INTRODUCTION AND OVERVIEW

1. This is a securities fraud class action on behalf of all persons who purchased or otherwise obligated themselves to purchase the stock of PhyCor, Inc. ("PhyCor" or the "Company") between April 22, 1997 and July 22, 1998, inclusive (the "Class Period"), alleging violations of the federal securities laws arising out of defendants' issuance of false financial statements and other false and misleading statements about PhyCor's operating performance and business prospects. PhyCor is a physician-practice management company that acquires and operates multi-specialty medical clinics and independent practice associations. PhyCor's acquisitions are structured so that PhyCor purchases a clinic's operating assets and simultaneously enters into a long-term service agreement with the affiliated physician group.

2. During the Class Period, PhyCor and its top officers falsified its reported profits and concealed the truth about the
failure of PhyCor's business model in order to allow PhyCor's securities to trade at artificially inflated levels. Defendants repeatedly misrepresented the strength of PhyCor's operations, including the operating efficiencies and cost savings achieved from its completed acquisitions, and PhyCor's ability to achieve promised earnings per share ("EPS") growth in order to prop up the price of PhyCor stock so that defendants could: (i) complete acquisitions of additional clinics and/or existing physician-practice management companies using PhyCor stock as currency, including the $8 billion MedPartners purchase and the $100+ million acquisitions of PFC and CareWise; and (ii) sell off $17+ million of the individual defendants' own PhyCor shares at prices as high $33 per share. Specifically, defendants maintained that:

- PhyCor's "very, very strong momentum" ensured that the Company would "continue on the very, very strong path that we've been on."

- PhyCor's operations were "sound" and the Company's pipeline was "strong"; justifying defendants' "strong expectations" for 1997 and 1998 earnings of $0.84 and $1.10-$1.15, respectively.

- PhyCor was "well positioned" to post EPS growth of 25%-30% in 1998 as well as "strong 1999" EPS.

- Defendants were "more confident about [PhyCor's] long-term future than at any time."

However, the truth was that PhyCor's business was failing miserably. PhyCor's lack of corporate infrastructure rendered it unable to integrate the acquisitions it was making. Moreover, because of the rapidly declining incomes suffered by physicians as a result of their affiliation with PhyCor, the physicians were refusing to honor their contractual commitments to PhyCor and/or were threatening legal action to terminate their PhyCor contracts.
In fact, by March 1998 things were so bad that PhyCor was unable to even meet its own payroll obligations. Moreover, the "record" profits reported by PhyCor were phony, resulting from illegal accounting manipulations and not from solid or sustainable business operations.

3. When it became impossible for defendants to continue their chicanery, they attempted to effect a soft landing by disclosing the truth about PhyCor's operations over time and thereby avoiding a complete collapse in the price of PhyCor stock. However, as defendants slowly disclosed the extent of PhyCor's operating problems, PhyCor stock dropped from over $28 per share in January 1998, to less than $15 per share. Finally, in July 1998, PhyCor shares plummeted to $8-1/4 per share as defendants admitted that PhyCor was not and could not grow at the rate previously asserted, that PhyCor would be taking another $65 million charge and that -- despite assurances to the contrary made just weeks before by defendants Hutts and Crawford -- PhyCor was actually suffering declining 1998 EPS.

SUMMARY OF THE ACTION

4. PhyCor is one of this country's first physician-practice management companies ("PPMs"). PhyCor was founded in 1988 and was created to effect what is known as a "consolidation play," whereby PhyCor would acquire and consolidate multi-specialty medical clinics under common ownership, integrating them and thereby achieving economies of scale and synergies of operation through management expertise, increased access to capital and improved information and accounting systems. During its first years of existence, PhyCor operated in a relatively competition-free
environment and steadily posted strong revenue and EPS growth by acquiring multi-specialty clinics. However, by the mid-1990's competition between PPMs in acquiring physician practices had become fierce and defendant Hutts was having trouble competing against some of his faster growing competitors (including MedPartners), which, unlike PhyCor, used their artificially inflated stock as currency to purchase physician practices. By using inflated stock as currency to acquire practices instead of cash, PhyCor's competitors were able to supercharge their growth because they did not have to regularly raise money from the public markets by selling equity or debt.

5. In an attempt to remain competitive with its rapidly growing competitors, PhyCor began paying increasing prices to purchase the assets of physician practices. However, as PhyCor paid increasing prices, PhyCor began increasing the management fee paid to PhyCor from as low as 11% of net operating income to as high as 20%. The higher management fee was acceptable to physicians because defendants promised to substantially increase revenues and reduce costs by implementing the PhyCor model. However, the revenue growth was a fiction because PhyCor did little or nothing to enhance revenue, and the 15%-20% management fee resulted in material declines in physician take home pay which in turn was causing a dramatic increase in physician dissatisfaction.

6. In an desperate attempt to avoid having to continue to pay the rapidly increasing market price for physician clinics, yet retain PhyCor's ability to generate the growth rate promised to investors, PhyCor began constructing its own multi-specialty clinics, acquiring and placing together unrelated physician
practices. Unlike existing multi-specialty clinics, these "put-together" or "group-formation" clinics lacked any cohesiveness or stable operating history. Consequently, by the beginning of the Class Period, a majority of these "put-together" clinics had imploded, with many physicians defecting and/or threatening PhyCor with legal action to terminate their contracts with PhyCor.

7. By early 1997, PhyCor was also running extremely short on cash. Only by claiming that PhyCor remained on track to post 1997 and 1998 EPS of at least $0.84 and $1.10, respectively, was PhyCor able to raise an additional $210 million from investors via the sale of PhyCor equity in February 1997. However, as concern about PhyCor's ability to keep up its growth rate and keep pace with its more aggressive competitors reached the market, the price of PhyCor stock started to slide, dropping to less than $23 in April 1997. Instead of revealing the truth regarding PhyCor's operations and financial performance, including the operational failure of PhyCor's "put-together" clinics (which defendants realized would have resulted in a complete collapse in PhyCor's stock price), defendants embarked upon the misconduct complained of herein. Defendants realized that PhyCor could no longer raise enough cash to purchase practices outright and thus planned to start using PhyCor stock as currency, which required defendants to reinflate the price of PhyCor stock. However, PhyCor's insiders knew that its stock price would only trade at high levels if PhyCor was presented to the investing public as a company that could continue to post the 30%-35% EPS growth.

8. Throughout 1997, PhyCor assured investors that PhyCor's conservative management practices combined with its sophisticated
accounting and management information systems were enabling the Company to achieve the economies of scale and operating synergies claimed by defendants. As a result, by June 1997, PhyCor's stock was reinfated to a Class Period high of $35-1/2 per share.

9. On October 29, 1997, PhyCor stunned the investment community announcing that it would use PhyCor shares to acquire the much larger MedPartners in a huge $8 billion merger, pursuant to which PhyCor would issue approximately 236 million new shares. Although the price of PhyCor stock immediately fell by more than 20%, PhyCor shares stabilized as defendants assured investors that the MedPartners acquisition was not a desperate act, but rather was an "extraordinary and unique opportunity." Defendants assured investors that the acquisition would be "accretive" to PhyCor's 1998 EPS. In December 1997, PhyCor also announced that it would acquire CareWise, Inc. of Seattle, Washington and First Physician Co. of Atlanta, Georgia in exchange for more than 5 million shares of PhyCor stock.

10. On January 7, 1998, PhyCor stunned the market again, announcing that the PhyCor/MedPartners merger had been terminated. Defendant Hutts attempted to dispel investors' consternation, assuring them that PhyCor's operational health had nothing to do with the decision to terminate the merger. In fact, Hutts asserted PhyCor's operations were experiencing "very, very strong momentum" and that defendants were "comfortable with the range of expectations that are on the Street for the fourth quarter and for 1998." Just four days later, PhyCor announced a $120 million charge against PhyCor's earnings, including a $105 million charge in connection with PhyCor's restructuring of five of its multi-
specialty clinics. Responding to the questions of bewildered investors who had just days before been told that PhyCor was on a "very, very strong path," defendants Hutts and Crawford again assured investors that the $105 million charge was more than adequate to address the problems experienced by PhyCor, which problems defendants asserted were limited to a few of its "first generation attempts at new group formations." To avoid a complete collapse in the price of PhyCor's stock as a result of the revelation of this dramatic $100+ million charge, defendants told the market they had "strong expectations for 1997 and 1998 earnings," reassuring investors that PhyCor's problems with its group formations had been "solved" and that defendants had put "everything out in front of [the] investment community." Defendants further stated that PhyCor's "operations are sound" and that the Company's "pipeline is strong."

11. On February 19, 1998, PhyCor released its financial results for FY97, and stated that PhyCor had entered 1998 "with increased momentum and opportunity." Defendant Hutts assured investors that "our operations are sound, and we have solid confidence in the future of our company." Then, in April 1998, PhyCor first disclosed that going forward, PhyCor might change the way that the Company amortized intangible assets and that this would be likely to have an adverse impact on 1998 EPS, but assured investors that despite this change, PhyCor's EPS would "increase between 25% to 30% over the comparable amount in 1997." Defendant Hutts reassured investors that PhyCor remained "well-positioned" and that PhyCor's senior executives were "more confident about our long-term future than at any time." In fact, as late as June 1998,
just six weeks before defendants admitted that PhyCor was actually suffering earnings declines, defendant Hutts continued to represent that PhyCor would post "earnings-per-share growth of 25%-30% this year."\(^1\)

12. Although defendants continued to paint a picture of continued growth and success through June 1998, this masquerade was a fiction reminiscent of Potemkin’s Village. In fact, PhyCor’s business was failing miserably, as:

- PhyCor had been unable to integrate the hundreds of practices acquired by PhyCor in 1996 and 1997 because of PhyCor’s total lack of corporate infrastructure.
- Physicians were refusing to honor their contractual commitments to PhyCor and/or were threatening legal action to terminate their PhyCor contracts because of the rapidly declining incomes suffered as a result of their affiliation with PhyCor.
- PhyCor physicians were defecting in droves.

In fact by March 1998, things were so bad, that PhyCor was unable to even meet its own payroll obligations.

13. When it became impossible for defendants to continue their chicanery, they were forced to reveal what they had known since early 1997, that PhyCor was incapable of growing at the rate previously asserted, that PhyCor would be taking another $65 million charge and that despite assurance to the contrary made just weeks before by defendants Hutts and Crawford, PhyCor was actually suffering EPS declines.

