ISS
1535

# IN THE UNITED STATES DISTRICT COURT
# FOR THE WESTERN DISTRICT OF PENNSYLVANIA

| | | |
|---|---|---|
| THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF ALLEGHENY HEALTH, EDUCATION AND RESEARCH FOUNDATION, | : | |
| Plaintiff, | : | No. 00-684 |
| v. | : | |
| PRICEWATERHOUSECOOPERS, LLP, | : | Judge: ________ |
| Defendant. | : | |

## COMPLAINT

Plaintiff, the Official Committee of Unsecured Creditors (the "Committee") of Allegheny Health, Education and Research Foundation ("AHERF") and its four debtor affiliates (collectively with AHERF, "Debtors"), brings this action derivatively on behalf of and for recovery to the Debtors' estates and on behalf of the Debtors' unsecured creditors, alleging as follows:

### NATURE OF THIS ACTION

1 At the end of the 1980s, the Allegheny Health, Education and Research Foundation ("AHERF") was the parent foundation of a financially sound healthcare system, anchored by the 120-year-old Allegheny General Hospital in Pittsburgh. In the ensuing ten years, AHERF would accumulate 55 total entities, including 14 hospitals, two medical schools, two captive insurance companies and hundreds of physician practices (collectively with AHERF, the "AHERF System," or "AHERF and its affiliates") AHERF and its affiliates would also be in

complete financial ruin, with a shortfall to creditors of the Debtors' estates in excess of $1.0 billion. Past the point of its own demise, however, and to the point where the senior officials of AHERF who had overseen and directed its financial ruin were removed from office, the financial statements of AHERF and its affiliates consistently depicted a business conglomerate in sound financial condition. Those false and misleading financial statements were audited and certified by the entity now known as PricewaterhouseCoopers, LLP ("Coopers").

2. AHERF's demise was neither immediate nor unpredictable. It was in fact the result of increasingly reckless growth and decision-making by AHERF's senior management, acting in concert with certain of AHERF's Board of Trustees who knowingly or recklessly condoned the conduct of the senior management, fueled by an internal structure lacking in meaningful financial controls.

3. AHERF's demise was also the result of the fact that Coopers — the one independent entity that was in a position to detect and expose both these senior officials' financial manipulations and the AHERF System's deficient financial controls — failed to disclose those manipulations and deficiencies to the innocent, unaware and misinformed Trustees of AHERF and its affiliates, and thereby to prevent the AHERF System's financial ruin. Instead, Coopers ignored the sure signs of AHERF's demise, accepted the representations and demands of a group of AHERF senior officials whom it had no legitimate reason to trust or believe, relied upon an accounting system it also had no legitimate reason to trust or believe, and issued "clean opinions" on the financial statements of AHERF and its affiliates Coopers thus certified that the false and misleading financial statements concocted by these senior officials of AHERF "fairly presented" the AHERF System's true financial condition

4. In compiling false and misleading financial statements, AHERF's senior management, acting in concert with certain of AHERF's Trustees, relied upon and exploited a deliberately complex corporate structure and the absence of a meaningful control environment within the AHERF System to conceal material operational losses through unsupportable accounting manipulations. Because of Coopers' failure to detect this misconduct — or, once detected, to expose it to the AHERF System's innocent, unaware and misinformed Trustees — the misconduct continued unabated to the point where AHERF was hopelessly insolvent, foreclosing any opportunity for the AHERF System's innocent Trustees, and others, to take prudent action which they could and would have taken to prevent the System's demise.

5. The Committee brings this adversary proceeding on behalf of the Debtors' estates and on its own behalf, to hold Coopers liable in damages for negligence and for breach of contract

**JURISDICTION AND VENUE**

6. On July 21, 1998 ("the Petition Date"), AHERF commenced its reorganization case, captioned *In re Allegheny Health, Education and Research Foundation*, Bankruptcy Case No. 98-25773 MBM, by filing a voluntary petition for relief under chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"). Simultaneously, four affiliates of AHERF — Allegheny University of the Health Sciences; Allegheny University Medical Practices; Allegheny Hospitals, Centennial; and Allegheny University Hospitals-East (collectively, the "Debtor Affiliates") — commenced their own reorganization cases by filing chapter 11 petitions, Bankruptcy Case Nos 98-25774 MBM through 98-25777 MBM inclusive. The chapter 11 cases of AHERF and the Debtor Affiliates (collectively, the "Debtors") have been consolidated for purposes of joint administration pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy

Procedure (the "Bankruptcy Rules") and are presently pending in the United States Bankruptcy Court for the Western District of Pennsylvania.

7. This Court has jurisdiction over this adversary proceeding under 28 U.S.C. § 1334(b), as it is related to AHERF's chapter 11 case.

8. Venue in this judicial district is proper pursuant to 28 U.S.C. § 1409.

## THE PARTIES

### A. PLAINTIFF

9. Plaintiff, the Committee, was appointed by the United States Trustee on July 30, 1998 to represent the unsecured creditors of the Debtors in their chapter 11 cases and to exercise the functions, powers and duties of the Committee set forth in section 1103 of the Bankruptcy Code. By virtue of a Stipulation and Agreed Order Granting Official Committee of Unsecured Creditors Authority to Investigate, Assert, Pursue and Settle Certain Claims and Causes of Action Against PricewaterhouseCoopers, LLP (a copy of which is attached as Exhibit A), the Bankruptcy Court has, pursuant to sections 105, 1103(c)(5), 1109(b) and 1123(b)(3)(B) of the Bankruptcy Code, granted to the Committee the authority to pursue all claims and causes of action held by the Debtors' estates against Coopers. Accordingly, the Committee brings the claims made in this Complaint on behalf of the Debtors' estates, pursuant to sections 105, 1103(c)(5), 1109(b) and 1123(b)(3)(B) of the Bankruptcy Code, and on behalf of the unsecured creditors of Debtors' estates.

