NO. 13-CI-01060

FRANKLIN CIRCUIT COURT
HON. THOMAS D. WINGATE
DIVISION II

NORTON HEALTHCARE, INC. — Plaintiff

v.

UNIVERSITY OF LOUISVILLE'S SUR-REPLY IN OPPOSITION TO NORTON HEALTHCARE, INC.'S MOTION TO DISMISS

UNIVERSITY OF LOUISVILLE — Defendant

And

COMMONWEALTH OF KENTUCKY, FINANCE AND ADMINISTRATION CABINET — Intervening Defendant

* * * * *

The Reply filed by Norton Healthcare, Inc. ("Norton") shifts the basis of its motion to dismiss from merely disputing the facts pleaded in the counterclaim to arguing *for the first time* that the covenants it made to the University of Louisville in the Lease are unenforceable recitals. Norton's Reply likewise cited new authorities and arguments that it could have made initially, but instead chose to "keep its powder dry." This Sur-reply addresses the new authorities and arguments.

Norton's motion should be denied because the facts stated in UofL's counterclaim must be taken as true, and all of Norton's unsupported and false allegations of "fact" in its memoranda must be disregarded.[1] And Norton cannot be permitted to re-write the Lease to remove its obligations to use Kosair Children's Hospital to "provide care, service and education benefitting UofL's School of Medicine," to make Kosair Children's Hospital "serve the interests of and be

[1] Despite the undisputed Kentucky legal standard of having to accept the allegations of UofL's counterclaim as true, Norton salted its motion to dismiss memoranda with a series of false and unsupported "facts" and innuendo that have no connection to this lawsuit – and which UofL flatly denies here. *See, e.g.*, Norton Mem. in Supp., at 1-2, 6, 8, 12-14; Norton Reply, at 1-2, 6-11, 13-14.

to the benefit of" the Commonwealth, to maintain an updated medical affiliation agreement and to make KCH's operations transparent to UofL. It simply makes no sense that the Commonwealth and UofL would rent the most strategically valuable parcel of property in Louisville's downtown medical complex to Norton for $1 a year for up to 149 years[2] without requiring Norton – for the term of the Lease - to act in partnership with UofL as required in the Lease and its mutual covenants.

ARGUMENT

I. The covenants set out in the Lease recitals and incorporated by reference are enforceable substantive provisions of the 149-year Lease.

Norton leads its Reply with four pages dedicated to a *new* argument that its covenants and promises set out in the Lease recitals and incorporated by reference "do not create enforceable obligations."[3] Reply, at 2-5. However, Norton's argument is a non-starter because it relies on cases that consider the effect of mere explanatory recitations that are not part of the deal at hand. The Lease between Norton, UofL and the Commonwealth expressly makes these recitals part of the operative agreement. First, the Lease describes the recitals as "covenants" and states that they form part of the "consideration" for the Lease. Lease, at 2.[4] It is well-settled that Kentucky courts enforce covenants contained in a lease. *Ashland Oil, Inc. v. Realty Farm Dev. Co.*, 485 S.W.2d 891, 893-894 (Ky. 1972).

Second, Paragraph 3 of the Lease expressly incorporates the entire August 12, 1981 agreement between UofL and Norton as part of the Lease. Paragraph 3 underscores that the

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[2] Norton describes this Lease as a 149-year lease on the premise that Norton may exercise an option to extend the Lease term by 50 years by paying $50 more in rent. Reply, at 7; Lease, Paragraph 2, at 3.

[3] Norton's initial memorandum *assumed* for purposes of argument that the covenants, if binding, did not create the obligations alleged; and cited no legal authorities for the proposition that these recitals did not create binding obligations. Norton Mem. in Supp., at 11 (*e.g.*, "even if that recital is binding"). Norton "saved" its legal authorities for the Reply.

[4] "[F]or and in consideration of the mutual covenants of the parties hereto, as set in the preambles hereto, and as hereinafter set forth . . . ."

