

NO. 13-CI-01060

FRANKLIN CIRCUIT COURT
HON. THOMAS D. WINGATE
DIVISION ONE

NORTON HEALTHCARE, INC.

Plaintiff

v.

**UNIVERSITY OF LOUISVILLE'S RESPONSE TO NORTON
HEALTHCARE, INC.'S MOTION TO DISMISS COUNTERCLAIM**

UNIVERSITY OF LOUISVILLE

Defendant

and

COMMONWEALTH OF KENTUCKY,
FINANCE AND ADMINISTRATION
CABINET

Intervening Defendant

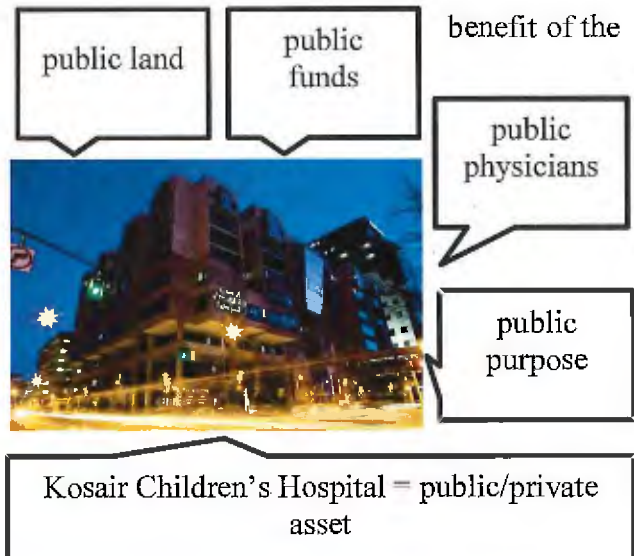
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Norton Healthcare, Inc.'s motion to dismiss the University of Louisville's counterclaim illustrates the parties' widely divergent views of their relationship and Norton's denial of the public purpose of Kosair Children's Hospital. Norton's motion asks this Court to ignore a series of covenants in a 99-year ground lease and affiliation agreement so that it can reduce a fiduciary relationship to a mere commercial lease of land for \$1 a year. Norton has breached its obligation to operate Kosair Children's Hospital, built on publicly owned land and funded by public aid, as an asset explicitly dedicated to benefit a public purpose - as UofL's dedicated pediatric teaching hospital. Norton has failed to honor its covenants and fiduciary obligations by diverting the Hospital's patients, government funding and revenue from benefiting the UofL School of Medicine. Norton's appropriation of the Hospital's benefits to its own uses has reduced the teaching cases available to UofL faculty and residents at the Hospital, under-funded UofL's cost of providing patient care and education at the Hospital and failed to meet commitments to cover

the costs of physician recruitment and research. UofL's counterclaim fully alleges facts which support each of its claims and Norton's motion to dismiss should be denied.

INTRODUCTION

UofL and Norton have long been parties to a 99-year ground lease, which enabled Norton to establish and operate Kosair Children's Hospital on strategically situated and highly valuable property titled in the Commonwealth for the UofL School of Medicine. In turn, Norton agreed that Kosair Children's Hospital would be operated – “for the benefit of” and “in the interest of” - the UofL School of Medicine. This included an obligation to provide “care, service and education” for UofL's benefit. Norton gave shape to these fiduciary commitments by agreeing to operational transparency and affiliation for the term of the lease.



Norton's longstanding contractual and fiduciary relationship with UofL has been extremely beneficial for Norton. Not only do UofL physicians provide the vast majority of patient care at Kosair Children's Hospital, but Norton receives tens of millions of dollars in federal and state aid benefits from being UofL's dedicated pediatric teaching hospital. Just last year, Norton received approximately \$32 million in such benefits predicated upon the costs required to operate a pediatric teaching hospital, most of which are shouldered by the UofL School of Medicine. Nevertheless, Norton has retained large government aid surpluses for its own use. By refusing to use its aid surplus to pay for UofL's increasing unreimbursed cost of

providing pediatric care at Kosair Children's Hospital, Norton has caused UofL to sustain large year-on-year operating deficits.

In addition to starving UofL of the funds needed to care for children at Kosair Children's Hospital and to educate the next generation of pediatric physicians, Norton has appropriated, divided and diluted the resources and patients of Kosair Children's Hospital to its own advantage. Norton has signed a letter of intent to share joint clinical, operational, and financial control of Kosair Children's Hospital—UofL's dedicated pediatric teaching hospital—with a *different university*. Norton has also undermined UofL's ability to continue using Kosair Children's Hospital as its dedicated pediatric teaching hospital by: closing service lines for various specialties and diverting patients from UofL physicians to its own captive employed physician network, refusing to update its Master Affiliation Agreement and other agreements with UofL in good faith, and renegeing on multiple reimbursement commitments for funds which are essential to UofL's pediatric teaching mission. In addition to these claims premised on breach of contract and fiduciary duty, UofL has also sought relief, in the alternative, in the form of promissory estoppel and unjust enrichment.

RELEVANT FACTUAL BACKGROUND

Norton and UofL Enter Into the Long-Term Lease, Which Consists of Three Agreements.

In 1981, Norton and UofL, who had long been partners in providing pediatric care at Children's Hospital, entered into the 99-year Lease. (CC ¶ 5.) The Lease allowed Norton to build Kosair Children's Hospital (which was to replace Children's Hospital) on strategically sited property titled in the Commonwealth for the use and benefit of UofL ("Real Property"). (CC ¶ 4.) For their part, UofL received a series of covenants, transparency commitments, a continuing pediatric teaching hospital affiliation agreement, rental payments of \$1 a year and a \$592,041.67 pediatric research grant. This was no arms-length ordinary commercial lease

negotiated for a tiny rental fee and small pediatric research grant. The lease established a continuing public-private partnership which fulfilled a public purpose.

The Lease between UofL as beneficial owner, the Commonwealth as legal title holder for UofL's use and benefit,¹ and Norton, consists of three agreements: (1) a December 8, 1981 lease agreement (CC Exh. B), which expressly incorporates in full an (2) August 12, 1981 agreement (CC Exh. C) ("which Agreement, *incorporated herein by reference*, shall survive the execution of this Lease") (emphasis added), and refers to the terms of an (3) Affiliation Agreement between UofL and Norton (*see* CC Exh. D (the 1962 version of the Affiliation Agreement, which was in place in 1981)). The first two agreements and the current version of the Affiliation Agreement ("Master Affiliation Agreement(s)") form the "Lease." (CC ¶ 9.)²

The Lease Provides that Kosair Children's Hospital is UofL's Dedicated Pediatric Hospital, Which Norton Must Operate to UofL's Benefit.

The Lease establishes that Kosair Children's Hospital is UofL's dedicated pediatric teaching hospital, and that Norton must operate the hospital accordingly. For example, in the mutual covenants to the Lease, (CC Exh. B at 2) Norton agrees that the new Kosair Children's

¹ Although Norton does not argue standing in its motion to dismiss, it implies UofL is not a party to the Lease and should not have the right to enforce it. (MTD Mem. at fn 3.) But, UofL is the beneficial owner of the Real Property and a party to the Lease. KRS 164.870 provides that real property owned or for the benefit of UofL must be titled in the name of the Commonwealth. And, UofL, the beneficial owner of the property, signed the Lease in addition to the Commonwealth as legal title holder. (CC Exh. B at 1.) As beneficial owner, UofL has authority to enforce the Lease. *See, e.g., Frankfort v. Silent Workers Circle of Kings Daughters & Sons, Inc.*, 548 S.W.2d 178, 179-180 (Ky. App. 1977); *see also Brandon v. Combs*, 666 S.W.2d 755, 759 (Ky. App. 1983) ("the real party in interest is...entitled to the benefits of the action upon the successful termination thereof.") Alternatively, UofL would have authority to enforce the Lease as a third-party beneficiary. The Commonwealth of Kentucky, which has filed a motion to intervene in this case, maintains that UofL is an "expressly named third-party beneficiary" to the Lease. (Mot. to Intervene at 3.) Even if UofL is treated as a third-party beneficiary (rather than a direct party to the Lease), then it is a distinction without a difference as third-party beneficiaries are entitled to enforce a contract under Kentucky law. *See Home Indem. Co. v. St. Paul Fire & Marine Ins. Co.*, 585 S.W.2d 419, 424 (Ky. App. 1979)(referring to the "well-settled rule that third party beneficiaries may enforce their rights" under a contract); *see also Truck America v. City of Hillview*, 2007 Ky. App. Unpub. LEXIS 134, at *12 (Mar. 23, 2007)("One who is not an actual party to an agreement may nevertheless enforce it if it creates obligations intended for his benefit.").

² Despite the fact that the December 1981 document expressly incorporates the August 1981 Agreement and the Master Affiliation Agreement, Norton quibbles that the contracts are separate agreements. (MTD Mem. at 4.) Regardless, Norton has breached contractual obligations to UofL. Further, Norton's argument that these agreements are "stand-alone" documents does not warrant dismissal. *See Pike v. George*, 434 S.W.2d 626, 627 (Ky. 1968) (the court must accept allegations in the counterclaim as true).