\(^1\) Keeping the price of PhyCor stock inflated remained extremely important to defendants during June and July 1998, as they were then in the midst of completing several acquisitions using PhyCor shares as currency, including the acquisitions of Morgan Health. Notably, the Morgan Health transaction was subject to termination if the price of PhyCor stock fell below $11.
14. These shocking disclosures were diametrically opposed to defendants' prior representations and caused PhyCor's stock price to collapse, ultimately falling to as low as $8-1/4 per share -- a 75% decline from its Class Period high. As a result of defendants' wrongful course of business, public investors, as well as the physicians whose practices PhyCor acquired, have been cheated out of hundreds of millions of dollars, which losses can only be remedied through this action.

15. The graph below demonstrates the price action of PhyCor's stock during the Class Period as defendants attempted to keep the price of PhyCor stock inflated in an attempt to: (i) complete the acquisition of several companies by issuing (selling) hundreds of millions of shares of PhyCor stock, including the acquisition of MedPartners, the largest PPM in the United States; and (ii) sell $17+ million shares of their own PhyCor common stock at prices as high as $33 per share. The graph also illustrates the collapse of PhyCor's stock price as the previously concealed facts about PhyCor's businesses emerged:
JURISDICTION AND VENUE


17. Venue is proper in this District pursuant to §27 of the Exchange Act and 28 U.S.C. §1391(b). Many of the acts giving rise to the violations complained of occurred in this District.
18. Defendants used the instrumentalities of interstate commerce, the U.S. mails and the facilities of the national securities markets.

THE PARTIES

19. Plaintiff James Meyer purchased shares of PhyCor stock during the class period as detailed in the attached certification and was damaged thereby.

20. Defendant PhyCor is headquartered in Nashville, Tennessee. PhyCor began operating in 1988. PhyCor is a PPM that operates multi-specialty medical clinics and independent practice associates. PhyCor acquires the operating assets of physician practices and purports to provide management expertise, marketing, information systems, capital resources and ancillary services. As of December 31, 1997, PhyCor operated 55 clinics with 3,800 physicians in 28 states. PhyCor's stock was traded throughout the Class Period in an efficient market on the NASDAQ National Market System.

21. (a) Defendant Joseph C. Hutts ("Hutts") was at all times relevant hereto Chief Executive Officer, President and Chairman of the Board of Directors of PhyCor. Because of Hutts' position, he knew or had available to him the adverse non-public information about the business of PhyCor, as well as its finances, markets and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management and Board of Directors' meetings and/or committees thereof and via reports and
other information provided to him in connection therewith. During the Class Period, Hutts participated in the issuance of false and/or misleading statements, including the preparation of false and/or misleading press releases and dissemination of false statements during conference calls and/or during individual conversations with securities analysts. Hutts took advantage of the defendants' false statements, selling at least 100,000 shares of PhyCor stock during the Class Period at prices as high as $32-3/4 per share for proceeds of more than $2.9 million. Hutts' sales constituted 60% of the PhyCor shares actually owned by him.

(b) Defendant Derril W. Reeves ("Reeves") was, until he was fired in the fall of 1997, Executive Vice President and Chief Development Officer of PhyCor. Because of Reeves position, he knew the adverse non-public information about the business of PhyCor, as well as its finances and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management and/or Board of Directors' meetings and committees thereof and via reports and other information provided to him in connection therewith. During the Class Period, Reeves participated in the issuance of false and misleading statements, which participation included the preparation of false and/or misleading press releases, dissemination of false statements during conference calls and/or dissemination of false statements during individual conversations with securities analysts. Reeves took advantage of the defendants' false statements, selling at least 120,000 shares of PhyCor stock.
during the Class Period at prices as high as $32-3/4 per share, for proceeds of approximately $3.6 million. Reeves' sales constituted 40% of the PhyCor shares actually owned by him.

(c) Defendant Richard D. Wright ("Wright") was, at all times relevant hereto, Executive Vice President of Corporate Services of PhyCor. Because of Wright position, he knew the adverse non-public information about the business of PhyCor, as well as its finances and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management meetings and via reports and other information provided to him in connection therewith. During the Class Period, Wright participated in the issuance of false and/or misleading statements, including the preparation of false and/or misleading press releases, dissemination of false statements during presentations at securities conferences and analyst conference calls and/or during individual conversations with securities analysts. Wright took advantage of the defendants' false statements, selling at least 182,188 shares of PhyCor stock during the Class Period at prices as high as $33 per share, for total proceeds of more than $5.2 million. Wright's sales constituted 85% of the PhyCor shares actually owned by him.

(d) Defendant John K. Crawford ("Crawford") was, at all times relevant hereto, Executive Vice President and Chief Financial Officer of PhyCor. Because of Crawford's position, he knew the adverse non-public information about the business of PhyCor, as
well as its finances and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management meetings and via reports and other information provided to him in connection therewith. During the Class Period, Crawford participated in the issuance of false and/or misleading statements, including the preparation of false and/or misleading press releases, dissemination of false statements during presentations at securities conferences and analyst conference calls and/or during individual conversations with securities analysts. Crawford took advantage of the defendants' false statements, selling at least 106,426 shares of PhyCor stock during the Class Period at prices as high as $32.38 per share for total proceeds of more than $2.6 million. Crawford's sales constituted 82% of the PhyCor shares actually owned by him and were the largest open market sales of PhyCor stock by Crawford since his initial SEC Form 3 filing in 1993.

(e) Defendant Thompson S. Dent ("Dent") was Executive Vice President and Chief Operating Officer of PhyCor. Because of Dent's position, he knew the adverse non-public information about the business of PhyCor, as well as its finances and present and future business prospects via access to internal corporate documents (including the Company's operating plans, budgets and forecasts and reports of actual operations compared thereto), conversations and connections with other corporate officers and employees, attendance at management meetings and via reports and
other information provided to him in connection therewith. During the Class Period, Dent participated in the issuance of false and/or misleading statements, including the preparation of false and/or misleading press releases, dissemination of false statements during presentations at securities conferences and analyst conference calls and/or during individual conversations with securities analysts. Dent took advantage of the defendants' false statements, selling at least 123,000 shares of PhyCor stock during the Class Period at prices as high as $32-3/4 per share, for proceeds of more than $3.5 million. Dent's sales constituted 86% of the PhyCor shares actually owned by him.

(f) The defendants identified in ¶21(a)-(e) are referred to herein as the Individual Defendants.

22. By reason of their management positions and/or their membership on the Company's Board of Directors, their ability to make public statements in the name of the Company, and their stock ownership, the Individual Defendants were controlling persons of the Company and participated in the preparation and/or dissemination of the statements in this Complaint alleged to be false. Each Individual Defendant had access to the adverse non-public information about the Company's business, finances, products, markets and present and future business prospects, as particularized herein, by means of internal corporate documents, conversations or connections with other corporate officers or employees, attendance at Company management and/or Board of Directors meetings and committees thereof, and via reports and other information provided to them in connection therewith.
23. During the Class Period, each Individual Defendant occupied a position as one of the top 5 PhyCor executives that made him privy to non-public information concerning PhyCor. Because of this access, each of these defendants knew or had access to the adverse facts specified herein. Notwithstanding their duty to refrain from causing PhyCor to sell (issue) stock or other securities while in possession of material, adverse, non-public information concerning PhyCor, these defendants caused PhyCor to sell (issue) millions of shares of the Company's stock, thus allowing PhyCor to benefit from the defendants' wrongful course of conduct. The Individual Defendants also took advantage of the artificial inflation in PhyCor's shares to dump $17+ million of their own PhyCor shares at prices as high as $33 per share, including 82%, 85% and 86% of the PhyCor shares actually owned by defendants Crawford, Wright and Dent. PhyCor's press releases, corporate reports to shareholders and filings with the SEC were each group-published documents for which each defendant is equally responsible.

24. Each of the defendants is liable for making false and misleading statements. All of the defendants inflated the price of PhyCor stock by making false and misleading statements and omitting material adverse information. The defendants' wrongful course of business: (i) artificially inflated the price of PhyCor stock during the Class Period; (ii) deceived the investing public, including plaintiffs and other Class members into buying PhyCor stock at artificially inflated prices; (iii) deceived thousands of
physicians into selling their practices to PhyCor; and (iv) permitted PhyCor to grow and benefit economically from the wrongful course of conduct.

DEFENDANTS' MOTIVE FOR PARTICIPATION IN THE WRONGFUL COURSE OF CONDUCT

25. PhyCor and PhyCor's top officers had strong motives to inflate the price of PhyCor stock. They wanted PhyCor to pursue an accelerated acquisition program, as PhyCor's internal rate of growth was a paltry 12% and defendants knew that growth by acquisition provided the only way that defendants could foster the perception in the business community that PhyCor was a "growth company," i.e., the only way PhyCor could post the revenue and EPS growth claimed by defendants. However, by early 1997, defendants' attempts at creating clinics by placing various physician practices together had proved to be an unmitigated disaster. Thus, the defendants could only continue the growth charade by issuing PhyCor shares in exchange for physician practices. Thus, reinflating the price of PhyCor stock was key to defendants' scheme, as doing so allowed defendants to reduce the number of PhyCor shares to be issued in connection with PhyCor's acquisitions, thus minimizing the dilutive impact of the badly needed acquisitions on PhyCor's EPS.

26. A high stock price was also important to each of the defendants as a material part of each defendant's net worth consisted of PhyCor stock. Moreover, each of the Individual Defendants was motivated to falsify PhyCor's operating performance as each of the defendants' base compensation and bonus compensation
was explicitly dependant in material part upon PhyCor's reported pre-tax earnings and EPS.

BACKGROUND TO THE CLASS PERIOD

27. PhyCor was founded in 1988. PhyCor went public in 1992 and has undertaken to effect what is known as a "consolidation play," whereby small fragmented businesses are acquired and, once under common ownership, are integrated so that economies of scale and synergies of operation are achieved through management expertise, increased access to capital, improved information and accounting systems, operating efficiencies and other operational synergies. PhyCor attempted its consolidation play by acquiring multi-specialty practice medical groups throughout the United States.

28. By the mid-1990's it became increasingly difficult for PhyCor to meet its revenue and EPS growth estimates, as PhyCor was having to pay rapidly increasing prices for the practices it sought to acquire. Simply put, PhyCor's competitors were bidding the market price of physician practices up because they were utilizing their own inflated stock as currency to acquire physician practices. PhyCor was at a distinct disadvantage because it relied upon cash raised in public offerings combined with bank credit lines to fund its purchases of medical clinics. To enhance its acquisition rate and thereby meet the revenue and EPS growth numbers expected by Wall Street, PhyCor began to form its own "put-together" groups, which involved PhyCor purchasing physician practices and placing them into multi-specialty clinics. Although this part of PhyCor's business had been troubled from its genesis, by 1997 the "put-together" clinics were literally imploding.
However, defendants concealed the truth about the pervasive problems that these "put-together" clinics were suffering from, as defendants realized that PhyCor could only post the growth promised to Wall Street if PhyCor stock continued to trade at artificially inflated levels which would enable defendants to continue using PhyCor's inflated stock to fund PhyCor's acquisitions.