## B. AHERF AND ITS AFFILIATES

10. AHERF is a Pennsylvania nonprofit corporation. It was originally created in 1983 to function as the sole member of Allegheny General Hospital, another Pennsylvania nonprofit corporation that has operated a charitable hospital in Pittsburgh for nearly 120 years. By the Petition Date, AHERF was the parent entity of one of the largest nonprofit, integrated healthcare systems in the country, operating large urban and small community hospitals, physician practices, medical schools and research facilities primarily in the Greater Pittsburgh and Greater Philadelphia markets. AHERF had and exercised ultimate authority over the entities within the AHERF System and the allocation of resources among them. When AHERF filed its chapter 11 case, most of the other significant entities in the AHERF System at that time could be grouped into one of two categories: the Debtor Affiliates (which were operating primarily in the Greater Philadelphia area and, together with an affiliate operating hospital in New Jersey, were sometimes referred to as the "Eastern Affiliates"); and the "Nondebtor Affiliates" (which were operating in the Greater Pittsburgh area, sometimes referred to as the "Western Affiliates").

11. Each of the Nondebtor Affiliates was, as of the time AHERF filed its chapter 11 case, a Pennsylvania nonprofit corporation of which AHERF was the sole member. At the time AHERF filed its chapter 11 case, the Nondebtor Affiliates included:

a. Allegheny General Hospital ("AGH"), which was first incorporated in 1882 and operated a nonprofit charitable hospital (over 800 beds) in Pittsburgh;

b Allegheny University Medical Centers ("AUMC"), which operated five community hospitals in the Greater Pittsburgh area — Forbes Regional Hospital (317 beds), Forbes Metropolitan Hospital (155 beds); Forbes Nursing Center (164 beds), Forbes Hospice (8 beds), and Allegheny Valley Hospital (288 beds) — and was also the sole member of Allegheny

University Hospitals, Canonsburg ("AUH Canonsburg"), a Pennsylvania nonprofit corporation that operated what was formerly known as the Canonsburg General Hospital; and

c. Allegheny University Hospitals-West ("AUH-West"), which provided support services for the hospitals operated by AGH and AUMC.

12. Each of the Debtor Affiliates is a Pennsylvania nonprofit corporation of which AHERF is the sole member, and each also filed a chapter 11 case on the Petition Date. The Debtor Affiliates are:

a. Allegheny University of the Health Sciences ("AUHS"), an accredited university in Philadelphia that owned and operated the MCP-Hahnemann School of Medicine (an accredited medical school that had 1,120 employed faculty members in 1997);

b. Allegheny University Hospitals-East ("AUH-East"), which operated five hospitals in the Philadelphia area: AUH, MCP (formerly known as the Medical College of Pennsylvania, an academic medical center with 495 beds); AUH, Hahnemann (formerly known as Hahnemann University Hospital, an academic medical center with 638 beds); AUH, Bucks County (a community hospital with 190 beds); AUH, Elkins Park (a community hospital with 304 beds), and St. Christopher's Hospital for Children (183 beds);

c. Allegheny Hospitals, Centennial ("AH-Centennial"), which operated four hospitals in the Philadelphia area: AUH, Graduate (an academic medical center with 330 beds), AUH, City Avenue (248 beds); AUH, Parkview (a community hospital with 212 beds), and AUH, Mt. Sinai (which closed in October 1997); and

d. Allegheny University Medical Practices ("AUMP"), which owned and managed physician medical practices that, in 1997, were staffed with about 200 physicians in the Pittsburgh area and 360 physicians in the Philadelphia area.

## C. DEFENDANT

13. Defendant Coopers is a limited liability partnership organized under the laws of the State of Delaware. Coopers is a product of a 1998 merger between Price Waterhouse, LLP and Coopers & Lybrand, LLP, two of the then so-called "Big Six" accounting firms. Coopers is successor to Coopers & Lybrand, LLP, which served as outside auditor for AHERF and certain of its affiliates during all times relevant to the claims made herein.

## BACKGROUND

## A. THE GROWTH OF THE AHERF SYSTEM

14. In the late 1980s, AHERF (then known as Allegheny Health Services) was a relatively modest and financially stable organization primarily serving as AGH's parent foundation and coordinating the efforts of a few affiliated healthcare entities. In 1988, AGH reported a healthy profit margin of nearly 15% and carried a debt portfolio of approximately $70 million.

15. Also in the late 1980s, AHERF's President and Chief Executive Officer, Sherif S. Abdelhak, AHERF's Executive Vice President and Chief Financial Officer, David C. McConnell, and others among the AHERF System's senior management ("senior management"), acting in concert with certain of AHERF's Trustees, adopted the view that in order to prosper in a changing market for healthcare institutions, AHERF would need to grow by acquisition of hospitals, educational institutions, research facilities and medical practices. The theory underlying such growth was in part that healthcare providers needed to achieve economies of scale and an assured supply of patient revenue through the acquisition of geographically-proximate hospitals and physician practices. Such action was supposedly needed in order to combat the growing trend in the health insurance industry to managed care programs, restrictions in the growth of

Medicare reimbursements, Medicaid cuts and increasing reliance on outpatient treatment. AHERF purported to pursue this "economies of scale" strategy through a series of almost uniformly ill-advised and unjustifiable acquisitions, beginning in 1988 and continuing through the decade of the 1990s. AHERF never took the steps necessary to implement its "synergistic" strategy, as it failed to perform proper due diligence, cut overhead costs or develop and employ the operational infrastructure essential to achieving the promised "economies of scale."

