does not justify dismissal on the merits.¹ In short, there is no legal or factual basis for dismissal of the Commission's claims.

¹ Scrushy has been granted an extension allowing him to respond to the Show Cause Order ten days after the Commission responds. As a result, the Commission will not see Scrushy's arguments until his opposition is filed on July 18. The Commission will reply to Scrushy's arguments ten days after Scrushy submits his opposition. See Order of July 5, 2005 (granting Commission's motion to file a reply brief).

Nature Of This Action

By statute, the Securities and Exchange Commission has primary responsibility for civil enforcement of the federal securities laws. Effective civil prosecution of financial fraud is essential to ensuring the integrity of America's public corporations. The reliability of corporate records, reports, and public statements is critical to maintaining investor confidence in the capital markets. Thus, vigorous civil enforcement of the securities laws protects the American financial system.

The Commission carries out its Congressional mandate by, among other things, filing civil enforcement actions against individuals who have violated the federal securities laws. In this action against Richard M. Scrusby ("Scrusby") and HealthSouth Corporation ("HealthSouth"), the Commission alleges that from at least 1999 through mid-2002, Scrusby orchestrated a massive accounting fraud at HealthSouth and engaged in insider trading, aided and abetted HealthSouth's reporting and record-keeping violations, and circumvented HealthSouth's internal accounting systems. Amended Complaint For Injunctive Relief (April 3, 2003) ¶¶ 13-40. The Commission alleges that Scrusby violated the anti-fraud prohibitions in Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, as well as numerous reporting, record-keeping, and internal control requirements. The Commission asks that the Court enjoin Scrusby from future securities violations, order him to disgorge his ill-gotten gains, impose civil penalties, and bar Scrusby from acting as an officer or director of any publicly-traded company. Amended Complaint at 16-20.

Shortly after this action was filed in March 2003, the SEC requested that the Court freeze Scrusby's assets during the pendency of the litigation. At the asset freeze

hearing, many of the witnesses (including Scrushy) asserted the Fifth Amendment privilege against self-incrimination and refused to testify. On May 7, 2003, the Court denied the SEC's petition for emergency relief, finding that the limited record failed to justify an asset freeze. Memorandum Opinion of May 7, 2003, at 63. The Court also stayed this case until resolution of criminal charges against Scrushy, noting that "both the SEC and defendant Scrushy would benefit from a stay of this case until all those who pled guilty have been sentenced, so that testimony may be obtained from them . . . rather than repeated insistence . . . on their Fifth Amendment rights." *Id.* at 56.

Current Status

Although Scrushy's criminal trial has gone to verdict, there has been little activity in the SEC's civil case since the stay was entered in May 2003. The only noteworthy development during this period was the entry of final judgment against HealthSouth in June 2005. Pursuant to that judgment, HealthSouth is enjoined from future securities violations and will pay \$100 million in civil penalties. Final Judgment As To Defendant HealthSouth Corporation (June 22, 2005).

Before this matter was stayed, the parties conducted limited discovery directed exclusively to the asset freeze issues. There has been no discovery in this case regarding the substantive allegations of the Complaint. Indeed, Scrushy has not yet filed an Answer to the Complaint. Thus, this litigation is at a very early stage.

Argument

I. The Acquittal Has No Collateral Estoppel Impact On The SEC's Civil Claims Against Scrushy

In this civil proceeding, the Commission need only prove the factual elements of its case by a preponderance of the evidence, *i.e.*, the Commission must show that it is

more likely than not that its key factual allegations are correct. In contrast, the prosecution in a criminal matter faces a much higher standard of proof, *i.e.*, prosecutors must prove the essential facts "beyond a reasonable doubt." State Farm Fire & Casualty Co. v. King, 851 F.2d 1369, 1372 n. 4 (11th Cir. 1988).