Hospital would “provide pediatric care, service and education *benefitting the UofL Medical School* and the citizens of the Commonwealth of Kentucky.” (*Id.* Exh. C at 1; *see also* MTD Mem. at 4 (emphasis added).) Norton also covenants that the new Kosair Children’s Hospital “will serve the interests of and will *be to the benefit of the Lessor* [UofL] by the availability of said new pediatric facility for *the programs and use of the University of Louisville’s School of Medicine.*” (CC Exh. B at 1 (emphasis added).) In addition to creating contractual duties, these Lease covenants create a partnership between Norton and UofL to benefit “the mutual interests and benefit of the parties hereto, in the conduct of their respective programs.” (*Id.*) In other words, Norton is obligated to operate Kosair Children’s Hospital as UofL’s dedicated pediatric teaching hospital. (CC Exh. B at 1; CC Exh. C at 2.)³

The Lease Also Provides that Norton Must Periodically Update the Master Affiliation Agreement.

In providing for a long-term partnership between Norton and UofL, the Lease stated that the parties would periodically update the Master Affiliation Agreement between them. The Lease states that the Master Affiliation Agreement (which at the time was the 1962 Agreement):

...shall be reviewed and updated by the appropriate officers of the parties hereto, and a new revised Agreement executed by NKC [Norton] and UofL. This Agreement *covers the long-standing relationship* between Children’s Hospital (now Kosair-Children’s Hospital) and UofL, particularly the Department of Pediatrics at UofL’s Medical School.

(CC Exh. C. at 2-3 (emphasis added).) In other words, the Lease specifically recognized that UofL and Norton would have a long-standing relationship, and would need to update the Master Affiliation Agreement accordingly. The parties understood that the costs of providing pediatric care and education would undoubtedly change over time. The parties further recognized that

³ The Commonwealth of Kentucky recently moved to intervene, and also rejected Norton’s claims that the Lease does not contain a covenant to operate Kosair Children’s Hospital for the use and benefit of UofL. (Commonwealth’s Answer at ¶ 25); *see infra* at 14 for discussion of the Commonwealth’s motion to intervene.

UofL would be subject to changing accreditation standards over the years, which would necessitate changes to the Affiliation Agreement.⁴ (See CC ¶ 12; *see also infra* at 22.) In fact, the parties spent years negotiating amendments to the Master Affiliation Agreements. (CC ¶ 34 (Master Affiliation Agreement and individual programmatic affiliation agreement negotiations “continued for months, and months became years.”); Resp. to Mot. to Compel at 2 (Norton admits that Master Affiliation Agreement negotiations were ongoing for over three years).)

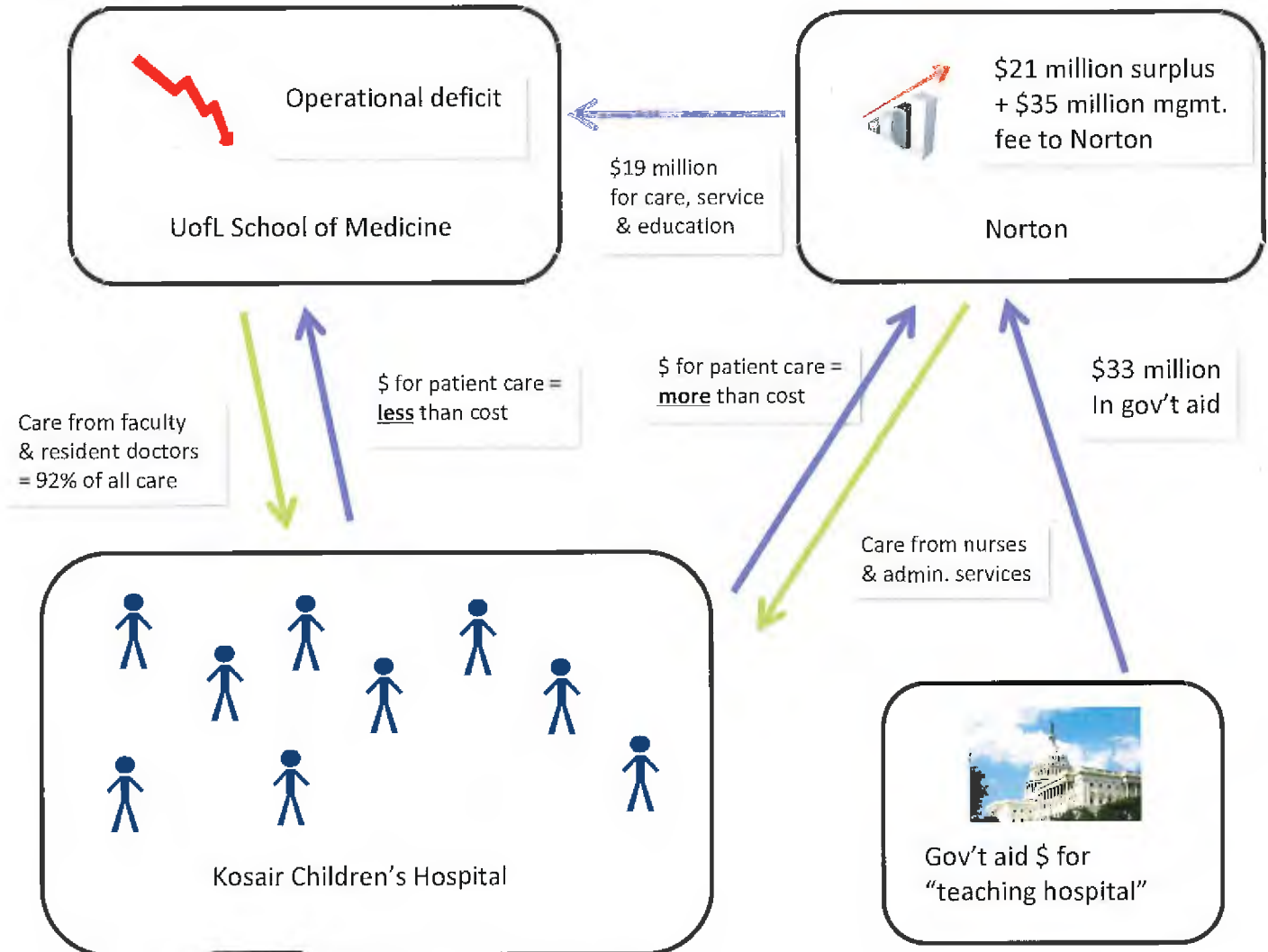
The Lease Obligates Norton to Pay UofL for the Unreimbursed Cost of its Services at Kosair Children’s Hospital.

The Lease also obligates Norton to pay for UofL’s services at Kosair Children’s Hospital. The Lease requires Kosair Children’s Hospital to “*provide* pediatric care, service and education benefitting the UofL Medical School.” (CC Exh. C at 4) (emphasis added.) All parties considered Norton’s obligation to “provide” care, service and education to include *paying* for UofL’s services at Kosair Children’s Hospital. (CC ¶ 12.) The parties specifically agreed to “negotiate resident stipends and benefits annually, with both parties agreeing to make annual adjustments so that resident stipends and benefits are competitive based on regional benchmarking.” (CC Exh. D at 6.) The Critical Care Agreement, one of the incorporated programmatic affiliation agreements, illustrates Norton’s obligation to pay UofL for the unreimbursed cost of critical care services, as set forth in Attachment D to that Agreement. Norton’s agreement to pay UofL for the unreimbursed cost of caring for critically ill children makes sense because Norton receives government benefits for operating a pediatric teaching

⁴ In fact, the 2007 ACGME accreditation requirements provided that any Master Affiliation Agreements be reviewed and updated at least every five years. (CC at ¶ 11.) Norton was well aware of this requirement, and yet, refused to update the Master Affiliation Agreement. *See infra*. Although this particular requirement may have been recently removed from the ACGME accreditation requirements (MTD Mem. at 13), this fact only proves that the accreditation standards evolve. Both parties understood the changing nature of the accreditation standards as well as pediatric education costs, and accordingly, ensured that the Affiliation Agreement would be updated over the years.

hospital while UofL (who incurs the vast majority of education-related expenses) would otherwise operate at a deficit.

“PROVIDE FOR CARE, SERVICE & EDUCATION” – 2009 ILLUSTRATION



Norton Also Has a Duty of Transparency and Communication.

Norton also owes UofL a duty of transparency and communication. UofL would not have accepted a 99-year lease of its Real Property unless Norton agreed to a dedicated pediatric teaching hospital which would be “for the benefit of” UofL’s School of Medicine. Norton is not a mere arms-length contracting party, but a fiduciary with certain duties of transparency, communication, and disclosure. *See infra* at 26. In fact, the Lease specifically requires that Norton permit UofL representatives to attend its Board of Directors and Executive Committee meetings in order to “assure full and open communication between them.” (CC Exh. B at 2.) As part of full and open communication, Norton historically provided financial and operating statements of Kosair Children’s Hospital to UofL, which showed the results of operations independent of Norton’s large system of adult healthcare facilities. (CC ¶ 41.)