16. AHERF's spree of acquisitions began with the 1988 acquisition of MCP, which at the time operated a medical school and an associated hospital in Philadelphia. At the time of the acquisition, MCP was in serious financial distress, and agreed to the acquisition when AHERF pledged a capital infusion of $40-60 million into MCP over a five-year period. The justification proffered for acquiring this entity, notwithstanding its distressed financial condition, was one repeated in the case of virtually every acquisition that would follow: AHERF could overcome the financial troubles of MCP through more effective management. "Synergies" and "efficiencies," supposedly to be achieved by size, coordination, and the integration and consolidation of management, were key features of the justification given, not only for the acquisition of MCP, but also for the acquisitions of additional financially and operationally troubled institutions that would follow

17. In fact, AHERF was not able to cure MCP's financial ills, in part because AHERF did not put in place the management structures and disciplines necessary to achieve the kind of "economies" and "efficiencies" which had been promised The failure of senior management to deliver on their promise with MCP, and to achieve the turnaround of that entity's fortunes, should have made it evident to them that the AHERF System was not in fact able to bring in and turn around troubled institutions

18. Nonetheless, through the 1990s, senior management, acting with the knowledge of and in concert with certain of AHERF's Trustees, continued to pursue similar acquisitions of failing institutions. Almost from the outset, these senior officials of AHERF had minimal — and ever decreasing — reason to believe that such acquisitions would contribute to the long term enhancement or stability of the AHERF System. Ultimately, however, their motives in making such acquisitions became more sinister, and the focus of prospective deals came to be the securing of immediate benefits in the form of access to new liquid assets, the use of acquisition accounting gimmicks to conceal serious operating shortfalls, and an ongoing excuse for reduced expectations.

19. In 1991, AHERF acquired the United Health System ("United"), which operated the St. Christopher's Hospital for Children in Philadelphia and three suburban hospitals: Warminster (later known as Bucks County Hospital), Rolling Hills (later known as Elkins Park Hospital) and Lawndale (which closed a year after acquisition). At the time, the three hospitals were struggling financially and United was headed toward bankruptcy. While MCP's faculty was interested in the acquisition of St. Christopher's as an opportunity to expand MCP's training and research in pediatric specialties, there was no place in the AHERF System for the additional beds that the three suburban hospitals would bring to it, as Greater Philadelphia was already one of the most overbedded hospital markets in the country.

20. Presented again with claims of economies of scale, promises of an eventual financial turnaround and the perceived "competitive benefits" of a larger, state-wide presence — claims proffered by both AHERF's senior management and certain of the Trustees acting in concert with them — AHERF's Board approved the acquisition of United's four hospitals in January of 1991 The AHERF System assumed the burden of those hospitals' $137 million in

long term debt and saddled itself with an increase in both the number and percentage of costly, unoccupied beds.

21. Two years later, again at the urging of senior management and certain of AHERF's Trustees, AHERF acquired another, much larger Philadelphia medical school, Hahnemann University Medical School, and its associated medical center, the 638-bed Hahnemann University Hospital — in the process loading yet additional debt onto the AHERF System. In 1994, AHERF merged its two Philadelphia medical schools into MCP-Hahnemann School of Medicine (which later became AUHS). In 1996, the medical school and what were then AHERF's five Philadelphia-area hospitals — MCP, Hahnemann, St. Christopher's, Elkins Park and Bucks County — combined to issue bonds and notes as the Delaware Valley Obligated Group ("DVOG"), amounting to some $407 million of new and replacement long term debt

22. In August of 1996, already straining under the load of its debt-ridden and failing acquisitions in a saturated market, and having failed to implement the economies of scale which had purportedly justified the acquisitions in the first place, AHERF negotiated a plan to acquire six more Philadelphia-area hospitals then owned by the Graduate Health System ("GHS"): Graduate Hospital, Mt. Sinai Hospital, Parkview Hospital, City Avenue Hospital and two hospitals in New Jersey (collectively, "the Graduate Acquisitions"). Considered collectively, the GHS hospitals were in deep financial distress at that time, a fact widely reported by the media. The deal was also structured in curious fashion, such that the hospitals were initially acquired by a shell corporation, SDN, Inc., and — after a holding period in that entity supposedly to allow for "due diligence" by AHERF — then transferred to an AHERF-controlled entity "SDN" was an acronym for the first names of Abdelhak, McConnell and Nancy Wynstra, respectively AHERF's CEO, Executive Vice President and General Counsel, and the three of them — plus Donald Kaye,

President and Chief Executive Officer of AUHS, AUH-East and later AH-Centennial — acted as its trustees.

23 The Graduate Acquisitions did not make long term or operational sense for AHERF. On a combined basis, the hospitals being acquired were already losing millions of dollars every month despite extended and extensive restructuring efforts previously undertaken, and the impending cuts in government reimbursements under Medicare and Medicaid were certain to increase the losses. Graduate Hospital and Mt. Sinai Hospital alone had $160 million in outstanding long term debt arising out of bonds issued in 1991 and 1993.

24. The Graduate Acquisitions were not in fact pursued because they made sense in any genuine way. By now, despite senior management's lip service to the contrary, these acquisitions were not in fact being pursued based on "synergies" or "economies of scale"— or any of the other buzz words senior management had employed to justify their ill-fated acquisitions in the past. Instead, the Graduate Acquisitions were pursued because they offered a platform for accounting gimmicks by senior management, that were used to provide one-time financial statement benefits exceeding $100 million, thereby continuing to mask the AHERF System's declining state of operations. It also offered to an increasingly desperate group of AHERF senior officials — its senior management and certain of AHERF's Trustees acting in concert with them — immediate and much needed access to additional liquid assets, and one more excuse for reducing expectations Central to their strategy was the use of SDN, Inc. as a shell "middle man" to provide a conduit for their financial manipulation. It gave them the opportunity to direct the making of accounting entries for the GHS entities before and during the technical amalgamation of those entities within the AHERF System — which entries were then, after amalgamation,

redeployed so as artificially to boost reported operating income and reduce reported operating costs of the AHERF System.