29. In late 1996, as PhyCor was running out of cash, defendants quickly prepared to issue another round of equity via a public offering. PhyCor completed the offering in February 1997, raising $210 million. However, the $210 million was needed to repay PhyCor's outstanding debt and was quickly expended. As rumors circulated about PhyCor's inability to deliver the 30+% growth promised by defendants, the price of PhyCor stock dropped from over $35 per share to just $23 per share in April 1997. Realizing that PhyCor's stock price could only trade at high levels if PhyCor could convince the investing public that PhyCor's operations were not only currently profitable, but that PhyCor was capable of continuing to achieve increased profitability going forward, defendants embarked upon the course of conduct alleged herein.

FALSE AND MISLEADING STATEMENTS MADE BY DEFENDANTS FOR THE PURPOSE OF SELLING AND/OR EXCHANGING PHYCOR STOCK AT INFLATED PRICES DURING THE CLASS PERIOD

30. On April 22, 1997, PhyCor issued a release announcing the Company's results for the quarter ended March 31, 1997. The release stated:

PhyCor, Inc. today announced revenues and earnings for the first quarter ended March 31, 1997.

Joseph C. Hutts, president and chief executive officer of PhyCor, said, "Our first quarter results
continue our momentum. We are building a company that has the potential to fundamentally impact our country's healthcare system."

For the quarter ended March 31, 1997, net revenues were $250.7 million, up 54% from $162.5 million a year ago. Net earnings for the quarter totaled $12.3 million, or $0.19 per share on 65.1 million average shares outstanding, versus $7.7 million, or $0.13 per share on 60.3 million average shares outstanding in the prior-year period, representing increases of 60% and 46%, respectively. On a base of 31 clinics and 13 IPA markets, PhyCor's same market revenue increased 13.2% for the quarter ended March 31, 1997, compared with the same period in 1996.

* * *

During the first quarter, PhyCor affiliated with three multi-specialty groups adding 182 physicians. The affiliation with St. Petersburg-Suncoast Medical Group was the merger of two groups in St. Petersburg, Florida. The affiliation with Vancouver Clinic, Inc., Vancouver, Washington, represented the Company's initial entry into the state. Also, First Physicians Medical Group in Palm Spring, California, is a new group formation that has developed from the Company's IPA management operations in that market.

31. In connection with the release of PhyCor's results for the quarter ended March 31, 1997, defendants Hutts and Crawford arranged a nationwide conference call from PhyCor's Nashville headquarters for securities analysts, large PhyCor shareholders, hedge fund managers, brokers and stock traders. During the conference call and in subsequent one-on-one conversations, defendants stated:

- PhyCor was poised for another strong year of growth.
- PhyCor's acquisition program was progressing successfully.
- PhyCor had the management expertise and experience as well as the management information and accounting systems and controls necessary to permit it to continue its growth-by-acquisition program.
- PhyCor had the personnel and expertise to do the necessary due diligence on acquisitions to assure it was
acquiring only high-quality, profitable practices that could be quickly and effectively integrated into PhyCor's operations.

- The St. Petersburg/Suncoast Medical Group and Vancouver, Washington clinic acquisitions were proceeding on track and already yielding operational benefits.

- PhyCor was on track to post revenue and EPS growth of 30%-35% in FY97 and FY98.

32. On July 23, 1997, PhyCor issued a release, stating that PhyCor's "strong performance" drove the Company's "Record Second Quarter Results." The release stated:

Nashville, Tennessee, PhyCor, Inc. (Nasdaq/NM:PHYC) today announced record revenues and earnings for the second quarter and six months ended June 30, 1997.

Joseph C. Hutts, president and chief executive officer of PhyCor, said "We are very pleased with our second quarter results and our progress through the first half of 1997. The increasing recognition by physicians that a relationship with PhyCor helps empower them to achieve success in today's healthcare environment is driving our strong performance and continues to provide us with a robust pipeline of affiliation candidates."

For the second quarter of 1997, net revenues were $267.4 million, up 51% from $176.6 million a year ago. Net earnings for the quarter totaled $13.7 million, or $0.20 per share, on 68.2 million average shares outstanding, compared with $8.4 million, or $0.14 per share, on 60.7 million average shares outstanding in the prior-year period, representing increases of 63% and 43%, respectively. On a base of 31 clinics and 13 IPA markets, PhyCor's same market revenue increased 13.1% for the quarter and six months ended June 30, 1997, compared with the same periods in 1996.

For the first six months of 1997, net revenues were $518.0 million, up 53% from $339.1 million in the year-earlier period. Net earnings for the first half of year amounted to $26.0 million, or $0.39 per share, on 65.9 million average shares outstanding, compared with $16.1 million, or $0.27 per share, on 60.4 million average shares outstanding in the prior-year period, representing increases of 61% and 44%, respectively.

33. In connection with the release of PhyCor's results for the quarter ended July 23, 1997, defendants Hutts and Crawford
arranged a nationwide conference call from PhyCor's Nashville headquarters for securities analysts, large PhyCor shareholders and money managers, brokers and stock traders. During the conference call and in subsequent one-on-one conversations, defendants stated:

- PhyCor's net revenues had fallen short of analysts' estimates because of a fall off in acquisitions but the acquisition pipeline remained "strong" and PhyCor was in the final stages of completing several significant acquisitions.
- PhyCor's acquisition program was progressing successfully and the Company would add 900 physicians in 1997.
- PhyCor had the management expertise, MIS systems and accounting systems and controls necessary to permit it to continue its rapid growth-by-acquisition program.
- PhyCor had the personnel and expertise to complete necessary due diligence on acquisitions to assure it was acquiring only high-quality, profitable practices that could be quickly and effectively integrated into PhyCor.
- PhyCor was posting internal clinic growth of 10%-12%.
- PhyCor was continuing to see strong operating trends in its existing clinics, including its put-together clinics.
- PhyCor was continuing to grow rapidly both internally and via acquisitions and remained on track to post second half 1997 and FY98 EPS of $0.46 and $1.13-$1.15, respectively.

34. The statements made by defendants between April 22, 1997 and July 23, 1997 were each false and misleading when made. The true facts which were then known by each of the defendants, based upon their access to internal PhyCor data, were:

(a) That in order to keep up with its rapid pace of acquisitions, PhyCor was doing virtually no due diligence prior to making acquisitions, failing to obtain accurate and complete financial statements prior to completing these acquisitions;

(b) That contrary to its representations PhyCor lacked the management personnel and management information systems and
internal accounting controls necessary to permit it to integrate and operate the large number of acquisitions it was pursuing;

(c) PhyCor's business model was fundamentally flawed and did not work as it was not possible for PhyCor to assemble the practices it was acquiring into efficient organizations which were profitable and able to generate accurate financial information;

(d) PhyCor's internal accounting department was overwhelmed and thus ineffective. It did not have adequate personnel, systems or controls to monitor PhyCor's existing operations, let alone cope with the increasing number of acquisitions. As a result, PhyCor could not generate accurate financial statements for its local practices or the parent public company;

(e) PhyCor had undertaken its vastly accelerated acquisition program without performing a feasibility study to determine whether or not it would be capable of acquiring and then integrating into its operations the large number of practices it was acquiring and thus defendants knew it was likely that PhyCor would encounter serious problems in integrating those acquisitions;

(f) PhyCor did not have a business plan by which it would integrate its acquired operations into its business in a way to achieve economies of scale or generate the type of accurate information on a timely basis that PhyCor management needed to oversee those acquired businesses and manage them in a profitable manner;

(g) That certain of the practices being acquired by PhyCor had internal accounting and management information systems which were incompatible with those utilized by PhyCor and PhyCor
did not have software available which would permit those systems to effectively communicate with PhyCor's existing accounting/management information systems. As a result, defendants knew that the process of integrating the acquired businesses into PhyCor's operations was taking much longer and was much more expensive than was being publicly presented and that as a result, after acquisitions were completed, PhyCor was encountering serious and persistent difficulties in obtaining the type of accurate business and accounting information it needed from the acquired entities in order to manage those businesses, let alone integrate them into PhyCor's operations;

(h) That those physicians who were coming off PhyCor's two-year income guarantee program were receiving little or no compensation;

(i) That the Company's infrastructure was so inadequate that it was unable to: (i) complete basic administrative tasks, which tasks included sending out and collecting patient bills in a number of its important markets, including Florida and Arkansas; and (ii) employ a centralized computer system to communicate and/or refer patients to other physicians in the same medical group;

(j) That many of PhyCor's acquired practices were incurring decreasing revenue rather than growth, due to the ongoing disputes between the physicians and PhyCor, and were not producing the operating synergies and efficiencies claimed by defendants;

(k) That revenues from many of its "put-together," or group-formation clinics, those in Oklahoma, Jacksonville, Florida and Ft. Smith, Arkansas, were declining;
(l) That there was no strategic fit between the various "put-together" practices and they did not comprise a profitable mix of different kinds of practices;

(m) That more than 10% of PhyCor's clinics were essentially failures and were suffering from rapidly declining revenue, massive increases in doctor defections and/or were so impaired that PhyCor should have taken a charge to reflect the impairment;

(n) That at least 50% of the multi-specialty groups formed by PhyCor were imploding because of declining PhyCor income and mounting dissatisfaction;

(o) PhyCor's decision to create the "put-together" practices was motivated by PhyCor's determination to acquire any practice it could, regardless of the quality or strategic value of the practice because PhyCor's management knew the only way PhyCor could grow was by acquisition;

(p) As a result of the foregoing, PhyCor was not experiencing the acquisition synergies, efficiencies or cost savings represented by the defendants, but rather was having difficulty integrating the operations of acquired practices, which was having an adverse impact on PhyCor's FY97 results;

(q) That PhyCor's financial statements were completely unreliable and false for the reasons detailed in ¶¶55-70;

(r) As a result of the foregoing, there was no basis for the assurances that the acquisitions contained the potential for significant economies of scale or synergies of operations or that they would be accretive or non-dilutive to PhyCor's results during
1997 as, in truth, defendants actually knew these acquisitions were having an adverse impact on PhyCor's operations;

(s) The forecasts of 30%-35% EPS growth for PhyCor over the next several years were false, as they were aware of the adverse information set forth above which contradicted these forecasts; and

(t) As a result of the foregoing, defendants' forecasts that PhyCor would achieve EPS of $1.13-$1.15 in 1998, were false, as such EPS were impossible to achieve in light of these undisclosed problems.