August 12, 1981 agreement is "further consideration for this lease" and "provides for the mutual benefit and cooperation in the development of the new pediatric facility," - and makes clear that the covenants in the August 12, 1981 agreement "shall survive the execution of this Lease." Third, each of the covenants relied upon by UofL in the counterclaim speaks in the language of future obligation and commitment, rather than mere explanation of historical facts.[5]

Kentucky law is clear that recitals which expressly form part of the *consideration* for the contract and which purport to operate as *covenants* create binding and enforceable obligations. Norton chiefly relies upon *Jones v. City of Paducah*, 142 S.W.2d 365, 367 (Ky. 1940) for the unremarkable proposition that an explanatory recital does not create a contract obligation. But the recitals in *Jones* did not expressly form part of the "consideration" for the deal, nor were they described as "covenants" between the parties. As Kentucky's highest Court recognized in *Ingram v. State Property & Bldg. Com.*, 309 S.W.2d 169, 172-73 (Ky. 1957), "this 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," distinguishing "[t]he contract in the *Jones* case" as "a series of preliminary clauses setting out the reasons why the agreement was desirable to the parties." *Id.*

Likewise, Norton's citation of *Pannell v. Shannon*, 425 S.W.3d 58, 64 (Ky. 2014), where the Court refused to consider a name appearing on the "cover page" of a lease an operative provision, citing the *Jones* decision as authority, does not support their argument that recitals described as "covenants" and "consideration" for the agreement are not substantive provisions. The two non-Kentucky cases cited by Norton, see Reply at 4, do not address or change Kentucky

[5] Norton agrees that the new Kosair Children's Hospital will "provide pediatric care, service and education benefitting the UofL Medical School and the citizens of the Commonwealth of Kentucky." August 12, 1981 agreement as incorporated by reference into the Lease, at 1; 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." Lease, at 1.

law as set forth in *Ingram*, *supra*, which looks to the substance of the provision rather than the label of "recital."[6] Norton's argument to disregard substantive recitals has been roundly rejected by Kentucky courts.

II. Norton's motion to dismiss must be denied because it is premised on disputed issues of fact; UofL should be permitted to take discovery and a special master should be appointed to investigate the hidden finances of Kosair Children's Hospital.

Norton weaves a consistent theme throughout its motion to dismiss – it does not agree with the facts alleged in UofL's counterclaim and wants the Court to consider its view of the facts instead.

A. Norton's motion to dismiss Count I should be denied because Norton simply disagrees with UofL's fact allegations and asserts disputed fact-based arguments.

Norton leads its opposition to UofL's contract claims by offering a "course of performance" argument which incorrectly – and without any record support - argues that UofL's reading of the Lease is inconsistent with the actions of the parties: "for 32 years . . . UofL never once suggested that Norton had any financial obligation" under the Lease; UofL's claims are "foreclosed by . . . the parties' 30-plus year operating history." Norton Mem. in Supp., at 1; Reply, at 3. Assuming Norton's course of performance argument could be used as a "wedge" to change the terms of the Lease – which it cannot – it would, at best, create a fact dispute to be resolved by a trier of fact. *Cater v. Starbucks Corp.*, 2010 U.S. Dist. LEXIS 81864 *14 (E.D. Pa. August 10, 2010); *Radiation Sys. v. Amplicon, Inc.*, 882 F. Supp. 1101, 1103 (D.D.C. 1995).

Norton similarly argues that Norton's Letter of Intent ("LOI") with UK does not demonstrate Norton's intent to breach its Lease obligations:

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[6] Neither of these cases help Norton's argument. In *Z-Rock Comms. Corp. v. William A. Exline, Inc.*, 2004 WL 1771569, *9 (N.D. Cal. 2004), the court refused to give substantive effect to an explanatory recital which was neither described as a "covenant" or part of the "consideration." Similarly, in *Grynberg v. F.E.R.C.*, 71 F.3d 413, 416 (D.C. Cir. 1995), the court merely refused to apply a recital – which recital did not purport to be a "covenant" or "consideration" for the agreement - to contradict another provision in the agreement.

> **Integration**. . . . . The Parties will jointly manage and engage in consolidated operations with respect to all aspects of patient care at the Hospitals . . . .
>
> [T]hey will share in the profits and losses resulting from the operation of the Hospitals in proportions to be determined by the Parties.