25. On May 1, 1997, in accordance with the earlier plan, the Graduate, Mt. Sinai, Parkview and City Avenue Hospitals were merged into AH-Centennial and the two New Jersey hospitals were merged into another AHERF affiliate, thereby officially saddling the already cash-starved AHERF System with yet another group of distressed, money-losing hospitals in the overbedded Philadelphia market and another $160 million in under-secured bond debt.

26. At the same time it was pursuing the Graduate Acquisitions, AHERF acquired five hospitals in the Greater Pittsburgh market — the four hospitals known as the Forbes Health System, and Allegheny Valley Hospital (collectively, "the AUMC Acquisitions") — adding another $122 million of bond debt to the AHERF System's consolidated balance sheet and providing another platform for accounting gimmicks by AHERF's senior management to inflate earnings. Although the AUMC entities operated essentially at "break even" level prior to their acquisition by AHERF, AUMC accounted for 90% of AHERF's consolidated net earnings in the fiscal 1997 financial statements. Virtually all of the alleged "improvement" in AUMC's fortunes supposedly derived from the post-acquisition performance of the Forbes and Allegheny Valley institutions -- even though they were part of the AHERF System for, respectively, only six and four months in fiscal 1997. At least $8 million dollars of such earnings resulted from improper acquisition entries.

27 Also during the latter half of the 1990s, AHERF, through an affiliate called Allegheny Integrated Health Group (a predecessor to Debtor AUMP), purchased the practices of hundreds of primary care physicians practicing in the Pittsburgh and Philadelphia markets AHERF spent millions of dollars for these practices, which in turn produced staggering losses to

the AHERF System. These losses were primarily due to AHERF's failures to perform meaningful due diligence before purchasing the practices and, after acquisition, to implement an effective operational infrastructure and control system to monitor and manage the practices' financial operation.

28. Further compounding AHERF's problems, it entered into "risk contracts" during the latter half of the 1990s with certain health insurance companies whereby AHERF agreed to be liable for healthcare services to subscribers of these insurers for inadequate revenue capitation. These risk contracts led to significant losses, again due to AHERF's failures to perform meaningful due diligence before entering into the contracts and to implement necessary operational controls in its performance of them.

29. Over the course of AHERF's decade-long journey of acquisition and expansion, the AHERF System's long-term debt increased from approximately $70 million in 1987 to approximately $1.1 billion in 1997. Annual payments on the System's bond debt in 1997 alone totaled $91 million, more than its entire debt portfolio just a decade earlier. The AHERF System had deteriorated from a healthy, rock solid regional hospital to a hopelessly insolvent conglomerate, with a shortfall to creditors in excess of $1.0 billion. As alleged in a separate proceeding filed in the Bankruptcy Court by the Committee against certain former senior officials of AHERF, *Official Committee of Unsecured Creditors of Allegheny Health, Education and Research Foundation v. Sherif S. Abdelhak, et al.* (Adv. Proceeding No. 99-2465), this deterioration was proximately caused by the breach of fiduciary duty, gross negligence and mismanagement, and corporate waste of AHERF's senior management and of the Trustees acting in concert with them

30. AHERF's deterioration also was proximately caused by defendant Coopers, which failed to discharge its duties as independent auditor of AHERF and its affiliates, and in so doing failed to expose the misconduct of these senior officials to the innocent, unaware and misinformed Trustees of AHERF and other entities of the AHERF System. These innocent Trustees, who were not parties to the aforesaid wrongdoing, could and would have taken affirmative action to bring the wrongdoing to an end, remove the wrongdoers and halt the decline of AHERF and its affiliates, had they been informed by Coopers of the true state of AHERF's financial condition. Defendant Coopers was the entity upon which these innocent, unaware and misinformed Trustees relied, and were entitled to rely, to present to them the true state of AHERF's financial affairs and to expose the aforesaid wrongdoing.

## B. THE AHERF SYSTEM'S CONTROL ENVIRONMENT AS OF THE 1996 AND 1997 AUDITS

31. The claims asserted herein against Coopers arise from its conduct while acting as the AHERF System's independent auditor in the fiscal years ending June 30, 1996 and June 30, 1997, not only with respect to its year-end audits of AHERF and its affiliates, but also with respect to critical "special reports" and other services performed by Coopers

32 With respect to its audits of the AHERF System, and in planning, staffing, and performing such audits for fiscal 1996 and 1997, Coopers was, among other things, required to meet certain obligations imposed upon it by so-called "Generally Accepted Auditing Standards" (GAAS), including the requirements that·

a. The audits be performed with an "independence in mental attitude" by the audit team, and

b The audits be performed with due professional care

33. As of the time of the fiscal 1996 and 1997 audits, Coopers also represented itself to have accounting expertise specific to AHERF's industry. Both the Engagement Partner and Manager who headed Coopers' AHERF audit team in fiscal 1996 and 1997, and prior thereto, had specialized in the healthcare industry, and were knowledgeable about the markets in which AHERF and its affiliates operated, the operating and financial issues pertinent to those markets, and the particular accounting issues uniquely affecting the healthcare industry. Because Coopers served as the AHERF System's auditor throughout the entire period of the System's rapid expansion, it had accumulated substantial knowledge about these clients, including the System's operational cycles, internal controls, internal control environment, management and key personnel.