35. On October 21, 1997, PhyCor issued a release announcing the Company's "Record Third Quarter Results." The release stated:

PhyCor, Inc. today announced record revenues and earnings for the third quarter and nine months ended September 30, 1997.

Joseph C. Hutts, president and chief executive officer of PhyCor, said, "We have completed another successful quarter of record financial results. Our momentum is building as we completed three clinic transactions in the third quarter and announced two additional affiliations this month. Our existing groups continued to grow by an additional 138 physicians during the quarter, and our independent practice associations (IPAs) added over 31,000 additional enrollees. Our development of new clinic and IPA opportunities continues to be strong as physicians throughout this country seek an affiliation with PhyCor."

For the third quarter of 1997, net revenues were $284.3 million, up 45% from $196.4 million a year ago. Net earnings for the quarter totaled $15.0 million, or $0.22 per share, on 69.1 million average shares outstanding, compared with $9.1 million, or $0.15 per share, on 60.8 million average shares outstanding in the prior-year period, representing increases of 65% and 47%, respectively.

For the nine months ended September 30, 1997, net revenues were $802.3 million, up 50% from $535.6 million in the year-earlier period. Net earnings for the period amounted to $41.1 million, or $0.61 per share, on 66.9 million average shares outstanding, compared with $25.2
million, or $0.42 per share, on 60.6 million average shares outstanding in the prior-year period, representing increases of 63% and 45%, respectively.

On a base of 31 clinics and 13 IPA markets, PhyCor's same market revenue increased 12.2% for the third quarter and 12.8% for the nine months ended September 30, 1997, compared with the same periods in 1996.

36. On October 29, 1997, PhyCor issued a release announcing an agreement whereby PhyCor would issue 236 million shares in connection with an $8 billion acquisition of MedPartners, the country's largest PPM. The release stated:

The Board of Directors of PhyCor, Inc. and MedPartners, Inc. today unanimously approved a definitive agreement under which PhyCor would acquire MedPartners, forming a nationwide physician management company with revenues of more than $8.4 billion. Under the terms of the agreement, holders of MedPartners common stock will receive a fixed ratio of 1.18 shares of PhyCor stock for each MedPartners share held. The transaction is valued at approximately $8.0 billion including the assumption of $1.2 billion of debt. The transaction is expected to be accounted for as a pooling-of-interests and to be treated as a tax-free exchange. It is subject to the approval of shareholders of both companies, various state and Federal regulatory agencies, and other customary conditions. Closing of the transaction is anticipated in the first quarter of 1998.

The combined company will operate in all 50 of the United States and will be affiliated with approximately 35,000 physicians. In addition, the combined company will serve more than three million patients under prepaid health plans.

"This is an extraordinary and unique opportunity," said Joseph C. Hutts, chairman, president and chief executive officer of PhyCor. "The purpose of PhyCor has always been to make a fundamental contribution to our healthcare system. This combination positions us to attain our goal. Despite the combining of the two largest physician management companies, we will only represent approximately 5% of all physicians in America. We have plenty of work to do. In an increasingly competitive environment, physicians need organizational strength and resources to make a positive difference in healthcare cost and quality. This transaction creates the most compelling physician organization in our nation -- one that meets the needs of physicians, employers, payors, and especially patients."
37. In connection with the October 29, 1997 announcement by PhyCor that it was acquiring MedPartners, the country's largest PPM, defendants Crawford and Hutts organized a nationwide conference from PhyCor's Nashville headquarters for securities analysts, money managers, large PhyCor shareholders, brokers and stock traders. During the conference call and in subsequent one-on-one conversations, defendants represented that:

- PhyCor's momentum was accelerating going into 4thQ 97 and 1998.
- Defendants were "very excited" about PhyCor's strong acquisition pipeline for 4thQ 97 and FY98.
- PhyCor's put-together/start-up clinics were gaining momentum.
- The MedPartners acquisition would be accretive to PhyCor's 1998 EPS.
- That the combined entity would generate 1998 EPS of $1.25.
- That PhyCor would obtain pre-tax cost savings from the merger of $40-$50 million.

38. The market was stunned by this attempt by defendant Hutts to acquire the much larger MedPartners, as MedPartners' CEO Larry House had been severely criticized by market analysts for his haphazard acquisition of physician practices. The market reacted to what it perceived to be defendant Hutts' desperate effort to attempt to deliver 30+% revenue growth regardless of the consequences, by sending the price of PhyCor stock tumbling almost 20%.

39. The statements made by defendants in October 1997 were each false and misleading when made. The true facts which were then known by or available to the defendants, based upon their access to internal PhyCor data, included:
(a) That PhyCor lacked the management personnel and management information systems and internal accounting controls necessary to permit it to integrate and operate the large number of acquisitions it was pursuing;

(b) That certain of the practices being acquired by PhyCor had internal accounting and management information systems which were incompatible with those utilized by PhyCor, and PhyCor did not have software available which would permit those systems to effectively communicate with PhyCor's existing accounting/management information systems. As a result, defendants knew that the process of integrating the acquired businesses into PhyCor's operations was taking much longer and was much more expensive than was being publicly presented and that as a result, after acquisitions were completed PhyCor was encountering serious and persistent difficulties in obtaining the type of accurate business and accounting information it needed from the acquired entities in order to manage those businesses, let alone integrate them into PhyCor's operations;

(c) That PhyCor's MIS systems were so inadequate PhyCor was failing to bill patients at its clinics, including those in Ft. Smith, Arkansas and Ft. Lauderdale, Florida, and was improperly submitting bills to third-party payors, resulting in nonpayment and/or rejection;

(d) That as many as 50% of the physicians at certain PhyCor clinics, including clinics in Florida, Oklahoma and Arkansas, had left and/or threatened to leave PhyCor because of: (i) PhyCor's unwillingness and/or inability to provide promised infrastructure investments; (ii) PhyCor's declining doctor
salaries; and (iii) PhyCor's inadequate infrastructure which rendered PhyCor unable to generate timely billing data, causing PhyCor clinics to send out patient bills as much as six months late, if at all;

(e) That PhyCor's lack of corporate infrastructure was so pervasive that PhyCor was unable to even generate paychecks for its employees and had designated certain PhyCor employees with the sole task of finding "lost money";

(f) That the Vancouver Clinic, acquired by Phycor in February 1997, was suffering markedly declining operating income and was having an adverse impact on Phycor's operations;

(g) That Phycor's infrastructure was so inadequate that many of Phycor's put-together clinics lacked a centralized computer system to allow communication and/or referral to other physicians in the same group;

(h) That Phycor was inflating its net income and EPS by amortizing the value of the non-real estate intangibles acquired by Phycor (i.e., management service agreements) over 40 years despite the fact that defendants knew that most physicians who contracted with Phycor were bound by non-compete agreements of approximately 3-5 years and the SEC was forcing PPMs then in registration to adopt amortization schedules of 25 years;

(i) That Phycor was artificially inflating its EPS by paying huge up-front payments and then amortizing the portion of the purchase price in excess of book value -- over 40 years. Although this practice boosted EPS, it was causing doctors to defect as physicians were suffering from earnings declines because
PhyCor was beginning to demand huge management fees in order to offset the high upfront payments;

(j) Many of PhyCor's acquired practices, including those in Florida, Washington and Arkansas, were experiencing decreasing revenues rather than growth due to the lack of synergies and efficiencies, as well as the ongoing disputes between the practices and PhyCor, which was resulting in physician defections and legal actions against PhyCor;

(k) That more than 10% of PhyCor's clinics were essentially a failure and were suffering from rapidly declining revenue, massive increases in doctor defections and/or were so impaired that PhyCor should have taken a charge to reflect the impairment;

(l) That at least 50% of the multi-specialty groups formed by PhyCor were imploding because of declining PhyCor income and mounting dissatisfaction;

(m) PhyCor had undertaken its vastly accelerated acquisition program without performing a feasibility study to determine whether or not it would be capable of acquiring and then integrating into its operations the large number of hospital and laboratory facilities it was acquiring and thus defendants knew it was likely that PhyCor would encounter serious problems in integrating those acquisitions;

(n) PhyCor did not have a business plan by which it would integrate its acquired operations into its business in a way to achieve economies of scale or generate the type of accurate information on a timely basis that PhyCor management needed to
oversee those acquired businesses and manage them in a profitable manner;

(o) PhyCor's reported financial results were materially false and misleading as detailed in ¶¶55-70;

(p) As a result of the foregoing, there was no basis for the assurances that the acquisitions contained the potential for significant economies of scale or synergies of operations or that they would be accretive or non-dilutive to PhyCor's results during 1997 as, in truth, defendants actually knew these acquisitions would badly hurt PhyCor's results from operations;

(q) The forecasts of 30%-35% EPS growth for PhyCor over the next several years were false, as they were aware of the adverse information set forth above which contradicted these forecasts;

(r) As a result of the foregoing, defendants' forecasts that PhyCor would achieve EPS of $1.13-$1.15 in 1998, were false, as such EPS were impossible to achieve in light of these undisclosed problems;

(s) That defendants were aware that PhyCor could not possibly post 1998 EPS of $1.13+ given increasing pressure being placed upon PhyCor by physicians, including those in Arkansas and Florida; and

(t) As a result of the foregoing, there was no basis for the assurances that the acquisitions contained the potential for significant economies or synergies of operations or that they would be accretive PhyCor's 1998 results.

40. Despite realizing MedPartners was a dog that just could not hunt, PhyCor desperately needed to close the MedPartners
transaction in order to generate the revenue and EPS growth promised to Wall Street. However, the further the Individual Defendant dug into the MedPartners organization, the more they realized that MedPartners was so riddled with fraud and incompetence, that PhyCor -- as desperate as it was -- could not risk closing the MedPartners acquisition. By December 1997, it became apparent that PhyCor could not risk completing the MedPartners acquisition and defendant Hutts quickly arranged the purchase of several smaller companies to provide PhyCor with the growth promised to Wall Street.

41. On December 10, 1997, defendant Hutts confirmed to Tennessean reporter Julie Bell that defendants "'expect to do the transaction. We want to do the transaction. We think we will.'"