Norton Has Duties Under its Programmatic Agreements with UofL.

Pursuant to the Lease, Norton and UofL also entered into various programmatic affiliation agreements, including the Critical Care Agreement—each of which imposed contractual duties upon Norton. (CC ¶¶ 15-16; CC Exh. E.) These agreements helped specify how much Norton was to pay in “provid[ing] for pediatric care, service and education benefitting the UofL Medical School.” (CC Exh. C at 4 (emphasis added).)

In the Critical Care Agreement Norton agreed to pay for critical care services, as set forth in attachment D to the Agreement. (CC ¶ 16.) In particular, the Critical Care Agreement required that Norton pay a group guarantee based on an Income Guarantee formula. (CC ¶ 16.) The formula used factors such as the number of full-time equivalent physicians (“FTEs”), account net revenue, and total operating expenses. Like the Master Affiliation Agreement, the Critical Care Agreement obligated Norton to update the agreement in good faith to account for increased costs from changes in accreditation standards and pediatric care. (CC ¶ 18; CC Exh.

E.) For example, ACGME accreditation standards have limited pediatric residents' duty hours over the years, which has in turn reduced the availability of resident staffing for patient care in the Critical Care Unit at Kosair Children's Hospital. Additionally, as patient acuity increased (more critically ill children were being admitted for care) and market pay for physicians increased, UofL has been required to hire additional physicians to provide increased patient care for a more critically ill patient population, while meeting resident supervision requirements. All the while, UofL has had to increase existing physician faculty compensation to meet the level of compensation required for new hires. (CC ¶ 17.) Like the Master Affiliation Agreements, which require the parties to amend their relationship as necessary; the Critical Care Agreement requires Norton to increase its level of support to reimburse UofL for increased costs in pediatric care, teaching, and education. (CC ¶ 18.)

Despite Benefitting from its Long-Term Partnership with UofL, Norton Has Breached its Duties to UofL.

Norton's covenant to use the resources of Kosair Children's Hospital to provide pediatric care, service, and education benefitting UofL includes not only patient treatment revenue, but tens of millions of dollars in government benefits Norton receives for operating a pediatric teaching hospital. *See supra* at 1-2. While Norton has a huge surplus from patient revenue and government aid, UofL, who shoulders the vast majority of all pediatric teaching expenses, operates at a deficit. Despite these benefits to Norton, Norton has systematically failed to account for and provide the benefit of Kosair Children's Hospital's resources, including massive public aid. (CC ¶ 22.) *See infra*.

At the Same Time It Claimed to be About to Complete an Updated Affiliation Agreement With UofL Including Financial Commitments – Norton Secretly Agreed to Bargain Away the Resources and Control of UofL’s Dedicated Pediatric Teaching Hospital Kosair Children’s Hospital to Another University.

Norton has violated the Lease and related agreements by secretly agreeing to cede joint control and management of Kosair Children’s Hospital—UofL’s dedicated pediatric teaching hospital—to a different university; and to share the Hospital’s patient revenue with another university. (CC ¶ 48.) On August 13, 2013, Norton cancelled a meeting to finalize the Master Affiliation Agreement amendments with UofL, which was scheduled for the very next day. (CC ¶ 1.) Just over a week later, Norton announced that it had signed a Letter of Intent (“LOI”) with another university. The LOI reflected Norton’s intent to “achieve clinical, operational and financial integration with [a different university] with respect to all aspects of patient care.” (CC ¶ 2.) As part of “the joint operation and management of the hospitals,” Norton stated its intent to have another university “share in the profits and losses” of Kosair Children’s Hospital. (CC Exh. G, at 3). The LOI revealed Nortons’ plan to divert the resources and funds of Kosair Children’s Hospital to itself and another university in a manner that would restrict, diminish, damage, impair and threaten UofL, and delegate joint recruitment, retention, and placement of pediatric specialists to the other university and its teaching hospital. (CC ¶ 48, Exh. G.) Although Norton has duties of transparency and communication to UofL under the Lease, Norton negotiated the LOI and agreement without any notice to its partner, UofL. (CC ¶ 49.)⁵

⁵ Norton’s unilateral talks with UK also violated Norton’s promise to UofL in a September 28, 2012 term sheet signed by both Norton and UofL. Exh. 1, at p. 3, ¶4 (“Both parties agree to develop a coordinated strategy to work with the University of Kentucky”)

By Closing Service Lines, Diverting Patients, and Reducing Certain Funds Paid for Pediatric Education, Norton Has Further Eroded UofL's Ability to Use its Dedicated Pediatric Teaching Hospital for Pediatric Education.

In addition to formally announcing its intent to cede joint control of Kosair Children's Hospital to another university, Norton has: restricted UofL from providing pediatric care, teaching, and research by closing service lines for certain pediatric specialties; diverted pediatric patients and teaching cases that would have otherwise been treated by UofL, to Norton's own burgeoning fleet of captive employed doctors,⁶ and reduced funds paid to UofL's neonatologists for patient care, education, and research, allocating them to Norton-employed neonatologists instead. (CC ¶¶ 24-31.) Norton has focused its efforts to draw Kosair Children's Hospital patients away from UofL faculty and residents in service areas with the most lucrative reimbursements and largest revenues, e.g., neonatal intensive care. As discussed below, by reducing the number of available teaching cases as well as the patient revenue each of these actions further impedes UofL's ability to achieve its pediatric teaching mission at its dedicated pediatric teaching hospital—in violation of Norton's duties to UofL.

Norton Has Failed to Negotiate and Update the Master Affiliation Agreement and Programmatic Agreements in Good Faith.

Notwithstanding the Lease and other contractual provisions requiring Norton to negotiate and update the Master Affiliation Agreement and programmatic agreements in good faith, Norton has refused to do so. (CC ¶ 45.) As discussed above, both parties agreed that the Master Affiliation Agreement would be updated regularly (and Norton has repeatedly reaffirmed that agreement to update). (CC ¶ 12.) In fact, Norton has failed to negotiate an updated Affiliation

⁶ Norton has incited its physician network to refer pediatric perinatal and neonatal patients to Norton-employed physicians and to various Norton system hospitals, offering a larger bonus pool for such referrals. Additionally, Norton has misleadingly steered referrals for transport services from hospitals in Western Kentucky to Kosair Children's Hospital to Norton-employed neonatologists. (CC ¶ 29.) Norton has placed labels on telephones in Western Kentucky medical facilities stating "direct access line for neonatal care and transports [to Kosair Children's Hospital]" and listing a number that went directly to Norton-employed neonatologists. (*Id.*)

Agreement in good faith for at least four *years*, repeatedly offering - and then withdrawing - proposed terms before the parties could agree to final documentation. As discussed above, Norton cancelled an August 2013 meeting between business executives intended to conclude agreement on open issues, only to announce the LOI ceding joint control and management of UofL's dedicated pediatric teaching hospital to another university a week later. All the while, Norton has refused to fulfill other funding obligations to UofL (or update other programmatic agreements) on the premise that Norton had not signed an amended Affiliation Agreement reflecting those commitments. *See infra* at 18.

Norton Reneged on Reimbursement Commitments for UofL's Increased Care, Service, and Education Costs.

Norton has also reneged on its financial commitments to reimburse UofL for increased costs for residents and faculty, education, and research—while simultaneously failing to apply surpluses from patient revenue and federal and state aid to reimburse UofL for its increasing cost of patient care and education at Kosair Children's Hospital. (CC ¶ 23; *see supra* at 2, 9.) Not only has Norton agreed to pay for UofL's services in the Lease and through programmatic affiliation agreements (*see* CC ¶¶ 12-13) - Norton has made and breached various promises to reimburse UofL for increased costs, which Norton reasonably relied on in incurring such costs.

For example, in late 2008, Norton committed to reimburse UofL for its increasing cost deficit for medical education ("MedEd") costs (costs which are necessary under ACGME accreditation standards). Norton and the patients at Kosair Children's Hospital receive direct benefits from the MedEd costs, paid for by UofL. After UofL explained its cost deficit and pointed out Norton's massive surplus from federal and state benefits awarded for patient care, service, and education at Kosair Children's Hospital, Norton committed to using Kosair Children's Hospital resources to reimburse UofL beginning in 2009. Norton also promised it

would catch up on unreimbursed sums when an updated Master Affiliation Agreement was signed. (CC ¶ 32.) UofL relied on these funding commitments and incurred unreimbursed MedEd costs of \$5,077,414 for fiscal years 2009-2014. (CC ¶ 33.) Throughout years of negotiating the Master Affiliation Agreement and incorporated programmatic agreements, Norton repeatedly affirmed its commitment to pay for UofL's cost deficits. (CC ¶ 34.)