34. In connection with its audits of AHERF and its affiliates for fiscal 1996 and 1997, and on the basis of both its industry expertise and its prior experience with these entities, Coopers was thus already possessed of considerable information relating to AHERF's markets, business environments, operating and acquisition experience, controls and management. Such information constituted or exposed numerous audit "red flags, " that should have made Coopers' audit team at least skeptical — if not downright suspicious — regarding the integrity of senior management, and the reliability of the information, representations and financial data being provided by those individuals Specifically, and as of the time Coopers provided audit, attestation and examination services in fiscal 1996 and 1997, Coopers knew or should have known that

a. AHERF had grown exponentially over a remarkably short period of time, principally by acquiring financially-troubled entities in a badly over-saturated market,

b The only legitimate justification being offered for the acquisitions — to wit, a claim that the fortunes of these acquired entities would be reversed by AHERF through enhanced efficiencies and effectiveness — could not be squared with what Coopers already knew about the AHERF System's past performance and the System's inadequate operational and financial controls;

c. AHERF, prior to these acquisitions, had neither created nor implemented prudent plans to finance the costs of the various acquisitions and repay the substantial debt assumed, to eliminate redundancies, to streamline bureaucracies and overhead, and to achieve whatever potential existed for maximizing economies of scale so as to assure the long term viability of the AHERF System after these acquisitions;

d. AHERF did not create and implement short and long term business plans for its acquisitions in order to rationalize the acquired entities' operations to the market in which they operated;

e. AHERF did not design, implement or adhere to an adequate internal control structure that would have safeguarded assets and ensured reliable financial reporting;

f. AHERF suffered from a bloated and byzantine bureaucracy within the AHERF System, such that — by the time of AHERF's bankruptcy — the organizational chart had ballooned to more than 55 separate legal entities, ten separate boards and well over 100 trustees and directors;

g. AHERF annually shuffled assets and liabilities among the entities within the System at whim, and otherwise manipulated the System's corporate organization and financial reports in ways that made it at best very difficult to recognize and understand the true financial performance of the System and of each operating entity,

h AHERF spent excessively and recklessly on physician medical practices, bestowing tens of millions of dollars on doctors to acquire their practices without necessarily conducting meaningful due diligence, and without creating or implementing the structures and incentives necessary to ensure the financial viability of the practices once they had become part of the AHERF System;

i. AHERF had entered into risk contracts that, because of its failure to conduct meaningful due diligence and to create and implement the structures necessary to ensure the financial viability of the contracts, caused significant losses throughout the AHERF System;

j. AHERF devoted corporate assets to the promotion of opulent lifestyles for its senior management, not only in the form of compensation that far exceeded that of executives in similar positions elsewhere in the market place, but also extravagances hardly reflective of AHERF's non-profit status, including two company-owned private jets, frequent and unnecessary business trips to exotic foreign destinations, frequent management "retreats" at posh resorts, generous car allowances, private golf club memberships and golf outings, lavish parties, and elite accommodations at professional sports venues in both Pittsburgh and Philadelphia;

k. AHERF maintained a level of overhead that was indefensible for a nonprofit charitable institution, let alone one that was continuing to acquire financially stressed hospitals based on promises of "synergy" and "economies of scale;"

l. AHERF, experiencing a liquidity crisis in the AHERF System, in part due to an inability to collect increasingly deteriorating patient receivables, had leveraged assets and delayed payments to vendors.

m. AHERF had failed to establish, maintain, and be faithful to an effective internal control structure for the 55-entity, integrated healthcare network that it was creating, and indeed the only comprehensive, formal internal documentation specifying the AHERF System's policies and procedures with respect to the recording of transactions, required approvals, minimum documentation requirements and retention of records were a "Corporate Finance Manual" and a "Tax Filings Reference Guide," which were out of date and in any event not designed for the kind of massive entity that AHERF had become; and

n. Senior management consistently overrode the internal control structure that existed throughout the AHERF System, and routinely allocated expenses and revenue among the various AHERF entities simply on the basis of how they wanted the entities to look.

35 Notwithstanding its professional obligations of independence and due care, and further notwithstanding what it knew or should have known regarding the AHERF System's senior management, operations and controls at the times of the fiscal 1996 and 1997 audits, Coopers failed to conduct its audits, special reports, and other services in accordance with either relevant professional standards or its contractual commitments to AHERF and its affiliates. As a result of Coopers' failure, the AHERF System's deteriorating financial condition over the years 1996 and 1997 escaped notice by the innocent, unaware and misinformed Trustees of AHERF and its affiliates, as well as regulators and others, until shortly before AHERF's bankruptcy filing.

## C. COOPERS' AUDIT FAILURES

36. For each of fiscal 1996 and 1997, the financial statements of AHERF and its affiliates, on which Coopers opined, were in fact materially misstated, in at least the following respects:

a. Even though the AHERF System was by fiscal 1996 incurring substantial operating losses, and facing a liquidity crisis in part due to its inability effectively to collect patient receivables, the financial statements of AHERF and its affiliates falsely depicted both profitability and stability, as the result of fabricated transactions and improper accounting employed by senior management in order to inflate revenues, understate expenses, and hide debt covenant defaults and other unfavorable conditions;

b. AHERF and its affiliates artificially enhanced their seeming profitability by creating and using phony reserves — denominated "cushions" or "general reserves" — which were for the most part created by recording excessive and fanciful "liabilities" and other acquisition entries for hospital entities being acquired by AHERF, and then "released" to income at the direction of and as deemed needed by senior management;

c. AHERF and its affiliates inflated their income by improperly recognizing as general income certain gains in funds that carried express restrictions that precluded such "income" treatment;

d. AHERF and its affiliates failed to record legitimate liabilities and improperly capitalized costs that should have been charged to income in the affected years;

e. AHERF and its affiliates improperly recognized as income the gain from a sale/leaseback transaction, when the gain should have been deferred and amortized to income in future years;

f. AHERF and its affiliates failed to disclose the impact of improper and unauthorized inter-company transactions in their reported financial results; and

g. AHERF and its affiliates misclassified certain assets in order to improve the System's perceived liquidity and hide debt covenant defaults

37 As the result of its audits of AHERF and its affiliates in each of fiscal years 1996 and 1997, Coopers either knew or should have known that the financial statements of AHERF and its affiliates were materially misstated and therefore Coopers should have issued qualified or

adverse opinions on such financial statements. Instead Coopers, in each of fiscal years 1996 and 1997, issued so-called "clean opinions" to the effect that the financial statements of AHERF and its affiliates "presented fairly, in all material respects, the financial position of [AHERF and its affiliates]. . . in conformity with generally accepted accounting principles."