LOI at 2-3. The Counterclaim alleges that Norton explicitly intended to divert the assets, operations and revenue of UofL's dedicated pediatric teaching facility to itself and to another university, all without having disclosed its secret negotiations and plans to do so.

Whether a party intends to take action which would breach contract is a question of fact, *Upton v. Ginn*, 231 S.W.3d 788, 791 (Ky. App. 2007), which is amply demonstrated by Norton's disagreement concerning UofL's allegations. Norton cites new authority for the novel proposition that UK LOI did not demonstrate Norton's intent to breach the Lease. Reply, at 6, citing *Brownsboro Rd. Rest., Inc. v. Jerrico, Inc.*, 674 S.W.2d 40, 41 (Ky. App. 1984). Norton then argues that its statement of intent to divert and divide control of and revenue from UofL's pediatric teaching hospital did not evidence its intent to repudiate the contracts. Reply, at 6. In the context of a motion to dismiss, however, UofL's facts must be taken as true. *See James v. Wilson*, 95 S.W.3d 875, 883-84 (Ky. App. 2002). Norton incorrectly characterizes Norton's formalized and executed letter of intent as a mere "exploration" of a potential collaboration with UK – and claims that the anticipated sharing of control and revenue impaired the "benefit" provided to U of L under the Lease. (Reply, at 6)

Norton's argument that UofL's claim that Norton's secret negotiation and execution of the LOI is insufficient to plead a prima facie claim for breach of the Lease should be rejected.

Norton's Reply, at 2, raises a new argument to dismiss UofL's breach of good faith claim, asserting that Uof L cannot maintain its claim because it arises from the same allegations as its breach of contract claim citing *In re Facebook PPC Advertising Litig.*, 709 F. Supp. 2d

762, 770 (N.D. Cal. 2010). Putting aside the fact that this is not Kentucky law, other California courts have refused to apply *In re Facebook* where the defendant's range of conduct deprive the plaintiff of the benefits of its contractual rights, including a steadfast refusal to engage in good-faith negotiations. *See Ariba, Inc. v. Rearden Commerce, Inc.*, 2011 U.S. Dist. LEXIS 101129 *30 (N.D. Cal. Sept. 8, 2011).

The Counterclaim alleges in detail that Norton has taken pains to undermine the very basis of the parties' agreements and deprive UofL of its contractual rights, from its secret efforts to divert control and revenue to another university, its diversion of teaching cases and revenue to its own fleet of captive physicians, by hiding financial information, refusing to permit attendance at board and committee meetings, holding government aid as leverage and refusing to negotiate an updated affiliation agreement in good faith.[7] UofL's claim for breach of the implied covenant of good faith fair dealing is based on *more* than mere allegations of contract breach.

Norton's Reply, at 9 n. 4, newly argues that the parties' agreement to periodically to update the affiliation agreement over the 149-year Lease term is merely an unenforceable agreement to agree, citing *Walker v. Keith*, 382 S.W.2d 198, 201 (Ky. 1964). More recent Kentucky cases recognize that a court may exercise powers of equity both to require a party to act in good faith to arrive at reasonable terms and to identify reasonable terms under the circumstances. *Stevens v. Stevens*, 798 S.W.2d 136, 139 (Ky. 1990), citing *Walker*, 382 S.W.2d at 201. UofL's Counterclaim alleges sufficient facts to support updating of an affiliation agreement over the term of this Lease, including: the express public purpose of the Lease for the benefit UofL's pediatric teaching faculty and residents who cannot function without this public asset, UofL's statutory obligation to operate a medical school, the lease term of 149 years,

[7] Norton's recent withdrawal of its bogus and unsupported allegations of an enforceable settlement, which it first used to frustrate mediation efforts and then to delay the prosecution of this case for months illustrates Norton's bare-knuckled tactics.

UofL's status as a non-profit public entity, the Commonwealth's interest in the pediatric care for its youngest citizens and intervention in this case to ensure its interests are protected, and numerous other exceptional facts of this case.