Norton also failed to honor commitments to increase the number of full-time equivalent hospitalists ("FTEs") under Schedule D to the Critical Care Agreement, and to reimburse UofL for increased compensation costs. *See supra* at 9. Specifically, in 2010 and 2011, UofL was required to increase the number of critical care FTEs due to increased patient acuity (increase in critically ill children being admitted for care), and also had to increase existing physician compensation to meet the market rates paid to new hires. (CC ¶ 35.) Before hiring new physicians, UofL asked Norton to negotiate an increased FTE figure pursuant to the terms of the Critical Care Agreement, and to reimburse UofL for its increased compensation costs. (CC ¶ 35.) Norton refused to negotiate a new FTE figure, but told UofL to hire physicians and it would pay for increased costs as soon as an updated Affiliation Agreement was signed. As a result, UofL incurred increased costs of \$2,009,496 for fiscal years 2011-2014, which have not been reimbursed to this day. (*Id.* ¶ 35.)

Likewise, Norton failed to honor commitments made in 2012 to pay for additional fellows (UofL incurred \$200,000 in costs relying on this commitment) and increase its annual support to the UofL School of Medicine to \$800,000. (CC ¶ 38.) Norton claimed it would not pay for these commitments until Norton signed an updated Master Affiliation Agreement. (CC ¶ 36.) In fact, Norton's failure to update the Affiliation Agreement in good faith is demonstrated

by its admission that the mounting unpaid reimbursement commitments have been used as a bargaining tool. (CC ¶ 37.)

Meanwhile, Norton's consistent failures to abide by its duties to UofL threaten UofL's accreditation status and teaching mission. When confronted about these failures, Norton filed suit in this Court, necessitating UofL's counterclaim.

Notably, the Commonwealth of Kentucky, who signed the Lease as legal title owner of the Real Property held for UofL's use and benefit, has recently moved to intervene in this case. In doing so, the Commonwealth stated that:

...obviously, in light of U of L's status as a state institution, the Commonwealth and the Cabinet have an interest in litigation pending against it. Further, this case involves U of L's School of Medicine and impacts the pediatric care provided to Kentucky's children. The Commonwealth has an interest in the health and well-being of its citizens, particularly its children...

(Mot. to Intervene at 3-4.) The Commonwealth also filed an answer along with its motion to intervene which, among other matters: (1) admits that the Real Property is a public asset, (2) denies Norton's claim that the Lease does not obligate it have a Master Affiliation Agreement with UofL in place, (3) denies Norton's claim that the Lease does not contain a covenant to operate Kosair Children's Hospital for the "use and benefit of UofL," (4) asks the Court to declare that Norton and UofL must remain affiliated with respect to operating Kosair Children's Hospital, and (5) admits that UofL and Norton have "been partners in a long term arrangement to operate the Children's Hospital[Norton's predecessor] and are partners to the 2008 Affiliation Agreement." (Commonwealth's Answer at ¶¶ 3, 11, 25, p. 10.)

UofL's counterclaim fully identifies the Lease provisions that give rise to Norton's duties, as well as Norton's acts and omissions that have breached the Lease and the fiduciary

duties created under it. Norton's motion to dismiss should be denied because it must accept UofL's allegations as true.

ARGUMENT

A motion to dismiss can be granted only when "it appears that the pleading party would not be entitled to relief under any set of facts which could be proved in support of his claim." *James v. Wilson*, 95 S.W.3d 875, 883 (Ky. App. 2002) (citation omitted). The Court must accept the allegations in a complaint or counterclaim as true for purposes of resolving the motion. *See Pike v. George*, 434 S.W.2d 626, 627 (Ky. 1968). The Court essentially "must ask if the facts alleged...can be proved, would the...[claimant] be entitled to relief?" *James*, 95 S.W.3d at 883. A pleading "need not contain 'detailed' factual allegations" although the allegations must be enough to raise a right to relief above the speculative level *on the assumption that all the allegations in the complaint are true.*" *Id.* (discussing cases interpreting the equivalent federal rule) (emphasis added). Not only does UofL's counterclaim contain detailed factual allegations, the allegations support the elements of each and every claim asserted.

Notably, Norton's motion to dismiss repeatedly makes factual arguments that are contrary to the allegations in UofL's counterclaim, or inserts allegations that are irrelevant to a motion to dismiss. For example, Norton claims that this case has been settled. (MTD Mem. ¶ 8.) Not only does UofL disagree with this claim, but also it is irrelevant to whether UofL has stated a claim for relief in the counterclaim. Because Norton has breached contractual, fiduciary, and various other obligations, UofL is entitled to relief.

I. UofL Has Stated a Claim for Breach of Contract and the Implied Duty of Good Faith and Fair Dealing (Count I).

In order to state a breach of contract claim in Kentucky, a claimant must allege the following: 1) existence of a contract; 2) breach of that contract; and 3) damages flowing from the breach of contract. *See, e.g., Metro Louisville/Jefferson County Gov't v. Abma*, 326 S.W.3d 1, 15 (Ky. App. 2009). Norton does not dispute the fact that contracts existed between UofL and Norton, or that UofL alleges a breach and damages. Rather, Norton claims that it “does not have a contractual obligation” to “do or refrain from doing any of [the] acts” described in the counterclaim. (MTD Mem. at 9.) But, the terms of the Lease and Critical Care Agreement demonstrate the nature and extent of Norton’s obligations, and the counterclaim fully identifies Norton’s breach of contractual and fiduciary obligations.

UofL has also stated a claim for breach of the implied covenant of good faith and fair dealing in the Lease and Critical Care Agreement. “[U]nder Kentucky law, parties have a duty in carrying out a contract to act in good faith, sincerely, and without deceit or fraud.” *Gresh v. Waste Servs. of Am., Inc.*, 738 F. Supp. 2d 702, 711 (Ky. 2009). A “contracting party impliedly obligates himself to cooperate in the performance of his contract and the law will not permit him to take advantage of an obstacle to performance which he has created or which lies within his power to remove.” *Id.* at 711; *see also Ranier v. Mt. Sterling Nat'l Bank*, 812 S.W.2d 154, 156 (Ky. 1991) (“contracts impose on the parties thereto a duty to do everything necessary to carry them out.”) Norton does not deny that it has an implied covenant to perform each of its obligations in good faith. Norton’s failure to perform in good faith has been fully alleged: Norton has failed to complete an updated Affiliation Agreement for four years, repeatedly withdrawing its proposals; it has induced UofL to expend funds to hire physicians, care for patients and educate physicians only to pull out from its commitments; it has diverted resources

and government aid from UofL; and has secretly “gone behind” UofL to divide the management, control and revenue of Kosair Children’s Hospital to another university. Norton has breached the implied covenant of good faith, which provides relief where a party cynically undercuts the value of a contract’s benefits by reducing performance to a pretense. *See Gresh*, 738 F. Supp. 2d at 711.

A. Norton Breached the Lease and the Implied Covenant of Good Faith and Fair Dealing By Secretly Negotiating and Agreeing to Share Joint Management, Control and Profits of Kosair Children’s Hospital, UofL’s Dedicated Pediatric Teaching Facility, with a Different University.

By secretly negotiating and agreeing to share joint operational control and “the profits and losses” of Kosair Children’s Hospital (UofL’s dedicated pediatric teaching hospital) with a *different* university, Norton breached several provisions of the Lease and the implied covenant of good faith and fair dealing. (CC ¶ 48; Exh. G, at 3.) As discussed above, Norton cancelled a meeting with UofL to finalize a new Master Affiliation Agreement the very day before the meeting was scheduled—only to announce its LOI with *another* university a few days later. The LOI stated that Norton and its new partner would “achieve clinical, operational and financial *integration*,” and that the parties would “*jointly manage* and engage in consolidated operations with respect to all aspects of patient care” at Kosair Children’s Hospital. (CC ¶ 2, Exh. G (emphasis added).) By its very terms (and contrary to Norton’s claims), the LOI is a formal statement of intent to share joint operational management and control with another university. (CC at Exh. G; MTD Mem. at 10.) And, Norton secretly negotiated its new partnership at the same time it cancelled talks to complete an updated Affiliation Agreement that was the product of three years of talks.

Norton’s expressed intent to divide and share the resources of UofL’s dedicated pediatric teaching hospital with another university threatens to undercut the mutual covenants in the Lease,

reducing access to financial resources, reducing patients and teaching cases, and jeopardizing faculty and resident recruitment. Notably, after signing the LOI, Norton even broke off Master Affiliation Agreement negotiations with UofL.⁷ In doing so, Norton has failed to update the hopelessly outdated 2008 Master Affiliation Agreement, and refused to honor the funding commitments that Norton made as part of the negotiations. *See infra* at 34.

Notwithstanding Norton's characterization of the LOI as a non-binding statement of intent, its covert agreement to enter into a partnership with another university violates the Lease, and the implied covenant of good faith and fair dealing, in multiple respects. Norton covenanted that Kosair Children's Hospital would "provide pediatric care, service and education *benefitting the UofL Medical School and the citizens of the Commonwealth of Kentucky.*" (CC Exh. C at 1 (emphasis added)). Norton also covenanted that Kosair Children's Hospital would "serve the interests of and will be to the benefit of the Lessor [UofL] by the availability of said new pediatric facility for the programs and use of the University of Louisville's School of Medicine." (CC Exh. B at 1.) Norton further agreed that its partnership with UofL would benefit "the mutual interests and benefit of the parties hereto, in the conduct of their respective programs." (CC Exh. C at 1.) Under each of these covenants, Norton agreed that Kosair Children's Hospital—situated on Real Property owned by, or on behalf of, UofL—would benefit UofL Medical School and that the hospital would be available for the "programs and use of the University of Louisville's School of Medicine"—not other schools of medicine with their own clinical and educational needs.⁸

⁷ The parties recommenced negotiations after this lawsuit was filed and reached agreement on many business terms, only to have Norton ultimately withdraw its proposals once again and unilaterally pull out of talks on January 16, 2014.