38. In each of fiscal years 1996 and 1997, Coopers knew or should have known, and should have disclosed in its reports on the financial statements of AHERF and its affiliates, that the financial statements were not prepared in accordance with Generally Accepted Accounting Principles (GAAP).

39. In each of fiscal years 1996 and 1997, pursuant to Generally Accepted Auditing Standards (GAAS) and its contract with AHERF, Coopers was also obligated to inform the Trustees and/or Audit Committees of AHERF and its affiliates of "reportable conditions" that may have affected the overall quality and reliability of management's financial representations. Indeed, at each meeting of AHERF's Audit Committee during the affected years, the Committee proffered an open invitation to Coopers — which Coopers declined — to meet in executive session to discuss any reportable conditions or other material accounting issues arising from its audits that Coopers wished to discuss.

40 Coopers knew or should have known of reportable conditions affecting the quality and reliability of the fiscal 1996 and 1997 financial statements which they did not disclose to the Trustees of AHERF and its affiliates. These reportable conditions included, but were not limited to, the following:

a. Senior management, without proper authorization, used cash and other resources of certain AHERF affiliates, including Board-designated and legally restricted funds, for the benefit of other affiliates.

b. Senior management effected transactions and moved funds, without proper authorization, between and among the constituent entities of the AHERF System for the purpose of masking adverse results;

c. The results of operations and other aspects of the financial reporting of AHERF and its affiliates were significantly impacted by both the questionable manner in which sensitive estimates were developed by senior management and the accounting methodologies which they selected;

d. AHERF and its affiliates failed to comply with specific requirements of debt agreements and recorded unusual inter-company transactions of dubious business merit to cover up loan covenant defaults;

e. The AHERF System lacked an effective internal control structure, and any internal structure that did exist was susceptible to override at the whim of senior management for improper purposes;

f. Coopers had actual knowledge of incidents where senior management had overridden internal controls;

g. The AHERF System lacked comprehensive and formal documentation specifying the System's policies and procedures relating to the recording of transactions, required approvals, minimum documentation requirements and retention of records;

h. The AHERF System's internal "budgeting process" was manipulated by senior management for improper purposes;

i AHERF could simply report the results of operations on the financial statements of itself and its affiliates based on "how Abdelhak wanted the company to look",

j. Coopers had actual knowledge of instances where AHERF manipulated operational results by portraying arbitrarily generated "budgeted" numbers as actual operational results;

k. Constituent entities within the AHERF System could likely not satisfy third party obligations or comply with related debt covenants because their ability to do so depended on the abilities of other constituent entities to repay inter-company/inter-fund advances in cash, and several significant inter-company account-debtors lacked the ability to make such repayment;

l. The due diligence and operational assumptions attending AHERF's acquisition of physician practices and entry into risk contracts were flawed, and as a result the acquisition prices of such practices were inflated; and justifications given for the inflated prices paid for the practices and the plausibility of entering into the risk contracts were unsubstantiated; and

m. Senior management was unduly aggressive in its accounting treatments, policies and approach, rendering the financial statements of AHERF and its affiliates materially misleading.

41. Had Coopers properly issued qualified or adverse opinions on fiscal 1996 and 1997 financial statements of AHERF and its affiliates, and/or had Coopers timely and adequately disclosed reportable conditions in accordance with both Generally Accepted Auditing Standards (GAAS) and their own commitments to the AHERF System's Trustees, the innocent, unaware and misinformed Trustees of AHERF and its affiliates, as well as regulators and other responsible officials, were so situated as to take corrective action to halt the decline of the AHERF System, and would have taken such corrective action. Moreover, the System would have been precluded

from incurring the obligations to creditors that eventually forced its bankruptcy and created the shortfall that exists today.

## COUNT I — PROFESSIONAL NEGLIGENCE

42. Plaintiff repeats and re-avers the allegations contained in paragraphs 1-41 of this Complaint as if the same had been fully rewritten herein.

43. Coopers owed a duty to bring to and to exercise in the auditing and accounting function that degree of skill and care possessed in the auditing and accounting profession generally. Included within that duty was an obligation to observe Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS) in performing its audits and in rendering its opinion on the financial statements of AHERF and its affiliates.

44. In auditing the financial statements of AHERF and its affiliates for the fiscal years 1996 and 1997, Coopers breached its duty to AHERF and its affiliates, and was guilty of professional negligence, in, among others, the following respects:

a. For each of fiscal years 1996 and 1997, Coopers issued unqualified opinions on the financial statements of AHERF and its affiliates when, in the exercise of due professional care, it should have qualified its opinion or rendered an adverse opinion on such financial statements;

b For each of fiscal years 1996 and 1997, Coopers issued unqualified opinions on the financial statements of AHERF and its affiliates, when Coopers knew or should have known that such statements were materially misstated;

c. For each of fiscal years 1996 and 1997, Coopers should have disclosed in its report on the financial statements of AHERF and its affiliates that said statements were not prepared in accordance with Generally Accepted Accounting Principles (GAAP);

d. For each of fiscal years 1996 and 1997, Coopers failed to disclose "reportable conditions" of which Coopers was aware or should have been aware to those ultimately responsible for governing and overseeing the AHERF System;

e. For each of fiscal years 1996 and 1997, Coopers failed in its audit reports to take exception to AHERF and certain affiliates' failure to disclose that their financial statements were presented on the assumption that the entities would continue as "going concerns," despite extant circumstances — known to Coopers — which raised substantial doubt regarding those entities' abilities to continue as going concerns;

f. For each of fiscal years 1996 and 1997, Coopers failed to disclose the false and misleading nature of senior management's representations concerning the Graduate and AUMC Acquisitions, when it knew or should have known of the false and misleading nature of these representations, and of the likely long-term impact of those acquisitions; and

g. For each of fiscal years 1996 and 1997, Coopers failed to monitor compliance with the various recommendations that it made to the AHERF System's management for improved operations and controls, and ignored those deficiencies when performing subsequent audits and other engagements pertaining to the AHERF System.