Additionally, the parties agreement to maintain and update the affiliation agreement has a sufficient reference for an enforceable agreement. *See Simpson v. JOC Coal*, Inc., 677 S.W.2d 305 (Ky. 1984). The *Simpson* court similarly enforced an agreement to negotiate in good faith for the sale of shares because there was a similar and contemporaneous agreement that could serve as a reference for a reasonable and sufficiently defined enforceable commitment. *Id.* at 309. Likewise, in this case, the parties have two prior affiliation agreements to serve as a basis for additional negotiations towards a future agreement. *See* 1962 Affiliation Agreement (CC Exh D); 2008 Affiliation Agreement (Complaint Exh C). Therefore, Norton's commitment to negotiate is enforceable, and its motion to dismiss UofL's claim on the updated affiliation agreement should be dismissed.

Norton's new arguments seeking to dismiss the claim for breach of the Critical Care Agreement ("CCA") similarly lack heft. Norton claims that UofL's CCA claims are moot because the parties amended the CCA in February 2014. Reply, at 9. While UofL did assert Norton's breach of its obligation to update the CCA, UofL also asserted additional breaches of the 2006 CCA, including Norton's past failures to financially reimburse UofL per its terms. CC ¶¶ 15-18, 34-35, 53-55. Because the February 2014 amendment did not replace the 2006 CCA, the 2006 CCA terms survive as a basis for UofL's claims for reimbursement. Additionally, UofL expressly reserved in the amendment all its claims against Norton under the 2006 CCA, stating, "The execution of this agreement does not release, settle, or waive any pending claims or dispute . . . ." *See* Reply, Exh C, 2014 CCA Amendment.

Norton then argues that UofL does not have standing to prosecute a claim for breach under the CCA because it is not a titular party to the CCA – even though UofL is undisputedly a third party beneficiary entitled to enforce rights and obligations under the agreement,[8] and Norton has consistently taken the position that the CCA is one of 135 written contracts that it claims govern the relationship between UofL and Norton. This argument fails.

For these reasons, Norton's motion to dismiss Count I of the counterclaim should be denied.

B. UofL pleads a *prima facie* claim for breach of fiduciary duty – Norton's fact-bound argument fails to support dismissal of Count II.

Norton opposes UofL's breach of fiduciary duty claim, filling pages disputing the facts alleged in the Counterclaim and offering its own set of competing facts. Reply, at 1-2, 13-14. Determining whether there is a fiduciary duty is a fact intensive inquiry, which is not appropriate for a motion to dismiss. *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). For example, Norton disputes UofL's allegations that show why the Lease was not an ordinary arm's length transaction for commercial gain: UofL and Norton's predecessors had been operating a pediatric teaching hospital partnership for many decades before the Lease, UofL and the Commonwealth granted a 149-year lease of publicly-owned land for $1 a year in exchange for a continuing partnership

[8] A third party for whose benefit a contract is made may maintain an action on that contract. *Long v. Reiss*, 160 S.W.2d 668, 673 (Ky.1942). Once a contract is made for the benefit of a third party, privity between a promisor and a third party beneficiary, necessary to be a binding legal obligation, is created by operation of law. *Lincoln National Life Ins. Co. v. Means*, 95 S.W.2d 264, 269 (Ky.1936). The CCA explains that its intent and purpose was to provide for the hiring and reimbursement of physicians from University of Louisville's School of Medicine, pursuant to Norton's ongoing relationship with the School, in order to provide teaching services to the UofL medical residents in the specialty of pediatrics utilizing the facilities of Hospital. Norton specifically contracted with the Group's physicians "to provide Pediatric Critical Care Services and Sedation Services at Hospital ," defined as members of UofL's School of Medicine's faculty. CCA ¶¶ 2.01, 1.05. Notice to the Group under the contract was required to be sent to the Chairman of the Department of Pediatrics, at the University of Louisville's School of Medicine. ¶ 23.01.

affiliation for a dedicated pediatric teaching hospital at the site, the Hospital is required to provide care, service and education for the benefit of UofL and Norton agreed to operate the Hospital in the interests – and for the benefit - of UofL, with special rights of transparency and disclosure, which UofL alleges that Norton has violated by refusing to account for the operations of Kosair Children's Hospital separately since 2009 - and by refusing to permit UofL representatives to attend Norton board and executive committee meetings. UofL and the Commonwealth would never have leased public property to Norton had it not agreed to these covenants.