⁸ Likewise, the LOI was negotiated without any notice to UofL—Norton's partner in providing pediatric care at Kosair Children's Hospital. (CC Exh. C. at 1.) The LOI further violates Norton's duties of transparency and communication with UofL.

While Norton urges this Court to treat its covenants as mere “preliminary recitals” that do not create “substantive” obligations (MTD Mem. at 11), this effort should be rejected. The Lease expressly provides that these contract provisions are “mutual covenants” (not mere recitals). The Lease expressly makes the covenants part of the consideration exchanged in the Lease: “NOW, THEREFORE, for and in consideration of the mutual covenants of the parties hereto, as set forth in the preambles hereto... the parties agree as follows....” (CC Exh. B at 2.)

Under Kentucky law, the mere fact that a contract provision is at the beginning of an agreement, or that it contains a “Wherefore” clause, does not make it nonessential or nonbinding. *See Ingram v. State Property and Buildings Commission*, 309 S.W.2d 169, 170-71 (Ky. 1957) (“[T]his Court has never held that the introduction of a portion of a contract containing a material provision by the word ‘whereas’ automatically creates a nonessential recital clause. It has long been a rule of interpretation that a contract must be construed as a whole...”); *see also Wall v. Chicago Park Dist.*, 37 N.E.2d 752, 757-758 (Ill. 1941)(contract containing preliminary recitals premised the agreement on those recitals by stating “in consideration of the premises and the mutual agreements of the parties.”).

Norton’s conduct likewise has breached the implied duty of good faith and fair dealing. As stated above, every contract contains an implied duty to act in good faith in carrying out the contract. *See supra* at 16. In the Lease, Norton agreed that Kosair Children’s Hospital would be operated to UofL’s benefit and that the hospital would be made available as UofL’s dedicated pediatric teaching facility. Norton’s covert negotiations and formal announcement of intent to provide the benefits accruing to UofL under the Lease to another university are not to UofL’s benefit, and run counter to Norton’s covenant that the hospital will be UofL’s dedicated pediatric teaching hospital. And, Norton’s lack of good faith in carrying out these provisions of the Lease

can be demonstrated by the fact that it secretly negotiated the LOI while in the midst of purporting to negotiate an amended Master Affiliation Agreement with UofL (even cancelling a meeting with UofL to finalize the Agreement). Further, Norton conducted its secret negotiations, while simultaneously withholding millions of dollars in past-due unreimbursed financial commitments from UofL as a bargaining ploy in the Affiliation Agreement negotiations. *See supra* at 14.

B. Norton Has Breached the Lease By Eroding UofL's Ability to Provide Pediatric Teaching Programs at Kosair Children's Hospital.

Norton has also closed service lines, diverted patients, and reduced funds paid to UofL for pediatric education—eroding UofL's ability to provide pediatric teaching programs at Kosair. (CC ¶¶ 24-31, 53; see also MTD Mem. at 15.) Denying its express obligation to use Kosair Children's Hospital to benefit the public purpose of serving as UofL's pediatric teaching hospital, Norton mischaracterizes UofL's claim as seeking to hold Norton responsible "for the quality of UofL's programs." (MTD Mem. at 15.) This statement misses the point. Norton certainly has an obligation not to actively erode UofL's pediatric teaching programs. Norton covenanted that Kosair Children's Hospital would "provide pediatric care, service and education benefitting the UofL Medical School and the citizens of the Commonwealth of Kentucky," and that Kosair Children's Hospital would "serve the interests of" and "be to the benefit" of UofL "by the availability of said pediatric facility for the programs and use of the University of Louisville's School of Medicine." (CC Exh. B at 1; CC Exh. C at 1.) The Lease also creates a partnership, which is to benefit "the mutual interests and benefits of the parties...in the conduct of their respective programs." (*Id.*) In other words, Norton must operate the hospital to provide pediatric care, service, and education benefitting UofL Medical School, must make the hospital

available for UofL's programs, and must benefit the *mutual* interests of the parties in their respective programs.

But, Norton's actions have directly contravened UofL's interests and benefit, and have diverted the financial resources of - and government aid received by - Kosair Children's Hospital, breaching the duty to use the Hospitals' resources to provide pediatric care, service, and education benefiting UofL. (CC ¶ 15.) Once again, Norton's conduct has included closing service lines in several pediatric specialties, diverting pediatric patients and teaching cases away from UofL physicians to Norton's own employed-physicians (in the field of neonatology), and reducing funds paid to UofL physicians for patient care, education, and research. (CC at ¶ 24, 26.) Each of these actions is either in direct breach of the Lease—or they violate the implied covenant of good faith and fair dealing by impeding UofL's ability to teach. Even if there is no provision of the agreement explicitly addressing service lines, the diversion of patients, and reducing funds paid to UofL, each of Norton's actions contravene the Lease, which is intended to benefit UofL's teaching mission.

C. Norton Breached the Lease By Refusing to Update the Master Affiliation Agreement and Other Programmatic Agreements.

Norton's attempt to disclaim any contractual obligation to update the Master Affiliation Agreement and related programmatic agreements contradicts the Lease, its related and incorporated agreements, and Norton's own conduct. (MTD Mem. at 12.) In its motion, Norton specifically claims that it agreed to amend the Master Affiliation Agreement in 2008, but was not required to do so. (*Id.* at 12.) Contrary to Norton's claims, the Lease, which expressly incorporated by reference the Master Affiliation Agreement, provides that the Affiliation Agreement "...shall be reviewed and updated by the...parties hereto, and an new revised Agreement executed by NKC [Norton] and UofL. This Agreement *covers the long-standing*

relationship between [Kosair-Children’s Hospital Division of NKC] and UofL, particularly the Department of Pediatrics at UofL’s Medical School.” (CC Exh. C at 2-3 (emphasis added).) The only reasonable interpretation of this Lease provision is that the parties agreed that the Master Affiliation Agreement would need to be updated periodically over time to permit the “long-standing relationship” between the parties continue for the term of the Lease. (See Commonwealth’s Answer at ¶ 3 (Norton and UofL must have an affiliation agreement in place).)

In fact, Norton has repeatedly affirmed (in the 2003 and 2008 Master Affiliation Agreements, as well as through other communications with UofL) its obligation to periodically update the Affiliation Agreement to reflect increased costs in providing care, service, and education at Kosair Children’s Hospital, as well as changing accreditation standards. (CC ¶ 12.) The 2008 Master Affiliation Agreement reflects the parties’ intent to update the Agreement periodically to maintain “accredited student and resident training programs.” (MTD Mem. at Exh. B at 4.) And, as Norton itself points out in its motion, UofL is subject to accreditation standards, which are in flux. (*Id.* at 13; *see also* CC ¶ 22.)⁹ The parties spent years negotiating amendments to a new Master Affiliation Agreement, before Norton broke off negotiations. (CC ¶ 34 (Master Affiliation Agreement and individual programmatic affiliation agreement negotiations “continued for months, and months became years.”); Resp. to Mot. to Compel at 2 (Norton admits that Master Affiliation Agreement negotiations were ongoing for over three years).)

⁹ Whether or not the 2007 AGME Institutional Requirements requiring amended Affiliation Agreements were in effect when the Lease was signed (and whether or not they are currently in effect), the fact remains that UofL is subject to changing accreditation standards. (MTD at 12.) As a result, Norton’s claim that the Affiliation Agreement only had to be amended once over the 99-year term of the Lease does not make sense. The Lease expressly incorporated the Master Affiliation Agreement, which expressly provided that it would be updated over time, as the needs of the parties changed. (CC Exh. C at 2-3.)

As a result, Norton's argument that the Master Affiliation Agreement only had to be updated once, which occurred in 2003, is inconsistent with its own conduct and the express language of the Master Affiliation Agreements. (MTD Mem. at 12.)

Norton also had an obligation to update programmatic agreements, such as the Critical Care Agreement. (CC ¶ 18.) The Critical Care Agreement obligates Norton to update the Agreement in good faith to account for changes in accreditation standards, such as the number of FTEs. (*Id.*) As discussed above, Norton has refused to update this agreement.

Norton's refusal to update the Master Affiliation Agreement and programmatic agreements like the Critical Care Agreement also violates the implied covenant of good faith and fair dealing. *See supra* at 5; (CC Exh. C.) Norton has a duty to act in good faith in carrying out the terms of the Agreement. Norton admits that the Lease imposed some obligation on it to amend the Affiliation Agreement existing when the Lease was executed. Norton has also admitted to using millions of dollars in overdue funding commitments to UofL as a bargaining ploy in an attempt to obtain an Affiliation Agreement beneficial to Norton. *See supra* at 14. Yet, Norton has now refused to update the Master Affiliation Agreement *or* pay UofL the millions of dollars it has promised it. Contrary to Norton's claims, Norton's conduct is "inconsistent with the parties' agreements" and therefore "prohibited by an implied covenant of good faith and fair dealing." (MTD Mem. at 17.)