45. In providing unqualified opinions on the fiscal 1996 and 1997 financial statements of AHERF and its affiliates, Coopers knew that such opinions would be relied upon, and intended that they be so relied upon, by the innocent, unaware and misinformed Trustees of AHERF and its affiliates — individuals who were so situated and duly motivated to act and to intervene, and who

would have acted and intervened, in order to protect AHERF and its affiliates against the effects of a financial deterioration.

46. In failing to inform the innocent, unaware and misinformed Trustees of AHERF and its affiliates of certain reportable conditions that would have called into question the accuracy, quality and reliability of the System's financial reporting, Coopers knew or should have known that this failure would be relied upon by those individuals, who were so situated and duly motivated to act and to intervene, and who would have acted and intervened, in order to protect against the effects of a financial deterioration.

47. As a result of the professional negligence of Coopers, the innocent, unaware and misinformed Trustees of AHERF and its affiliates, and others, refrained from taking steps within their powers and authority to halt further deterioration in the AHERF System's financial condition. Further, even after the disastrous operating results experienced by the AHERF System came to light, the above-described negligence of Coopers contributed materially to significant delays in discovering the true financial state of affairs in the AHERF System and materially aided in preventing the immediate implementation of effective measures in time to reverse the decline in the System's financial condition. Moreover, after the Debtors' petitions for bankruptcy protection were filed, the inaccuracies revealed in the AHERF System's financial statements had a material and negative effect on the sale price of certain Debtor affiliates, further escalating the shortfall to the Debtors' creditors.

48 Cooper's breach of duty as aforesaid was a direct and proximate cause of Debtors' present financial condition, in that such breach of duty allowed the continued deterioration of the Debtors into insolvency and prevented those ultimately responsible for governing the Debtors, and others, from taking steps to prevent or minimize the Debtors' financial deterioration

49. By virtue of the aforesaid breach of duty and negligence of Coopers, the Debtors' estates have been damaged to the full extent of the Debtors' insolvency, which amount is in excess of $1.0 billion.

## COUNT II — BREACH OF CONTRACT

50. Plaintiff repeats and re-avers the allegations contained in paragraphs 1-49 of this Complaint as if the same had been fully rewritten herein.

51. As part of its engagement and contract with AHERF for the rendition of auditing, special reports, and other services for fiscal years 1996 and 1997, Coopers agreed to perform such services in accordance with that degree of special competence which Coopers claims to possess, and to perform its services in accordance with those internal standards which Coopers has adopted for its rendition of client services. Such internal standards articulate, among other things, how Coopers will perform audits and other services for its clients.

52. In its audits and special reports for AHERF and its affiliates in each fiscal years 1996 and 1997, Coopers breached its contract to AHERF in, among others, the following respects:

a. For each of fiscal years 1996 and 1997, Coopers issued unqualified opinions on the financial statements of AHERF and its affiliates when, under Coopers' own internal standards, it should have qualified its opinion or rendered an adverse opinion on such financial statements;

b. For each of fiscal years 1996 and 1997, Coopers issued unqualified opinions on the financial statements of AHERF and its affiliates, when Coopers knew or should have known that such statements were materially misstated,

c. For each of fiscal years 1996 and 1997, Coopers failed to disclose in its report on the financial statements of AHERF and its affiliates that said statements were not prepared in accordance with Generally Accepted Accounting Principles (GAAP);

d. For each of fiscal years 1996 and 1997, Coopers failed to disclose "reportable conditions" of which Coopers was aware or should have been aware to those ultimately responsible for governing and overseeing the AHERF System;

e. For each of fiscal years 1996 and 1997, Coopers failed in its audit reports to take exception to AHERF and certain affiliates' failure to disclose that their financial statements were presented on the assumption that the entities would continue as "going concerns," despite extant circumstances — known to Coopers — which raised substantial doubt regarding those entities' abilities to continue as going concerns;

f. For each of fiscal years 1996 and 1997, Coopers breached its own internal standards in failing to disclose the false and misleading nature of management's representations concerning Graduate and AUMC Acquisitions, when it knew or should have known of the false and misleading nature of these representations, and of the likely long-term impact of those acquisitions.

53. In providing unqualified opinions on the fiscal 1996 and 1997 financial statements of AHERF and its affiliates, Coopers knew that such opinions would be relied upon, and intended that they be so relied upon, by the innocent, unaware and misinformed Trustees of AHERF and its affiliates — individuals who were so situated and duly motivated to act and to intervene, and who would have acted and intervened, in order to protect AHERF and its affiliates against the effects of a financial deterioration

54. In failing to inform the innocent, unaware and misinformed Trustees of AHERF and its affiliates of certain reportable conditions that would have called into question the accuracy, quality and reliability of the System's financial reporting, Coopers knew or should have known that this failure would be relied upon by those individuals, who were so situated and duly motivated to act and to intervene, and who would have acted and intervened, in order to protect against the effects of a financial deterioration.