42. On December 22, 1997, PhyCor announced that it would acquire First Physician Care, Inc. ("FPC") in exchange for PhyCor stock. FPC was a leading private PPM with 217 providers and operations in seven markets in Texas, Florida, Illinois, New York and Georgia.

43. On December 23, 1997, PhyCor announced a stock-for-stock acquisition of CareWise, Inc., a Seattle-based provider of healthcare decision-support services.

44. On January 7, 1998, PhyCor issued a release announcing the termination of the merger between PhyCor and MedPartners, claiming that "'[a]fter a lengthy review and planning process, we determined due to significant operational and strategic differences we would be unable to successfully and effectively integrate the two companies.'" Hutts went on to state that "'MedPartners is a
very well managed company with tremendous management talent, and I feel sure it will continue to be very successful in the future.'"

45. On January 8, 1998, defendant Hutts participated in a telephone interview from PhyCor's Nashville headquarters with Kathleen Sullivan of Bloomberg Business News. Defendant Hutts represented:

KATHLEEN SULLIVAN: Now that this MedPartners acquisition has been put aside, what alternatives do you see for PhyCor being able to do that?

JOSEPH HUTTS: Well we've come out of this process with renewed excitement about our company, our strategy and our prospects. We end also with very, very strong momentum. During the, actually the time of this quarter that we've been involved in these discussions, we've completed transactions with four clinics, we also have a definitive agreement to acquire another private physician practice management company and a healthcare decision support company. So we have very real momentum, we have a full pipeline, and we'll continue on the very, very strong path that we've been on. . . . So I think you'll see PhyCor to be on the aggressive path that has been and just with some, perhaps added momentum and added opportunities.

    * * *

KATHLEEN SULLIVAN: The shares have dipped a little bit this morning. There appears to be some concern, certainly about 1999 earnings estimates. What can you say to investors out there to reassure them?

JOSEPH HUTTS: We're comfortable with the range of expectations that are on the Street for the fourth quarter and for 1998 and I would expect that you'll see us finish up to that. I wouldn't know of any other reason that we wouldn't.
On January 12, 1998, PhyCor issued a release announcing nonrecurring charges related to merger expenses, asset revaluations and "Operational Restructuring Activities." The release stated:

NASHVILLE, Tenn.--(BUSINESS WIRE)--Jan. 12, 1998--PhyCor, Inc. (Nasdaq/NM:PHYC) announced today that it anticipates recording, in the first quarter of 1998, a pre-tax charge to earnings of approximately $15 million relating to its recently terminated merger with MedPartners, Inc. (NYSE:MDM). The Company also announced plans to restructure five of its multi-specialty clinic operations with approximately 300 physicians and provide for the potential sale or closure of two additional clinics with approximately 70 physicians.

In connection with these plans, the Company anticipates recording a pre-tax charge for asset revaluation of approximately $83 million in the fourth quarter of 1997, of which approximately $70 million represents intangible asset value. In addition, the Company expects to incur approximately $22 million in the first quarter of 1998 in pre-tax restructuring charges relating to anticipated costs which are to provide for consolidating facilities and clinic operations and to reduce overhead costs.

Exclusive of these nonrecurring costs, these restructuring plans are not expected to adversely affect the Company's earnings targets for either 1997 or 1998.

"These plans involve clinics that represent less than 6% of PhyCor's operating income for the nine months ended September 30, 1997, and the total charges, net of taxes, represent approximately 5% of total assets as of the end of the third quarter of 1997," commented John K. Crawford, chief financial officer of PhyCor.

"Given the uncertainty surrounding the termination of our merger discussions, we felt it was important to announce these plans and actions as early as possible and to confirm our strong expectations for 1997 and 1998 earnings," said Joseph C. Hutts, president and chief executive officer of PhyCor. "These restructured groups primarily represent first generation attempts at new group formations. These plans address problems that have developed in these markets, but we modified our approach early and have, for some time, been successful in the formation of several new groups. Overall, our operations are sound, our pipeline is strong, our people are confident, and we feel we are positioned to lead this facet of the health field and make a difference in our healthcare system," concluded Hutts.
47. On January 12, 1998, in connection with the announcement of the termination of the PhyCor/MedPartners merger, defendants Crawford and Hutts convened a nationwide conference call from PhyCor's Nashville headquarters for securities analysts, portfolio managers, brokers, stock traders and large PhyCor shareholders. During the conference call and in one-on-one follow-up conversations, these defendants stated:

- PhyCor's attempt to construct clinics by aggregating individual practices had not been a complete success.

- $15 million was related to expenses associated with the cancelled merger and the remaining $105 million of restructuring expenses were linked to only five of the Company's 55 clinics and that the problems attributable thereto had been "solved."

- PhyCor's operating earnings remained "on track" and PhyCor remained on target to post 4Q97 EPS of $.23-.24 and FY98 EPS of $1.10-$1.15 per share, excluding charges.

- PhyCor was not having any material problems with the remainder of its put-together clinics.

48. Investors and securities analysts were surprised by the termination of the merger and PhyCor's stock price responded by falling 15%. However, PhyCor's Executive Vice President Wright assured investors that the Company's decision to take a $120 million writeoff was a proactive maneuver designed to "get everything out in front of our investment community." With respect to PhyCor's attempts to form five multi-specialty clinics, Wright admitted that "we knew it was a difficult proposition." Wright further admitted that defendants had "quite frankly made some mistakes," but assured investors that PhyCor had "corrected those" mistakes. PhyCor shares continued to trade at artificially inflated levels throughout the remainder of the Class Period as defendants maintained the Company's operations and earnings
prospects remained strong. Consequently, the statements made by defendants between December 10, 1997 and January 12, 1998, including those made in connection with the unraveling of the PhyCor/MedPartners transaction, were each false and misleading when made. The true facts which were then known by or available to defendants based upon their access to internal PhyCor data were:

(a) That PhyCor was unable to successfully convert the cash basis accounting systems used by the practices it acquired to the accrual accounting methods necessary for PhyCor to prepare accrual financial statements conforming with both Generally Accepted Accounting Principles ("GAAP") and SEC regulations;

(b) That defendants were aware that PhyCor could not possibly post 1998 EPS of $1.10-$1.15, given increasing pressure being placed upon PhyCor by physicians with 15+% management fee agreements, including those in Arkansas and Florida;

(c) That PhyCor was not reinvesting back into its acquired clinics anywhere near the amount or at the rate represented by defendants in connection with their purchases of acquired practices;

(d) That, in a desperate attempt to control practice costs, PhyCor was terminating key employees at the clinic level which was further aggravating the billing problems experienced by PhyCor;

(e) That PhyCor's MIS systems were so inadequate PhyCor was unable to generate timely or accurate patient billings at many of its clinics, including those in Ft. Smith, Arkansas and Ft. Lauderdale, Florida, and was improperly submitting bills to third-party payors, resulting in nonpayment and/or rejection;
(f) That as many as 50% of the physicians at certain PhyCor clinics, including clinics in Florida, Oklahoma and Arkansas, had left and/or threatened to leave PhyCor because of:
(i) PhyCor's unwillingness and/or inability to provide promised infrastructure investments; (ii) declining physician salaries; and (iii) PhyCor's inadequate infrastructure which rendered PhyCor unable to generate timely billing data, causing PhyCor clinics to send out patient bills as much as six months late, if at all;

(g) That the Vancouver Clinic, acquired by PhyCor in February 1997, was suffering markedly declining operating income and was having an adverse impact on PhyCor's operations;

(h) That revenues from many of its "start-up" or "put-together" clinics, including those in Oklahoma and Jacksonville, Florida, were declining;

(i) That many of PhyCor's acquired practices, including those in Florida, Washington and Arkansas, were experiencing decreasing revenues rather than growth, due to the lack of synergies and efficiencies, as well as the ongoing disputes between the practices and PhyCor, which was resulting in physician defections and legal actions against PhyCor;

(j) That by 3Q97, defendants had been apprised by physicians at the Holt-Krock clinic that they would drop their affiliation with PhyCor, which meant that PhyCor would have to accept the sale of Holt-Krock back to the physicians at a discount or engage in a lengthy legal battle with its physicians;

(k) That the Company's infrastructure was so inadequate that many of PhyCor's put-together clinics were unable to use a centralized computer system to communicate and/or refer patients to
other physicians in the same group and/or were unable to complete basic administrative tasks, including sending out and collecting bills;

(1) That PhyCor was inflating its net income and EPS by amortizing the value of the non-real estate intangibles acquired by PhyCor (i.e., management service agreements) over 40 years despite the fact that defendants knew that most physicians who contracted with PhyCor were bound by non-compete agreements of approximately 3-5 years and the SEC was forcing PPMs then in registration to adopt amortization schedules of 25 years;

(m) That PhyCor's reported financial results were materially false and misleading as described in ¶¶55-70;

(n) That defendants were aware that PhyCor's "start-up" practices lacked internal MIS systems to properly report information to PhyCor and had been unable to meet operational and financial targets set by PhyCor;

(o) That PhyCor's business model was fundamentally flawed and did not work as it was not possible for PhyCor to assemble the practices it was acquiring into efficient organizations which were profitable and able to generate accurate financial information; and

(p) The forecasts of 30%-35% EPS growth for PhyCor over the next several years were false, as they were impossible to achieve in light of these undisclosed problems and defendants aware of the adverse information set forth above which contradicted these forecasts.

49. On February 19, 1998, PhyCor issued a release announcing the Company's 1997 results. The release stated:
PhyCor, Inc. today announced revenues and earnings for the fourth quarter and year ended December 31, 1997.

Joseph C. Huts, president and chief executive officer of PhyCor, said, "Calendar year 1997 was a significant and turbulent year for PhyCor, that included significant new affiliations with outstanding medical groups and physicians in independent practice associations, plus growth in existing operations. Early in the fourth quarter, we announced a major strategic move to acquire MedPartners, but terminated the transaction in early 1998. We also announced a nonrecurring charge to restructure five of our first "newly formed" groups and the sale of two existing small clinics. Notwithstanding the merger termination and restructuring efforts, we feel we have emerged with increased momentum and opportunity. Our pipeline is strong, our operations are sound, and we have solid confidence in the future of our company."

For the fourth quarter, net revenues were $317.3 million, up 37% from $230.8 million a year ago. Net earnings for the quarter, before the nonrecurring charge, totaled $16.0 million, or $0.24 per share - diluted, on 67.7 million shares outstanding ($0.25 per share - basic, on 64.5 million shares outstanding), compared with net earnings of $11.2 million, or $0.18 per share - diluted, on 62.1 million shares outstanding ($0.20 per share - basic, on 54.8 million shares outstanding), in the prior year period, increases of 43% and 33% on a diluted basis, respectively. Net loss for the quarter, including the nonrecurring charge, totaled $37.8 million, or $0.59 per share - diluted.