D. Norton Breached the Lease and Critical Care Agreement By Failing to Provide for Care, Service, and Education at Kosair, and By Failing to Reimburse UofL for Accumulated Cost Deficits.

In its motion, Norton claims that it had no contractual obligation to provide funding to UofL, or reimburse it for cost deficits. (MTD Mem. at 13.) But, in the Lease, Norton specifically covenanted that the newly-constructed facility would "provide pediatric care, service and education benefitting UofL." (CC Exh. C at 4 ("... it will be to the mutual interests and

benefit of the parties hereto, in the conduct of their respective programs, that said new pediatric facility...will provide pediatric care, service and education benefitting the UofL Medical School....”).) Both UofL and Norton have always considered this provision as requiring Norton to *pay* UofL for services at Kosair Children’s Hospital, thereby “providing” for pediatric care, service and education benefitting UofL’s Medical School. (*Id.* at ¶ 7.) And, the Critical Care Agreement further obligated Norton to pay for UofL’s critical care services (and to update the Critical Care Agreement to account for increased costs). (CC ¶ 16, Exh. E.)

As pleaded in the counterclaim, Norton breached its funding commitments, including specific financial commitments to reimburse UofL for increased costs for residents and faculty, education and research—while simultaneously failing to apply federal and state aid payments and resources generated by the UofL School of Medicine at Kosair Children’s Hospital for UofL’s increased costs). (CC ¶ 23.) *See supra* at 34 (discussing Norton’s specific reimbursement commitments). In addition, Norton’s conduct breaches the implied covenant of good faith and fair dealing with respect to its covenant to use Kosair Children’s Hospital to provide for pediatric care, services, and education benefitting UofL.¹⁰ Norton has repeatedly confirmed its obligation to *pay* for such care, services, and education, and yet has refused to do so (even after using its past-due financial commitments as a bargaining chip in the now four-year long Master Affiliation Agreement negotiations).

E. Norton Has Waived Any Argument that Breach of Contract Claims Premised on the Critical Care Agreement Must Be Dismissed for Lack of Venue.

Norton also maintains that contract claims premised on the Critical Care Agreement should be dismissed because the Agreement has an exclusive venue provision, which requires

¹⁰ See the “flow-of-funds” illustration appearing above at page 7, which shows how Norton refuses to use Kosair Children’s Hospital’s funding surplus to cover UofL’s unreimbursed cost of providing care and education at the Hospital.

venue in Jefferson County, Kentucky, or the United States District Court for the Western District of Kentucky. (MTD Mem. at 16.) But, Norton has waived any such objection to venue in this Court by filing suit here. *Palmer & Cay, Inc. v. Marsh & McLennan Cos.*, 2003 U.S. Dist. LEXIS 26365, at *9-10 (S.D. Ga. Nov. 11, 2003) (vacated on other grounds) (plaintiff waived any forum-selected venue rights it had by filing suit in a different court); *Jalin Realty Capital Advisors, LLC v. A Better Wireless, NISP, LLC*, 2012 U.S. Dist. LEXIS 32730, at *8-9 (D. Minn. Mar. 12, 2012) (a “plaintiff waives venue privileges with respect to any counterclaim, either permissive or compulsory, when he commences an action in a forum where venue otherwise would not lie.”)

After UofL notified Norton of its systematic breaches of the Lease *and* Critical Care Agreement, Norton filed its claims against UofL in this Court. (Cmplt. at Exh. A.) In its complaint, Norton asserts that *none* of the breaches in UofL’s “notice of breach” have any basis. (*Id.* at ¶ 11.) But, several of the breaches listed in UofL’s notice of breach were related to the Critical Care Agreement. Nonetheless, Norton voluntarily submitted itself to this Court, for the specific purpose of determining whether it had breached the Lease and other programmatic agreements, such as the Critical Care Agreement. Meanwhile, UofL had to assert any compulsory counterclaims in response to the complaint, or otherwise those claims could be waived. *See* CR 13.01. Norton’s breaches of the Critical Care Agreement were directly tied to whether UofL had a “factual basis” to assert a breach of contract. (Am. Cmplt. at Declaratory Relief Claim.) Because the Critical Care Agreement arises out of the occurrences that are the subject matter of Norton’s claims, UofL had to assert its claims based on the Critical Care Agreement. Norton cannot seek dismissal of this claim, when it chose this Court as the forum.

II. UofL Alleged Sufficient Facts to Establish a Fiduciary Relationship and Norton's Breach of that Duty (Count II).

Count II of UofL's counterclaims asserts Norton breached its fiduciary duties in its partnership with UofL to: exercise the utmost good faith, loyalty and honesty in the performance of its duties, avoid taking any improper advantage of UofL, operate and manage Kosair Children's Hospital for the benefit of and in the interest of the UofL School of Medicine, maintain an updated Affiliation Agreement which "covers [their] longstanding relationship" throughout the Lease term and provide full access and information to UofL concerning the operations and finances of Kosair Children's Hospital, a public asset. (CC ¶ 57.) In its motion to dismiss, Norton states UofL's fiduciary duty counterclaim should be dismissed because UofL has not alleged sufficient facts showing the existence of a fiduciary relationship. (MTD Mem. at 17.) To reach this conclusion, Norton ignores all of its Lease covenants and the unique relationship consisting of affiliation, disclosure and transparency, baldly characterizing the relationship as a mere arms-length commercial relationship in exchange for \$1 a year rentals. (*Id.* at 18.) In this long-term relationship created to establish a public/private asset that exists in order to promote a public purpose, it is simply not credible to make such claim.

As the Kentucky Supreme Court has found, "[t]he circumstances which may create a fiduciary relationship are so varied, it is extremely difficult, if not impossible, to formulate a comprehensive definition of it that would fully and adequately embrace all cases." *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 485 (Ky. 1991). Therefore, determining whether a fiduciary relationship exists is a fact intensive inquiry that requires the consideration of a number of factors. *See James T. Scatuorchio Racing Stable, LLC v. Walmac Stud Mgmt., LLC*, 2014 U.S. Dist. LEXIS 68981 at *38 (E.D. Ky. May 20, 2014)(determination of whether a fiduciary relationship existed was not appropriate for motion to dismiss). Norton fails to

acknowledge, let alone analyze, the plain language of the parties' contracts and the extraordinary facts concerning the parties' special fiduciary relationship and the breach of Norton's duty that are extensively pled in the counterclaim.

To survive dismissal of its fiduciary claim, UofL need only offer sufficient facts to demonstrate a *prima facie* case that: (i) the parties' relationship existed prior to the transaction that is subject of the claim; (ii) the reliance was not merely subjective but reasonable; and (iii) the nature of the relationship imposed a duty upon the fiduciary to act in the principal's interest, even if such action were to the detriment of the fiduciary. *See In re Sallee v. Fort Knox Nat'l Bank, N.A.*, 286 F.3d 878, 892 (6th Cir. Ky. 2002). In addition to the plain language of the contracts, there are numerous extraordinary facts demonstrating the parties' fiduciary relationship.

Norton did not cite or analyze these elements, but there does not appear to be any dispute about the first and second elements. There is no question the parties' relationship existed prior to the 1981 Lease at issue. (*See* CC ¶ 5 (“At the time [May 1981], the UofL School of Medicine and its Department of Pediatrics had been partners with Norton and its predecessor, Children’s Hospital, for decades.”).)

UofL’s reliance and trust in Norton to act as a fiduciary is reasonable, satisfying the second element. Based on a plain reading of the parties’ contracts, UofL is entitled to rely on and trust Norton to operate the hospital in a manner that supports and benefits UofL Medical School’s teaching, accreditation, and funding needs, not eviscerate them. The Lease and its related and incorporated agreements reflects UofL’s trust in Norton to update the Affiliation Agreement, apply surplus funds to cover UofL’s unreimbursed costs, and take other actions to benefit UofL’s Medical School rather than Norton’s current actions which undermine the

viability of the medical school by diverting funds, patients, and service lines to the benefit of Norton or another university. (UofL Am. Answer ¶ 10.). UofL's Medical School must remain financially sustainable but instead, suffers a growing annual deficits in order to care for critically ill and at-risk children at Kosair Children's Hospital. (CC ¶ 12.) Norton's covenant to use the resources of Kosair Children's Hospital to provide for care, service and education for the benefit of UofL makes it eminently reasonable to require Norton to use surplus funds to cover the unreimbursed portion of UofL's increased costs, particularly considering the tens of millions of dollars it receives in federal and state aid payments expressly awarded to cover the increased costs associated with the operation of UofL's accredited pediatric teaching hospital. (CC ¶ 19.)

The third element appears to be the only element Norton disputes. (MTD Mem. at 18 (asserting the nature of the relationship is an arms-length commercial one).) Norton's failure to analyze the varied circumstances required by *Steelvest* and conduct the fact intensive inquiry and consideration of fiduciary factors recognized by *Scatuorchio* is fatal to its motion to dismiss. Courts analyze several factors as part of its inquiry, which indicate the existence of a fiduciary relationship here.