55 As a result of Coopers' breach of contract, and its failure to conduct its audit and other professional services in accordance with the internal standards formulated by Coopers for the performance of such services, the innocent, unaware and misinformed Trustees of AHERF and its affiliates, and others, refrained from taking steps within their powers and authority to halt further deterioration in the AHERF System's financial condition. Further, even after the disastrous operating results experienced by the AHERF System came to light, this breach of contract by Coopers contributed materially to significant delays in discovering the true financial state of affairs in the AHERF System and materially aided in preventing the immediate implementation of effective measures in time to reverse the decline in the System's financial condition. Moreover, after the Debtors' petitions for bankruptcy protection were filed, the inaccuracies revealed in the AHERF System's financial statements had material and negative effects on the sale price of certain Debtor affiliates, further escalating the shortfall to the Debtors' creditors

56. Coopers' breach of contract as aforesaid was a direct and proximate cause of Debtors' present financial condition, in that such breach of duty allowed the continued deterioration of the Debtors into insolvency and prevented those ultimately responsible for

governing the Debtors, and others, from taking steps to prevent or minimize the Debtors' financial deterioration.

57. By virtue of the aforesaid breach of contract by Coopers, the Debtors' estates have been damaged to the full extent of the Debtors' insolvency, which amount is in excess of $1.0 billion.

## RELIEF

WHEREFORE, the Committee demands judgment against Coopers as follows:

A. actual damages, including compensatory and consequential damages, in amount to be determined at trial, up to and including the full extent of the Debtors' insolvency;

B. an award of prejudgment interest in an amount to be determined at trial,

C. an award of costs to the Committee, including reasonable attorney, accountant and other expert fees and other disbursements; and

D. such other relief, both at law and in equity, as may be just and proper.

## JURY DEMAND

The Committee hereby demands a trial by jury on all issues and claims so triable in this matter.

Dated: April 11, 2000

Respectfully submitted,

Laura E. Ellsworth

Laura E. Ellsworth (PA #39555)
Jones, Day, Reavis & Pogue
One Mellon Bank Center, 31st Floor
500 Grant Street
Pittsburgh, Pennsylvania 15219
(412) 391-3939

and

Richard B. Whitney

Richard B. Whitney (OH #0008004)
J. Kevin Cogan (OH #0009717)
Jones, Day, Reavis & Pogue
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
(216) 586-3939

and

Stanley E. Levine

Douglas A. Campbell (PA #23143)
Stanley E. Levine (PA #19819)
Campbell & Levine
1700 Grant Street
Pittsburgh, Pennsylvania 15219
(419) 261-0310

Attorneys for Plaintiff The Official Committee of Unsecured Creditors of Allegheny Health, Education and Research Foundation

Mc/gla

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

In re:

ALLEGHENY HEALTH, EDUCATION AND RESEARCH FOUNDATION, et al.,

Debtors.

Bankruptcy Case No. 98-25773 MBM through 98-25777 MBM inclusive

Chapter 11

Consolidated for Administration at 98-25773 MBM

Motion No. 00-0918

---

WILLIAM J. SCHARFFENBERGER, CHAPTER 11 TRUSTEE and THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF ALLEGHENY HEALTH, EDUCATION AND RESEARCH FOUNDATION,

Movants,

v.

NO RESPONDENT,

Respondent.

## CONSENT ORDER

Upon consideration of a Stipulation and Agreed Order submitted by the Official Committee of Unsecured Creditors and the Trustee regarding the pursuit of proposed causes of action against PricewaterhouseCoopers, LLP, successor to Coopers & Lybrand ("Coopers"), the Response filed by Coopers and the arguments of counsel at a

EXHIBIT A

hearing held on March 21, 2000, with the consent of counsel for the Trustee, the Creditors' Committee and Coopers, it is hereby ORDERED:

1. The Creditors' Committee is granted authority to prosecute any claims and causes of action against Coopers possessed by the Debtors' estates, pursuant to Sections 105, 1103, 1109 and 1123 of the Bankruptcy Code.

2. Any Complaint filed by the Creditors' Committee against Coopers shall be filed in the United States District Court for the Western District of Pennsylvania. Pursuant to a joint stipulation among the Trustee, Creditors' Committee and Coopers, the parties will request the District Court to refer any case filed back to this Court for pretrial management, development of a discovery schedule, handling of discovery matters, entry of interlocutory rulings and entry of rulings upon dispositive motions either as final rulings or proposed rulings; depending upon the subject of and law applicable to any such dispositive motions.

3. The Trustee, Committee and Coopers agree that the trial of any case filed against Coopers will be conducted by this Court if the parties to the case subsequently agree to waive a demand for a jury trial in accordance with F.R.C.P. 38(d) and Bankruptcy Rule 9015. In addition, the commencement of the case in the United States District Court will not preclude the conduct of a jury trial by this Court pursuant to 28 U.S.C. § 157(e) in the event (i) all parties to the case consent in writing, (ii) this Court is willing to conduct such a jury trial and (iii) this Court is specially designated to do so by the District Court.

4. The Committee and its professionals are authorized to take such action as is necessary and appropriate to assert and pursue claims and causes of action against Coopers immediately upon the execution of this Consent Order.

5. The Committee and the Trustee shall have all joint prosecution, work product and other privileges available under applicable law with respect to all aspects of their prosecution of claims and causes of action against Coopers and the Committee and its professionals shall consult with the Chapter 11 Trustee and his professionals as they deem necessary and appropriate with respect to the prosecution and/or settlement of any claims and causes of action against Coopers.

6. Any recovery by the Committee or the Chapter 11 Trustee on account of any claims or causes of action pursued against Coopers shall be distributed pursuant to a Chapter 11 Plan of Reorganization or a Chapter 7 Liquidation of the Debtors' estates.

IT IS SO ORDERED.

United States Bankruptcy Judge

Dated: April 5, 2000