For the year ended December 31, 1997, net revenues were $1.12 billion, up 46% from $766.3 in the prior year. Net earnings for 1997, before the nonrecurring charge, totaled $57.0 million, or 0.85 per share - diluted, on 69.9 million shares outstanding ($0.91 per share - basic, on 62.9 million shares outstanding), compared with net earnings of $36.4 million, or $0.60 per share - diluted, on 61.1 million shares outstanding ($0.67 per share - basic, on 54.8 million shares outstanding) in the prior year, representing increases of 57% and 42% on a diluted basis, respectively. Net earnings for 1997, including the nonrecurring charge, totaled $3.2 million, or $0.05 per share - diluted.

As announced in January, PhyCor expects to record, in the first quarter of 1998, a pre-tax charge to earnings of approximately $15 million relating to the terminated merger with MedPartners, Inc. (NYSE:MDM). The Company also announced plans to restructure five of its multi-specialty clinic operations with approximately 300 physicians and provide for the potential divestiture of
two additional clinics with approximately 70 physicians. In connection with these plans, the Company recorded a pre-tax charge for asset revaluation of $83 million in the fourth quarter of 1997. In addition, the Company expects to incur approximately $22 million in the first quarter of 1998 in pre-tax restructuring charges relating to anticipated costs which are to provide for consolidating facilities and clinic operations and reduce overhead costs.

50. On April 22, 1998, PhyCor issued a release announcing the Company's results for 1Q98. For the first time, defendants admitted that certain of the Company's multi-specialty clinics were failing, but continued to conceal the fact that scores of physicians had informed PhyCor that they would be filing suit against PhyCor, and that PhyCor had taken an inadequate reserve to reflect the problems PhyCor was experiencing with its "put-together" clinics. The release also disclosed for the first time that PhyCor would be revising its accounting practices such that PhyCor would no longer be amortizing the cost of its practice management contracts over 40 years. The release stated:

PhyCor, Inc. today announced revenues and operating results for the first quarter ended March 31, 1998.

Joseph C. Hutts, president and chief executive officer of PhyCor, said, "Our first quarter was challenging, particularly with the termination of our merger with MedPartners. At the termination of this merger, we announced one-time charges to earnings to allow us, primarily, to address some mistakes with 'new group formations.' These charges somewhat cloud what I consider solid operating results. They also added to the confusion surrounding our merger termination and concerns about the physician practice management industry. We have a very full pipeline of transactions and expect to consummate several strong agreements in the second quarter. However, because of this industry confusion and several factors relating to timing of acquisitions; timing of improvements of our restructured operations; and a potential change in amortization of our intangible assets, we currently estimate that our 1998 full year's earnings per share, before nonrecurring charges, will increase between 25% to 30% over the comparable amount in 1997.
"We expect to be well positioned for a strong 1999, with the potential for growth of approximately 30%. We are more confident about our long-term future than at any time, and we have never been more intensely focused."

For the first quarter, net revenues were $322.7 million, up 29% from $250.7 million a year ago. As previously announced, the Company recorded a pre-tax charge to earnings in the first quarter of 1998 of approximately $14 million relating to the terminated merger with MedPartners, Inc. (NYSE:MDM) and $22 million in pre-tax restructuring charges relating to costs to provide for consolidating facilities and clinic operations and reduce overhead costs. Net earnings for the quarter, before the pre-tax charges, totaled $16.0 million, or $0.24 per share - diluted, on 67.9 million shares outstanding ($0.25 per share - basic, on 64.9 million shares outstanding), compared with net earnings of $12.3 million, or $0.19 per share - diluted on 63.5 million average shares outstanding ($0.21 per share - basic, on 58.4 million shares outstanding), in the prior year period, increases of 30% and 26% on a diluted basis, respectively. Net loss for the first quarter of 1998, including nonrecurring charges, totaled $7.5 million, or $0.12 per share - diluted.

On a base of 39 clinic and 27 IPA markets, PhyCor's same market revenue increased 10.8% for the quarter ended March 31, 1998, compared with the same period in 1997.

On April 22, 1998, in connection with the release of the Company's financial results for the quarter ended March 31, 1998, defendants Hutts and Crawford arranged a nationwide conference call from the Company's Nashville headquarters for securities analysts, portfolio managers, brokers and large PhyCor shareholders. During the conference call and in follow-up one-on-one conversations, these defendants stated:

- PhyCor might prospectively begin utilizing a 25-year amortization schedule for intangible assets which would have the effect of slightly reducing PhyCor's future net income and EPS.
- PhyCor was "taking advantage" of the changing competitive landscape to reduce its upfront lump payments which in turn would enable PhyCor to charge a lower management fee going forward.
• PhyCor remained on track to post 1998 EPS growth of 25%-30%.
• PhyCor would post 1998 and 1999 EPS of $1.08 and $1.40, respectively.

52. On April 27, 1998, PhyCor issued a release announcing a change in its amortization policy. The release stated:

NASHVILLE, Tenn.--(BUSINESS WIRE)--April 27, 1998--PhyCor, Inc. (Nasdaq/NM:PHYC) today announced that it is changing, effective April 1, 1998, its policies regarding amortization of its intangible assets in order to recognize the impact of various events and trends relating to the physician practice management segment of the health care industry.

The Company is adopting a maximum of 25 years as the useful life for amortization of its intangible assets, which are primarily comprised of costs of service agreements. These costs have historically been charged to expense through amortization using the straight line method over the periods during which the agreements are effective, generally from 30 to 40 years.

Joseph C. Hutts, president and chief executive officer of PhyCor, said, "This action does not reflect in any way a change in our estimate of the value and expected duration of our relationships with physicians in groups and IPAs. In fact, this is an accounting event that will result in a more conservative and accelerated recognition of costs associated with forming these relationships."

John K. Crawford, executive vice president and chief financial officer of PhyCor, said, "This action is being taken at this time in order to address issues and concerns that have been raised in recent months within our industry and relates more to overall industry factors as opposed to issues that are unique to PhyCor. We have been contemplating a potential change to a shorter term of amortization and, until last Friday, had expected to prospectively effect a change relating to assets which we expect to acquire in 1998 and subsequent years. However, taking into account all the current facts and circumstances, we are obliged to apply the shorter term retrospectively to all of the Company's intangible assets, including those acquired in prior years.

"This change represents a change in accounting estimate and, accordingly, does not require the Company to restate reported results for prior years. We expect this estimate change to increase amortization expense relating to existing intangible assets at March 31, 1998,
by an estimated $3.3 million in each of the three remaining quarters of 1998. Assuming a tax rate of 37% and projected diluted shares outstanding, this would result in a reduction in diluted earnings per share of approximately $0.08 in 1998. It is important to point out that this represents a reduction in 'accounting earnings' and that this change does not impact PhyCor's cash flows or negatively impact the Company's operations.

* * *

Mr. Hutts, concluded, "Although we regret any reduction in our earnings, even a non-cash event, we are very well positioned to accept this change and continue our rapid growth. We have continued to evolve our affiliation model, mainly focusing on improving our long-term relationships with physicians and continuing to align our mutual incentives. We expect these model innovations to yield numerous benefits to the Company including, potentially, a reduction in intangible assets associated with an affiliation with physicians. We are exploring alternative approaches to provide for the capital needs of physician organizations, and, if we are successful, this change in amortization periods will have a diminished impact on the Company in the future."

53. On April 30, 1998, based upon the representations defendants Hutts and Crawford made to analysts on or about April 27, 1998, Merrill Lynch analyst Kenneth Weakley upgraded his rating on PhyCor to a "strong buy." Moreover, based upon the assurances of Crawford and Hutts that PhyCor would "meet or exceed" EPS estimates of at least $1.00 and $1.27 for FY98 and FY99, respectively, the report stated:

Recently, the downward pressure on PHYC's stock has intensified, due in part to reduced expectations for growth and an accounting change that resulted in lower EPS. In addition, with its fourth and first quarter restructuring charges, the stock has lost some of its luster. We believe that all of the "bad" news for PHYC is out, and that investor sentiment has reached a low. We put "bad" in quotes because, despite the announcements, we believe that PHYC can still grow earnings between 25% and 30% over the next year or two, and at a 25% clip longer term. We believe that PHYC's recent announcements will serve to stabilize expectations.
Consistent Results: After speaking with the company, we are very confident that results for the balance of the year will meet or exceed expectations. This, in turn, should boost confidence in longer term prospects.

Acquisition Pipeline is Very Attractive: We believe that PHYC's acquisition pipeline is as attractive as ever. With other companies focused more on internal developments, PHYC is likely to get its pick in terms of acquisitions (and at a more reasonable price).

54. On June 2, 1998, an article written by Julie Bell appeared in the Tennessean. The article quoted defendant Hutts as stating that he "expects earnings-per-share growth of 25%-30% this year."