CONTRACT LANGUAGE. Courts consider the express or implied contract provisions supporting the creation of a fiduciary relationship. *Scatuorchio*, 2014 U.S. Dist. LEXIS 68981 *46. Generally, a fiduciary relationship is one "founded on trust or confidence reposed by one person in the integrity and fidelity of another and which also necessarily involves an undertaking in which a duty is created in one person *to act primarily for another's benefit* in matters connected with such undertaking." *Steelvest*, 807 S.W.2d at 485 (emphasis added). The parties' contracts expressly establish that the express public purpose for entering into a 99-year Lease was to ensure that Kosair Children's Hospital would serve and benefit UofL as its dedicated

pediatric teaching hospital, requiring a long-term “affiliation” relationship supported by transparency, communication and financial resources. *See e.g.*, 1981 Agreement at 1, Cmplt. Ex. E (The “new pediatric facility is to be constructed on said property where it will provide pediatric care, service and education *benefitting the UofL Medical School ...*”); 1981 Lease at 1, Cmplt. Ex. D (“This Lease made and entered intofor the use and *benefit of the University of Louisville...*”).

Norton’s claim that it only need allow UofL any modicum of access to the pediatric facility disregards the contract language that UofL must also benefit from the operation of the hospital. Such interpretation is contrary to contract construction rules. *See Elkhorn Star Coal Co. v. Hall*, 222 Ky. 345, 300 S.W. 864, 866 (1927) (courts cannot read words out of a written contract because it disregards the writing which the parties executed as the final evidence of the contract.). The parties’ undisputed contract language requires Norton to operate the pediatric hospital to benefit UofL’s Medical School, and thus satisfies *Steelvest’s* definition of a fiduciary duty.

EXTRAORDINARY FACTS. Another factor demonstrating the confidential and fiduciary relationship of trust is the presence of extraordinary facts. *See In re Sallee*, 286 F.3d at 892 fn10. There is nothing “ordinary” about this 99-year Lease of strategic public land located in the center of Louisville’s downtown medical center campus for a nominal rental. Contrary to Norton’s conclusory statement, the parties are not two for-profit commercial entities involved in a simple arms-length commercial relationship. Instead, both parties are non-profit entities operating a dedicated pediatric teaching hospital together on land owned by the Commonwealth of Kentucky with the express purpose of benefitting Kentucky’s children and UofL’s Medical School, a state agency.

The issues involved in this case are so important to the Commonwealth of Kentucky that it has moved to intervene in this case to protect these interests, explaining:

...this case involves UofL's School of Medicine and impacts the pediatric care provided to Kentucky's children. The Commonwealth has an interest in the health and well-being of its citizens, particularly its children. The Cabinet therefore seeks to intervene to defend and protect this interest, providing a voice in the dispute for Kentucky's youngest citizens.

Commonwealth's Motion to Intervene at pp. 3-4.

PUBLIC ASSET AND UNIVERSITY. The real property on which the pediatric facility was built pursuant to the Lease is titled in the name of the Commonwealth of Kentucky for the use and benefit of UofL. (CC ¶¶ 4, 9). The Commonwealth considers the land leased to Norton a public asset. Commonwealth Answer ¶ 22. The express purpose for constructing the new pediatric hospital on the state-owned public property was to benefit UofL, which is an agency and instrumentality of the Commonwealth and part of the state university system. (CC ¶ 4.)

UofL's status as a state university required to operate its School of Medicine to benefit Kentucky's citizens also makes the facts here unique. Among its findings about Kentucky's state universities, Kentucky's General Assembly specifically found "[t]he general welfare and material well-being of citizens of the Commonwealth depend in large measure upon the development of a well-educated and highly trained workforce." KRS § 164.003 (1)(a). The General Assembly declared a goal to be achieved by the year 2020 is "[a] premier, nationally recognized metropolitan research university at the University of Louisville." KRS §164.003(2)(c). KRS §164.815(1)(c) requires UofL to provide professional degree programs including medicine. All of these extraordinary facts combine to demonstrate a special relationship of trust and confidence.

NON-PROFIT ENTITIES. The fact that both parties are non-profit entities is another factor making it more likely a court will find a fiduciary relationship. *See Riverside Auto Sales,*

Inc. v. GE Capital Warranty Corp., 2004 U.S. Dist. LEXIS 18965 *28 (W.D. Mich. Mar. 30, 2004) (citing various cases) (courts are less likely to find a fiduciary relationship when the parties are experienced, for-profit entities.). *See also Crestwood Farm Bloodstock, LLC v. Everest Stables, Inc.*, 864 F. Supp. 2d 629, 640 (E.D. Ky. 2012) (same).

Norton is a non-profit healthcare provider, and Norton's Kosair Children's Hospital specifically serves as the dedicated pediatric hospital for UofL's School of Medicine. (MTD Mem. at 3.) For nearly 30 years, the City of Louisville has had a tradition of providing excellent care to children in a centrally-located, downtown facility, providing safety-net services to the community's poorest, sickest children. (UofL Am. Answer ¶ 35 (quoting press release).) The parties have been partners for decades to provide this critically needed health care. As the Commonwealth explained, "UofL and Norton have been partners in a long term arrangement to operate the Children's Hospital and are partners to the 2008 Affiliation Agreement." (Commonwealth Answer ¶ 11.)

CONFIDENTIAL RELATIONSHIP. A confidential relationship augurs in favor of a fiduciary relationship. *Steelvest*, 807 S.W.2d at 486. The position of trust, the freedom of decision, and access to confidential corporate information in the relationship between Norton and UofL evidences a fiduciary duty. *See Aero Drapery of Kentucky, Inc. v. Engdahl*, Ky., 507 S.W.2d 166, 168 (Ky. 1974). As per the parties' contract, UofL's medical staff and Board of Trustee members are supposed to be permitted to attend not only Norton's Board of Directors' meetings – but also its Executive Committee meetings - for the express purpose of assuring complete communication about the operations of the public/private asset, Kosair Children's Hospital. (CC ¶¶ 40-41; Cmpl. Ex E at 2.) As partners in providing pediatric care at Kosair

Children's Hospital for the 99-year term of this Lease, Norton is in a position of trust and confidence to UofL. (CC ¶ 57.)

UNDUE POWER. The undue exercise of power or influence by one party is yet another sign of a fiduciary relationship. *Quadrille*, 242 S.W.3d at 365. See also *Riverside*, 2004 U.S. Dist. LEXIS 18965 *24 (The fiduciary concept has to do with one party's inequality in the face of the other party's advantage.). To satisfy the statutory requirement and ability to operate a pediatric teaching program, UofL's Medical School must be accredited and have a current affiliation agreement with Norton at Norton's Kosair Children's Hospital. (CC ¶ 11.) Norton receives and holds millions in patient revenue and government aid for the benefit of offsetting UofL's unreimbursed cost of providing medical care and education at Kosair Children's Hospital. (CC ¶ 19.) As the recipient of disproportionate revenue and government aid, Norton is in a position to – and does - take advantage of UofL by diverting funds to its own purposes and refusing to apply Hospital funds and aid to benefit UofL. Norton then uses its control over these accumulated surplus funds as a bargaining chip in talks with UofL. Norton has also taken advantage of its superior economic and market power by closing service lines to UofL's School of Medicine, incentivizing its own physicians to divert patients from University physicians, refusing to negotiate an updated affiliation agreement, and withholding funds threatens the accreditation and financial viability of UofL's School of Medicine, demonstrates the undue power factor evident in a fiduciary relationship. (UofL Am. Answer ¶ 10.)

NORTON'S BREACHES. An analysis of the extraordinary facts and circumstances of this case establishes the existence of Norton's fiduciary duty. UofL has pleaded extensive facts pled to give shape to Norton's breach of that duty. Norton has:

- (1) eroded the UofL School of Medicine's ability to use Kosair Children's Hospital to educate students and pediatric residents;
- (2) reneged on its financial commitments to

reimburse the UofL School of Medicine for its increased costs for residents and faculty, education and research required to maintain its accreditation as a pediatric teaching hospital; (3) failed to account for the application of its federal and state aid payments and resources generated by the UofL School of Medicine at Kosair Children's Hospital for UofL's increased costs to the benefit of the UofL School of Medicine and the Kosair Children's Hospital; (4) hid from both UofL and the public information concerning the operations and finances of Kosair Children's Hospital beginning in 2010 by consolidating the Hospital's separate operations into one set of financial statements for the entire Norton "system" — which effectively concealed the revenues, expenses and surplus generated by Kosair Children's Hospital and permitted Norton to use such surplus for the benefit of Norton's other facilities; (5) withheld reimbursement of UofL's increased costs as leverage to negotiate more favorable terms for itself in years of protracted negotiations with UofL over an updated Master Affiliation Agreement (and individual programmatic agreements); and (6) secretly negotiated a Letter of Intent without UofL's knowledge or consent, which purports to delegate joint management and operational control of Kosair Children's Hospital to another university.