Norton disagrees with these facts and claims that it has paid the $99 rent in advance and will pay $50 more if required. Mem in Supp., at 2, 5; Reply, at 10. Norton argues that certain appraisals established that UofL was paid "fair market value" for the land under the Lease. Reply, at 2, 10, 13. Norton's arguments contradict its own legal positions,[9] and in any event the value of the land is, at best, an issue of fact to be resolved in discovery.[10] Norton also asserts that UofL may only attend Norton committee and board meetings as "guests," denies that it has refused access and claims that "UofL has never routinely sent such guests" to the meetings. Reply, at 14 n. 8. These are all disputed facts.

UofL alleges that the Lease requires Norton to maintain and update a pediatric teaching hospital affiliation with UofL for the full term of the Lease, that an affiliation agreement is required by ACGME guidelines, and that if Norton were to sever or impair its affiliation with UofL, UofL would either have no pediatric teaching hospital, or insufficient access and resources

[9] This payment was made under the August 12, 1981 agreement, which Norton has consistently argued is not part of the Lease, *see* Norton Mem. in Support, at 3-4 ("separate, stand-alone agreements"); but for purposes of this argument argues the opposite, urging the Court to treat this payment as part of the Lease. Reply, at 10, 13 n.7 ("structured as a land lease, Norton paid [for the land] upfront"). Norton can't have it both ways.

[10] The August 12, 1981 agreement states that the small amount paid to the foundation amounted to "appraised value" of the land, but the agreement does not incorporate the appraisals as part of the agreement and they are not part of the record for this motion.

to operate its programs. Once again, Norton disagrees with UofL's facts, asserting that an affiliation agreement with Norton is unnecessary to UofL's continued operation of a pediatric teaching hospital, claims that there is no need to update affiliation agreements based on changes in patient acuity and healthcare delivery standards, and disputes the content and meaning of ACGME requirements, and asserts that all it has to do is allow UofL faculty and students to be able to be present in the facility. Reply, at 8-9, 13-14.

UofL alleges that Norton exercises undue power over UofL by hiding the results of Kosair Children's Hospital financial operations from UofL beginning in 2009, refusing to use the Hospital's surpluses from government aid received as a teaching hospital and other revenue to provide service, care and education benefitting UofL's School of Medicine, refusing to update the out-of-date affiliation agreement and programmatic agreements and distribute funds due to UofL, threatening to divide the patients, revenues and benefits of the parties' shared public asset with other universities, or to terminate the affiliation altogether, and by closing physician service lines and diverting teaching cases, patients and revenue at the Hospital from UofL to its own fleet of employed physicians – all in order to secure greater revenue and market power for itself and wrest concessions from UofL and reduce its funding for services provided at the Hospital. Once again, Norton's motion to dismiss disputes these facts and alleges counter-facts. Reply, at 8, 10, 11, 13-14.

Norton also incorrectly asserts that courts have rejected a claim of fiduciary duty based on a party's non-profit status, citing *Best Western*, 2010 WL 2595274, *4 (D. Ariz. 2010). Reply, at 14. The *Best Western* court's refusal to find a fiduciary duty had nothing to do with the fact that the Best Western franchisee group was a non-profit organization. The decision in *Jobscience, Inc. v. CVPartners, Inc.*, 2014 U.S. Dist. LEXIS 2741 *16 (N.D. Cal. Jan. 9, 2014) -

which confirms Kentucky law that the court should consider a variety of factors when determining whether a fiduciary relationship exists - confirms that a contract for the benefit of a non-profit entity is a positive factor in in that inquiry. Norton's motion to dismiss UofL's fiduciary duty claim should be denied and the parties permitted to take discovery.

CONCLUSION

For the reasons set out in its opposition and sur-reply, UofL respectfully requests that Norton's motion to dismiss be denied, it be permitted to proceed with discovery and a special master be appointed to investigate and make findings of fact concerning the financial operations of Kosair Childrens' Hospital.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by electronic mail and United States. First Class Mail, postage prepaid, on this 5th day of November, 2014 to the following:

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