55. The statements made by defendants between February 19, 1998 and June 1998 were each false and misleading when made. The true facts which were then known by or available to the defendants based upon their access to internal PhyCor data were:

   (a) That in order to keep up with its rapid pace of acquisitions, PhyCor was doing virtually no due diligence prior to making acquisitions, failing to obtain accurate and complete financial statements prior to completing these acquisitions;

   (b) That contrary to its representations, PhyCor lacked the management personnel and management information systems and internal accounting controls necessary to permit it to integrate and operate the large number of acquisitions it was pursuing;

   (c) That certain of the practices being formed and/or created by PhyCor had internal accounting and management information systems which were incompatible with those utilized by PhyCor and PhyCor did not have software available which would permit those systems to effectively communicate with PhyCor's existing accounting/management information systems. As a result,
defendants knew that the process of integrating the acquired businesses into PhyCor's operations was taking much longer and was much more expensive than was being publicly presented and that as a result, after acquisitions were completed PhyCor was encountering serious and persistent difficulties in obtaining the type of accurate business and accounting information it needed from the acquired entities in order to manage those businesses, let alone integrate them into PhyCor's operations;

(d) PhyCor's internal accounting department was overwhelmed and ineffective, as it lacked adequate personnel, systems or controls to monitor PhyCor's existing operations, let alone cope with the increasing number of acquisitions;

(e) That many of PhyCor's acquired practices were incurring decreasing revenue rather than growth, due to the ongoing disputes between the physician and PhyCor, and were not producing the operating synergies and efficiencies claimed by defendants;

(f) That defendants were aware that PhyCor could not possibly post 1998 EPS of $0.95-$1.00;

(g) That PhyCor was on the verge of bankruptcy and had created contingency plans in consideration thereof;

(h) That PhyCor was not reinvesting back into its acquired clinics anywhere near the amount or at the rate represented by defendants in connection with their purchases of acquired practices;

(i) That, in a desperate attempt to control practice costs, PhyCor was terminating key employees at the clinic level which was further aggravating the billing problems experienced by PhyCor;
(j) That PhyCor's MIS systems were so inadequate that PhyCor was failing to bill patients at its clinics, including those in Ft. Smith, Arkansas and Ft. Lauderdale, Florida, and was improperly submitting bills to third-party payors, resulting in nonpayment and/or rejection;

(k) That because PhyCor was requiring the payment of 15%-20% management fees, physician take-home pay was declining and clinics were not being provided with the necessary funds to make infrastructure investments to remain competitive;

(l) That many of PhyCor's clinics, including Vancouver and First Coast, were suffering reimbursement declines during the last half of 1997 and the first half of 1998;

(m) That as many as 50% of the physicians at certain PhyCor clinics, including clinics in Florida, Oklahoma and Arkansas, had left and/or threatened to leave PhyCor because of: (i) PhyCor's unwillingness and/or inability to provide promised infrastructure investments; (ii) PhyCor's declining doctor salaries; and (iii) PhyCor's inadequate infrastructure which rendered PhyCor unable to generate timely billing data, causing PhyCor clinics to send out patient bills as much as six months late, if at all;

(i) That PhyCor's financial condition was so bad that at certain of its facilities, including the Jacksonville clinics, PhyCor was unable to even pay for basic services which was resulting in the cancellation of those services;

(n) That many physicians who were no longer entitled to IDP were receiving little or no compensation from PhyCor;
(o) That the Vancouver Clinic, acquired by Phycor in February 1997, was suffering markedly declining operating income and was having an adverse impact on Phycor's operations;

(p) That PhyCor's lack of corporate infrastructure was so pervasive that PhyCor was unable to even generate paychecks for its employees and had designated certain employees with the sole task of finding "lost money";

(q) That by January 1998, PhyCor's MIS systems were in such disarray that Hutts and Crawford had hired a Boston-based consultant, Hunnington Group, to reconfigure PhyCor's MIS systems;

(r) That defendants were aware that PhyCor's group-formation clinics lacked internal MIS systems to properly report information to PhyCor and had been unable to meet operational and financial targets set by PhyCor;

(s) That PhyCor was operating in violation of applicable federal and state health laws;

(t) That Phycor was inflating its net income and EPS by amortizing the value of the non-real estate intangibles acquired by Phycor (i.e., management service agreements) over 40 years despite the fact that defendants knew that most physicians who contracted with Phycor were bound by non-compete agreements of approximately 3-5 years and the SEC was forcing PPMs then in registration to adopt amortization schedules of 25 years;

(u) That the SEC was subjecting PhyCor's improper accounting practices to strict scrutiny which was rendering it impossible for Phycor to close acquisitions in a manner that would allow Phycor to post 1998 EPS of $1.00;
(v) That many of PhyCor's acquired practices, including those in Florida, Washington and Arkansas, were experiencing decreasing revenues rather than growth, due to the lack of synergies and efficiencies, as well as the ongoing disputes between the practices and PhyCor, which was resulting in physician defections and legal actions against PhyCor;

(w) That at least 50% of the multi-specialty groups formed by PhyCor were imploding because of declining PhyCor income and mounting dissatisfaction;

(x) PhyCor's business model was fundamentally flawed and did not work as it was not possible for PhyCor to assemble the practices it was acquiring into efficient organizations which were profitable and able to generate accurate financial information;

(y) PhyCor did not have a business plan by which it would integrate its acquired operations into its business in a way to achieve economies of scale or generate the type of accurate information on a timely basis that PhyCor management needed to oversee those acquired businesses and manage them in a profitable manner;

(z) As a result of the foregoing, PhyCor was not experiencing the acquisition synergies, efficiencies or cost savings represented by the defendants, but rather was having difficulty integrating the operations of acquired practices, which was leading to increased costs and deteriorating revenue growth, which was hurting PhyCor's 1998 results;

(aa) As a result of the foregoing, there was no basis for the assurances that the acquisitions contained the potential for
significant economies or synergies of operations or that they would be accretive PhyCor's 1998 results; and

(b) As a result of the foregoing, defendants' forecasts that PhyCor would achieve EPS of $0.95-$1.00 in 1998 were known by defendants to be false, as they were impossible to achieve in light of these undisclosed problems.

56. On July 23, 1998, PhyCor stunned beleaguered shareholders and securities analysts, announcing that despite assurances that it had been experiencing "very, very strong momentum," that PhyCor's operations were "sound" and that PhyCor's 1998 EPS would "increase between 25% to 30% over the comparable amount in 1997," PhyCor would be taking another pre-tax asset impairment charge of approximately $65 million in 1998. Shell-shocked PhyCor investors watched in disbelief as the price of PhyCor dropped by almost 40% to less than $9 per share on a huge volume of more than 20 million shares, erasing more than $300 million of PhyCor's market value in a single day!

FALSE FINANCIAL STATEMENTS

57. In order to overstate its net income and EPS during the Class Period, the defendants caused the Company to violate GAAP and SEC rules by failing to record required write-downs of its intangible assets associated with its group-formation physician operations and by improperly amortizing intangible assets over an unreasonably long period of time, 40 years.
58. PhyCor reported the following financial results for 1997 and the 1stQ of 1998:

<table>
<thead>
<tr>
<th></th>
<th>Q197</th>
<th>Q297</th>
<th>Q397</th>
<th>Q497*</th>
<th>Q198*</th>
</tr>
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<tbody>
<tr>
<td>Net Income</td>
<td>$12.3M</td>
<td>$13.7M</td>
<td>$15.0M</td>
<td>$16.0M</td>
<td>$16.0M</td>
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<tr>
<td>EPS</td>
<td>$.19</td>
<td>$.20</td>
<td>$.22</td>
<td>$.24</td>
<td>$.24</td>
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</tbody>
</table>

*Excluding merger charges.

59. PhyCor later included the interim 1997 and 1998 results in Form 10-Q's filed with the SEC. The Form 10-Q's represented the following:

In the opinion of management, the unaudited interim consolidated financial statements contained in this report reflect all adjustments, consisting of only normal recurring accruals, which are necessary for a fair presentation of the financial position and the results of operations for the interim periods presented.

60. This statement was false and misleading as to the financial information included in the Form 10-Q's, as such financial information, as well as the financial results for the year ended December 31, 1997 was not prepared in conformity with GAAP, nor was the financial information "a fair presentation" of the Company's operations due to the Company's improper accounting for intangible assets associated with the acquisition of practices, particularly those included in the group-formation operations, causing the financial results to be presented in violation of GAAP and SEC rules.

61. GAAP are those principles recognized by the accounting profession as the conventions, rules and procedures necessary to define accepted accounting practice at a particular time. Regulation S-X (17 C.F.R. §210.4-01(a)(1)) states that financial statements filed with the SEC which are not prepared in compliance
with GAAP are presumed to be misleading and inaccurate. Regulation S-X requires that interim financial statements must also comply with GAAP, with the exception that interim financial statements need not include disclosure which would be duplicative of disclosures accompanying annual financial statements. 17 C.F.R. §210.10-01(a).

62. Moreover, pursuant to §13(b)(2) of the Securities Exchange Act of 1934, PhyCor was required to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer[,] and . . . devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that -- (i) transactions are executed in accordance with management's general or specific authorization; transactions are recorded as necessary (I) to permit the preparation of financial statements in conformity with generally accepted accounting principles . . . ."

63. During the Class Period, the single largest item on PhyCor's balance sheet was Intangible Assets, which are primarily costs of service agreements which PhyCor had signed with physicians. Because Intangible Assets were such a significant part of PhyCor's financial statements, comprising more than half of total assets, the accounting treatment for them was crucial to the proper and accurate determination of PhyCor's net income. Thus, by failing to properly value these assets and by choosing an unreasonably long amortization period for Intangible Assets, PhyCor's management was able to materially overstate the Company's earnings during the Class Period.
64. GAAP, as set forth in FASB Statement of Concepts No. 5, requires that a loss be accrued for assets whose future economic benefits have been reduced or eliminated. Concepts No. 5, ¶83. GAAP, as set forth in FASB Statement of Financial Accounting Standard No. 121, ¶5, identifies several examples of events or changes in circumstances that indicate that the carrying amount of an asset should be assessed, stating:

The following are examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed:

(a) A significant decrease in the market value of an asset

(b) A significant change in the extent or manner in which an asset is used or a significant physical change in an asset

(c) A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator

(d) An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset

(e) A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue.

65. GAAP, as set forth in Accounting Principles Board Opinion No. 17, ¶27, states that:

The Board believes that the value of intangible assets at any one date eventually disappears and that the recorded costs of intangible assets should be amortized by systematic charges to income over the period estimated to be benefitted.

66. During the Class Period, contrary to GAAP, PhyCor failed to adequately reflect the deterioration in value of the service agreements it had entered into and amortized the agreements over 40
years so as to inflate reported earnings. In fact, PhyCor management was aware of several factors which indicated that the agreements, particularly the group-formation operations, were not worth anywhere near what PhyCor reported in its financial statements and that the 40 year amortization period was too long:

- Doctors were leaving the practices in droves because of PhyCor's inability to adequately manage its operations and because of PhyCor's poor payment practices in which doctors were not making anywhere near the money they made prior to associating with PhyCor, nor anywhere near the amounts they believed they were owed pursuant to the agreements with PhyCor. The loss of doctors greatly reduced the benefits to be derived under the service agreements.

- PhyCor had failed to implement proper billing and collection procedures depriving both the doctors and PhyCor of revenues.

- PhyCor was not paying medical staff timely and accurately, causing services to be poor, and staff and doctors to be unhappy which would greatly diminish future revenues and profitability.

- PhyCor had failed to adequately implement government regulations at the practices which exposed the practices to fines and other penalties.

- PhyCor was failing to coordinate its network of doctors leading to failures to refer within PhyCor, thus losing business and helping competitors to gain market share.

67. As a result of these factors, PhyCor's management knew that the group-formation operations would not provide the benefits estimated when they were acquired, and that the benefits from these assets would not last anywhere near 40 years on average. Nevertheless, PhyCor did not take required write-downs of intangible assets and maintained a 40-year amortization period throughout the Class Period to report strong earnings.