(CC ¶ 23.)

III. UofL Has Stated Claims for Promissory Estoppel and Unjust Enrichment and its Alternative Pleading is Not a Basis for Dismissal.

UofL has alternatively pleaded claims for unreimbursed costs by asserting actions under the theories of Promissory Estoppel and Unjust Enrichment. (Counts III and IV.) In other words, in the event that the Court finds that *neither* the Lease or the Critical Care Agreement support a "contract" claim for Norton's refusal to pay for its funding commitments, then these non-contractual claims permit recovery. UofL has alleged a sufficient factual background and *prima facie* case to satisfy both claims.

A. Alternative Pleadings are Expressly Permitted Under the Civil Rules.

Norton asserts that UofL's promissory estoppel and unjust enrichment claims should be dismissed because they are duplicative of UofL's claims for breach of contract. (MTD Mem. at 19.) The fact that UofL has pled its claims in terms of both contract and equity is not a basis for dismissal. Whether Norton's numerous commitments sound in contract or equity, pleading in the alternative is standard legal practice. *See Huddleston v. Hughes*, 843 S.W.2d 901, 904 (Ky.

App. 1992). Because a party is the master of his own complaint or counterclaim, he is entitled to plead alternative courses of action. *Whitley v. Robertson County*, 406 S.W.3d 11, 17 (Ky. 2013).

Kentucky Rule of Civil Procedure (“CR”) 8.01(1) expressly provides that in pleading a claim, relief in the alternative or of several different types may be demanded. Whether the claims are based on legal or on equitable grounds (or both), a party is permitted to state as many separate claims as he has, regardless of whether they may concurrently provide recovery. CR 8.05(2). The only limitation is that the claimant must be able to demonstrate a *prima facie* case for each cause of action and may ultimately recover only once for an injury. *MV Transp. Inc. v. Allgeier*, 2014 Ky. LEXIS 230 *26 (Ky. June 19, 2014) (internal quotation omitted). UofL is expressly permitted by the civil rules to assert its claims alternately and has stated *prima facie* cases for both equitable claims.

B. UofL has alternatively pleaded a sufficient basis for its equitable claims.

1. Promissory Estoppel: Norton has refused to honor its funding commitments to UofL.

To the extent the Court finds Norton’s claims for Norton’s refusal to honor funding commitments do not sound in contract, Norton’s funding promises are enforceable in equity. (CC ¶¶62, 64.) Promissory estoppel can be invoked when a party reasonably relies on a statement of another and materially changes his position in reliance on the statement. *Rivermont Inn, Inc. v. Bass Hotels & Resorts, Inc.*, 113 S.W.3d 636, 642 (Ky. App. 2003).

The allegations supporting UofL’s counterclaims, taken as true for this motion to dismiss, establish that Norton made multiple funding commitments for UofL’s unreimbursed costs, including reimbursement for salary increases, medical education expenses, and clinical and research investments. (See CC ¶¶ 32-39, 62-63.) UofL reasonably relied on Norton’s express commitments and materially changed its position by expending funds in anticipation of Norton’s

reimbursement promises. (See CC ¶¶ 35-36, 39.) UofL has been damaged by experiencing significant financial losses, as well as losing out on teaching, hiring, and research opportunities. (CC ¶¶ 39, 65.) Because estoppel is always a question of fact to be determined by the circumstances of each case, dismissal is not proper. See *McKenzie v. Oliver*, 571 S.W.2d 102, 106 (Ky. App. 1978).

C. Unjust Enrichment: Norton has been unjustly enriched by retaining the governmental funding it received for UofL's services.

Uof L has also adequately pleaded an estoppel claim. Count IV of the Counterclaims describes Norton has been unjustly enriched by receiving the benefit of millions of dollars in physician care and education for which it has not paid, despite its commitments to do so, coupled with Norton's refusal to use tens of millions of dollars in government aid to pay for care, service and education. (CC ¶¶ 68-71.)

Unjust enrichment is one basis of "restitution to prevent one person from keeping money or benefits belonging to another." *Haeberle v. St. Paul Fire and Marine Ins. Co.*, 769 S.W.2d 64, 67 (Ky. App. 1989). A *prima facie* case for unjust enrichment requires: (1) a benefit conferred upon defendant at plaintiff's expense; (2) a resulting appreciation of benefit by defendant; and (3) inequitable retention of benefit without payment for its value. *Jones v. Sparks*, 297 S.W.3d 73, 78 (Ky. App. 2009). As stated in UofL's counterclaims, Norton received significant funding from federal and state government aid sources as a result of operating UofL's pediatric teaching hospital. (CC ¶¶ 19-21.) In return, Norton agreed to make certain funding payments to UofL. (CC ¶ 32, 69.) Norton, however, failed to honor its funding commitments, resulting in Norton's inequitable retention of the millions it received. (CC ¶71.) UofL satisfies a *prima facie* case for its alternative claim of unjust enrichment.

D. If Norton Prevails in its Claim that the Parties' Contracts Do Not Cover its Various Promises, UofL is Entitled to Prevail with its Equitable Relief.

Norton espouses two diametrically opposed positions in support of its motion to dismiss the promissory estoppel and unjust enrichment claims. First, Norton claims that it has no contract obligation to honor such commitments; second, Norton asserts that UofL's equitable claims should be dismissed because they represent the same performance contemplated under the parties' written contracts. (MTD Mem. at 19.) Norton's argument about UofL's equitable claims *totally contradicts* its argument about UofL's contractual claims. In moving to dismiss UofL's contract claims, Norton admits the contracts between the parties but denies those contracts contain obligations for the majority of UofL's claims, stating:

The contracts do not impose any funding obligation on Norton, do not prevent Norton from exploring a potential affiliation with UK's pediatric hospital, or require that Norton operate KCH for UofL's "exclusive" benefit. (MTD Mem. at 2.)

Norton does not have a contractual obligation to continue to be a party to (or update) an affiliation agreement with [] U of L... (*Id.*)

Norton never agreed in any contract to be responsible for U of L's accreditation with ACGME. Thus, U of L has identified no contractual obligation for Norton to renegotiate the current affiliation agreement. (*Id.* at 13.)

[U]nder the plain language of the contracts asserted by U of L, Norton has no general funding obligation to U of L. (*Id.* at 13.)

U of L does not identify a contractual provision that prohibits them or that requires Norton to maintain the quality of U of L's programs. (*Id.* at 15.)

Nothing in the Ground Lease or any other agreement prohibits Norton from giving patients the right to be treated by non-U of L doctors in favor of private doctors who have better qualifications, or from hiring a private practice group or bringing in faculty from UK to work alongside U of L doctors at KCH. *Id.*

If, as Norton asserts, the parties' contracts do not govern these issues, then UofL's equitable claims are not barred by the existence of certain contracts. If the parties' contracts *do* govern all of UofL's claims, Norton's argument that UofL's breach of contract claims fail to

state a claim is fatally flawed. In any event, UofL is entitled to pursue both its contractual and equitable remedies in the alternative. Further, the allegations supporting UofL's equitable claims must be taken as true in connection with this motion to dismiss. UofL should have the opportunity to discover and present the facts supporting the allegations of its equitable claims. *See Brewer v. Branch Banking & Trust Corp.*, 2005 U.S. Dist. LEXIS 18496 *7-8 (W.D. Ky. Aug. 26, 2005).

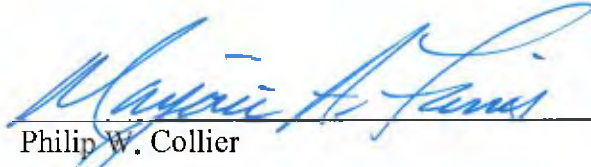
IV. UofL Has Stated a Claim for Declaratory Relief (Count V).

Norton also contends that UofL's declaratory relief claim fails, because it believes UofL has failed to state a claim for breach of the Lease or any other agreement. As discussed above, UofL has stated a claim for breach of contract. *See* Argument I, *supra*. In addition, UofL has alleged a sufficient case or controversy to undergird a claim for declaratory relief. KRS 418.040 provides that "[i]n any action in a court of record of this Commonwealth having general jurisdiction wherein it is made to appear that an actual controversy exists, the plaintiff may ask for a declaration of rights, whether or not consequential relief is or could be asked." UofL has alleged that (1) the Lease is valid and enforceable against Norton, (2) that UofL may enforce the Lease, (3) that Norton has breached the Lease and failed to timely cure, and (4) that UofL may terminate the Lease and pursue its remedies. (CC Count V.) Because Norton and UofL are locked in a dispute about these very issues, this Court can (and should) issue a declaration of rights in UofL's favor.

CONCLUSION

The express covenants in the Lease and its incorporated agreements entitles UofL to relief for Norton's systematic breaches of contract and breaches of fiduciary duty. Additionally, UofL has sufficiently pleaded its promissory estoppel and unjust enrichment claims in the

alternative, and its declaratory claims present a justiciable controversy. Accordingly, Norton's motion to dismiss UofL's counterclaims should be denied.



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by electronic mail and U.S. Mail, on the 29th of August, 2014 upon:

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