"It is clear that the difference in the relative burdens of proof in the criminal and civil actions precludes the application of the doctrine of collateral estoppel" in a civil action following an acquittal. United States v. One Assortment of 89 Firearms, 465 U.S. 354, 361-62 (1984). See also One Lot Emerald Cut Stones v. United States, 409 U.S. 232, 235 (1972); Helvering v. Mitchell, 303 U.S. 391 (1938); Zwak v. United States, 848 F.2d 1179, 1184-85 (11th Cir. 1988). An acquittal establishes only that criminal prosecutors were unable to prove all of the necessary factual elements of the alleged crime beyond a reasonable doubt. United States v. One Assortment of 89 Firearms, 465 U.S. at 362. Consequently, "acquittal in the criminal action does not bar a civil suit based on the same facts." 2A Wright, Federal Practice and Procedure: Criminal (3rd ed. 2000) § 468 at 315.

Thus, even when both the criminal and civil actions have been brought by the same governmental entity, the civil action is not collaterally estopped by the defendant's prior acquittal. Here, the Commission is an independent federal regulatory agency with its own litigating authority and a distinct statutory mandate.

Moreover, the Commission's claims raise numerous issues particular to that statutory mandate. One issue crucial to this civil case -- but irrelevant to the criminal matter -- is whether Scrusby departed so far from the ordinary standard of care demanded of a senior corporate officer that he is civilly liable for fraud. Likewise, this civil

proceeding will address whether Scrusby should be barred from serving in the future as an officer or director of a public company. Also at issue will be whether Scrusby should disgorge the vast sums he gained as a result of the fraud, and whether a monetary penalty should be imposed. Under the securities laws, these issues are not to be determined under the "beyond reasonable doubt" standard of a criminal proceeding, but under the "preponderance of the evidence" standard applicable in civil litigation.

HealthSouth and a number of its employees engaged in one of the largest securities frauds in United States history -- a fraud that began while Scrusby was CEO and ended only when he was forced out. The Commission's civil case is the appropriate setting in which to address Scrusby's civil liability and identify the necessary civil remedies. The acquittal has no impact on the Commission's claims, the appropriateness of having those claims heard in this civil proceeding, or the Commission's right to pursue those claims at this time.

II. Denial Of The Petition For Emergency Relief Was Not A Determination On The Merits Of The Underlying Action

By law, a ruling on a request for a preliminary injunction or analogous emergency relief is not a determination on the merits of the underlying claims. The Eleventh Circuit addressed this issue in McArthur v. Firestone, 817 F.2d 1548 (11th Cir. 1987), rejecting the argument that denial of a temporary restraining order decided plaintiff's underlying claim:

The Supreme Court rejected this type of argument in University of Texas v. Camenisch, 451 U.S. 390, 394-95, 101 S. Ct. 1830, 1833-34, 68 L.Ed. 2d 175 (1981) (citations omitted), holding that a decision concerning a preliminary injunction is not tantamount to a decision on the underlying merits of the case and that "the findings of fact and conclusions of law made by a court granting a preliminary injunction are not binding at trial on the merits."

817 F.2d at 1552. Accord In re Dixie Broadcasting, Inc., 871 F.2d 1023, 1029 (11th Cir.), cert. denied 493 U.S. 853 (1989); Home Oil Co. v. Sam's East, Inc., 199 F. Supp. 2d 1236, 1239 (M.D. Ala. 2002); Carr v. State of Alabama Dept. of Human Resources, 952 F. Supp. 1496, 1500 (M.D. Ala. 1996). Thus, the findings and conclusions in this Court's May 2003 decision denying emergency relief do not resolve the merits of the Commission's claims.

Conclusion

Neither Scrushy's acquittal nor the Court's 2003 denial of emergency relief provides a basis for dismissal of this civil action. Wherefore, the Commission requests that the Court find that there is no basis for dismissal.

Respectfully submitted,

Dated: July 7, 2005

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Certificate Of Service

On July 7, 2005, I electronically filed the foregoing COMMISSION'S RESPONSE TO ORDER TO SHOW CAUSE with the Office of the Clerk, using the CM/ECF system. Notification of this filing will be served electronically by the Clerk on counsel who have registered in the CM/ECF system and appeared in this case, including the following:

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On July 7, 2005, I also caused a copy of the foregoing COMMISSION'S RESPONSE TO ORDER TO SHOW CAUSE to be served by U.S. Mail, first class postage prepaid, on the following:

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