68. Plaintiffs estimate the extent of PhyCor's misstated financial results related to the Company's improper accounting on EPS (excluding merger charges) by a minimum of $0.09, $0.09, $0.13,
$0.14 and $0.15, in the 1Q97, 2Q97, 3Q97, 4Q97 and 1Q98, respectively.

69. Ultimately, on April 27, 1998, PhyCor belatedly announced that it was changing its accounting for amortizing service agreements, effective April 1, 1998, instituting a cap of 25 years for amortization of Intangible Assets. PhyCor estimated the effect of this change alone would have reduced 1997 EPS by $0.10. Later, on July 23, 1998, PhyCor announced charges of $65 million to reflect the impairment of assets associated with at least four of its group-formation physician operations. The $65 million charge exceeded 85% of all the net income PhyCor reported during the Class Period.

70. Due to these accounting improprieties, the Company presented its financial results and statements in a manner which violated GAAP, including the following fundamental accounting principles:

(a) The principle that interim financial reporting should be based upon the same accounting principles and practices used to prepare annual financial statements (APB No. 28, ¶10);

(b) The principle that financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions was violated (FASB Statement of Concepts No. 1, ¶34);

(c) The principle that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and effects of transactions, events
and circumstances that change resources and claims to those resources was violated (FASB Statement of Concepts No. 1, ¶40);

(d) The principle that financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it was violated. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general (FASB Statement of Concepts No. 1, ¶50);

(e) The principle that financial reporting should provide information about an enterprise's financial performance during a period was violated. Investors and creditors often use information about the past to help in assessing the prospects of an enterprise. Thus, although investment and credit decisions reflect investors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance (FASB Statement of Concepts No. 1, ¶42);

(f) The principle that financial reporting should be reliable in that it represents what it purports to represent was violated. That information should be reliable as well as relevant is a notion that is central to accounting (FASB Statement of Concepts No. 2, ¶¶58-59);

(g) The principle of completeness, which means that nothing is left out of the information that may be necessary to insure that it validly represents underlying events and conditions was violated (FASB Statement of Concepts No. 2, ¶79); and
(h) The principle that conservatism be used as a prudent reaction to uncertainty to try to ensure that uncertainties and risks inherent in business situations are adequately considered was violated. The best way to avoid injury to investors is to try to ensure that what is reported represents what it purports to represent (FASB Statement of Concepts No. 2, ¶¶95, 97).

71. Further, the undisclosed adverse information concealed by defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed.

STATUTORY SAFE HARBOR

72. The statutory safe harbor provided for forward-looking statements under certain circumstances does not apply to any of the allegedly false statements pleaded in this Complaint, either because the statements pleaded herein were not identified as "forward-looking statements" when made, or because it did not state that actual results "could differ materially from those projected," or because the statement was not accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from the statements made. Alternatively, to the extent that the statutory safe harbor does apply to any statements pleaded herein, because they are "forward-looking," the defendants are liable for those statements because at the time each of those statements was made, the speaker knew the
statement was false and the statement was authorized and/or approved by an executive officer of PhyCor who knew that those statements were false when made.

CLASS ACTION ALLEGATIONS

73. Plaintiffs bring this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of all persons who purchased or otherwise obligated themselves to purchase the publicly traded securities of PhyCor during the Class Period (the "Class"). Excluded from the Class are the defendants herein, members of their immediate families, any entity in which a defendant has a controlling interest, and the legal representatives, heirs, successors-in-interest, or assigns of any excluded party.

74. The members of the Class are so numerous that joinder of all members is impracticable. The disposition of their claims in a class action will provide substantial benefits to the parties and the Court. As of June 30, 1998, PhyCor had more than 78 million shares of stock outstanding, owned by hundreds, if not thousands, of shareholders.

75. There is a well-defined community of interest in the questions of law and fact involved in this case. The questions of law and fact common to the members of the Class which predominate over questions which may affect individual Class members include the following:

(a) Whether the federal securities laws were violated by defendants;

(b) Whether defendants misrepresented material facts;
(c) Whether defendants' statements omitted material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading;

(d) Whether defendants knew or recklessly disregarded that their statements were false and misleading;

(e) Whether the price of PhyCor stock was artificially inflated during the Class Period; and

(f) The extent of damage sustained by Class members and the appropriate measure of damages.

76. Plaintiffs' claims are typical of those of the Class because plaintiffs and the Class sustained damages from defendants' wrongful conduct.

77. Plaintiffs will adequately protect the interests of the Class and have retained counsel who are experienced in class action securities litigation. Plaintiffs have no interests which conflict with those of the Class.

78. A class action is superior to other available methods for the fair and efficient adjudication of this controversy.

79. The prosecution of separate actions by individual Class members would create a risk of inconsistent and varying adjudications.

FIRST CLAIM FOR RELIEF
For Violation Of §10(b) Of The Exchange Act And Rule 10b-5 Against All Defendants

80. Plaintiffs incorporate ¶¶1-79 by reference.

81. Each of the defendants: (a) knew the material, adverse, non-public information about PhyCor's financial results and then-existing business conditions, which was not disclosed; and
(b) participated in drafting, reviewing, and/or approving the misleading statements, releases, reports, and other public representations of and about PhyCor.

82. During the Class Period, Defendants disseminated or approved the false statements specified above, which they knew were misleading in that they contained misrepresentations and failed to disclose material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

83. Defendants violated §10(b) of the Exchange Act and Rule 10b-5 in that they:

(a) Employed devices, schemes, and artifices to defraud;
(b) Made untrue statements of material facts or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which they were made, not misleading; or
(c) Engaged in acts, practices, and a course of business that operated as a fraud or deceit upon plaintiffs and others similarly situated in connection with their purchases of PhyCor common stock during the Class Period.

84. The undisclosed adverse information concealed by defendants during the Class Period is the type of information which, because of SEC regulations, regulations of the national stock exchanges and customary business practice, is expected by investors and securities analysts to be disclosed and is known by corporate officials and their legal and financial advisors to be the type of information which is expected to be and must be disclosed. For example:
(a) Under Item 303 of Regulation S-K, promulgated by the SEC under the Exchange Act, there is a duty to disclose in periodic reports filed with the SEC "known trends or any known demands, commitments, events or uncertainties" that are reasonably likely to have a material impact on a company's sales revenues, income or liquidity, or cause previously reported financial information not to be indicative of future operating results. 17 C.F.R. §229.303(a)(1)-(3) and Instruction 3. In addition to the periodic reports required under the Exchange Act, management of a public company has a duty promptly "to make full and prompt announcements of material facts regarding the company's financial condition." SEC Release No. 34-8995, 3 Fed. Sec. L. Rep. (CCH) ¶23,120A, at 17,095, 17 C.F.R. §241.8995 (10/15/70). The SEC has repeatedly stated that the anti-fraud provisions of the federal securities laws, which are intended to ensure that the investing public is provided with "complete and accurate information about companies whose securities are publicly traded," apply to all public statements by persons speaking on behalf of publicly traded companies "that can reasonably be expected to reach investors and the trading markets, whoever the intended primary audience." SEC Release No. 33-6504, 3 Fed. Sec. L. Rep. (CCH) ¶23,120B, at 17,096, 17 C.F.R. §241.20560 (1/13/84). The SEC has emphasized that "[i]nvestors have legitimate expectations that public companies are making, and will continue to make, prompt disclosure of significant corporate developments." Sharon Steel Corp., SEC Release No. 18271, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶83,049, at 84,618 (11/19/81); and
(b) Schedule D of the National Association of Securities Dealers ("NASD") Manual, which governs companies whose securities are included in the NASDAQ requires a NASDAQ company to "make prompt disclosure to the public through the press of any material information that may affect the value of its securities or influence investors' decisions." NASD Manual, Schedule D, Part II, §1(c)(13) [¶1803(c)(13)].

85. Plaintiffs and the Class have suffered damages in that, in reliance on the integrity of the market, they paid artificially inflated prices for PhyCor stock. Plaintiffs and the Class would not have purchased PhyCor stock at the prices they paid, or at all, if they had been aware that the market prices had been artificially and falsely inflated by defendants' misleading statements.

SECOND CLAIM FOR RELIEF
For Violation Of §20(a) Of The Exchange Act Against All Defendants

86. Plaintiffs incorporate ¶1-85 by reference.

87. The Individual Defendants acted as controlling persons of PhyCor within the meaning of §20(a) of the Exchange Act. By reason of their positions as directors and/or officers of PhyCor they had the power and authority to cause PhyCor to engage in the wrongful conduct complained of herein. PhyCor controlled each of the Individual Defendants and all of its employees.

88. By reason of such wrongful conduct, the Individual Defendants and PhyCor are liable pursuant to §20(a) of the Exchange Act. As a direct and proximate result of these defendants' wrongful conduct, plaintiffs and the other members of the Class suffered
damages in connection with their purchases of PhyCor common stock during the Class Period.

BASIS OF ALLEGATIONS

89. Because the PSLRA, §21D(c) of the Exchange Act [15 U.S.C. §78u-4(c)], requires complaints to be pleaded in conformance with Federal Rule of Civil Procedure 11, plaintiffs have alleged the foregoing based upon the investigation of their counsel, which included a review of PhyCor's SEC filings, securities analysts' reports and advisories about the Company, press releases issued by the Company, media reports about the Company, private investigations and discussions with consultants, and pursuant to Rule 11(b)(3), believe that after reasonable opportunity for discovery, substantial evidentiary support will likely exist for the allegations set forth herein.

PRAYER FOR RELIEF

WHEREFORE, plaintiffs pray for judgment as follows:

1. Declaring this action to be a proper class action pursuant to Rule 23(a) and (b)(3) of the Federal Rules of Civil Procedure on behalf of the Class defined herein;

2. Awarding plaintiffs and the members of the Class compensatory damages, including rescissory damages, where applicable;

3. Awarding plaintiffs and the members of the Class pre-judgment and post-judgment interest, as well as reasonable attorneys' fees, expert witness fees, and other costs;

4. Awarding extraordinary, equitable, and/or injunctive relief as permitted by law, equity, and federal statutory provisions sued hereunder, including rescission, the imposition of a constructive trust upon the proceeds of the Individual Defendants'
insider trading, pursuant to Rules 64, 65, and any appropriate state law remedies; and

5. Awarding such other relief as this Court may deem just and proper.

JURY DEMAND

Plaintiffs demand a trial by jury.

DATED: September 9, 1998

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