**COMMONWEALTH OF KENTUCKY**
**SUPREME COURT**
**CASE NO. 2012-SC-000242-D**

BAPTIST PHYSICIANS LEXINGTON, INC., BAPTIST HEALTHCARE SYSTEM, INC., MICHAEL MCKINNEY, M.D., GREGORY COOPER, M.D., and JAMES WINKLEY, M.D. — APPELLANTS

v.

ON DISCRETIONARY REVIEW FROM
KENTUCKY COURT OF APPEALS
CASE NOS. 2010-CA-001182, 2010-CA-001183,
2011-CA-001128 and 2011-CA-001129

FAYETTE CIRCUIT COURT
CIVIL ACTION NOS. 08-CI-01004 and 09-CI-06390

THE NEW LEXINGTON CLINIC, P.S.C. — APPELLEE

# BRIEF FOR APPELLEE

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## CERTIFICATE OF SERVICE

This is to certify that a true copy of this Brief was served on this the 22nd day of January, 2013, by first class mail, postage prepaid, to: Clerk, Kentucky Court of Appeals, 360 Democrat Dr., Frankfort, KY 406011; the Hon. Kimberly Bunnell, Fayette Circuit Court Judge, 521 Robert F. Stephens Courthouse, 120 N. Limestone, Lexington KY 40507; Gregg E. Thornton, Licha H. Farah, Jr., Ashley K. Brown, Ward, Hocker & Thornton, PLLC, 333 W. Vine Street, Suite 1100, Lexington, Kentucky 40507; Anne A. Chesnut, Wendy Bryant Becker, Bingham Greenebaum Doll, LLP, 300 W. Vine Street, Suite 1100, Lexington, Kentucky 40507; B. Lee Kessinger, III, Adrian M. Mendiondo, Kinkead & Stilz, PLLC, 301 E. Main Street, Suite 800, Lexington, KY 40507.

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## STATEMENT CONCERNING ORAL ARGUMENT

The Appellee believes that oral argument in this case will prove valuable to the Court's understanding of the issues. Therefore, Appellee requests an oral argument.

## COUNTERSTATEMENT OF POINTS AND AUTHORITIES

## COUNTERSTATEMENT OF THE CASE

This appeal arose out of the grant of summary judgment to the Appellants in two cases that are similar to *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky.1991), in facts, claims and procedural posture. Contrary to the efforts of Appellants to confuse the Court, this dispute relates to their joint conduct in establishing a competitive enterprise in contravention of their fiduciary duties. In their Brief to this Court, the Appellants ignore *Steelvest's* holding that in moving for summary judgment (and on appeal therefrom), all facts and inferences must be viewed in the light most favorable to the non-movant, The New Lexington Clinic, PSC ("NLC" or "Appellee"). The Appellants present only evidence that favors them. A presentation of the evidence in the record and in conformity with *Steelvest* follows:

### I. DR. MCKINNEY'S MISCONDUCT

Appellant Michael McKinney, M.D. ("Dr. McKinney") was employed by NLC in 1997. Record on Appeal[1] in 2010-CA-1129, NLC's sealed Response to Motion for Summary Judgment at 7 ("Sealed Response") and Exhibit 1. He worked at NLC's facility in Veteran's Park ("VP") in Fayette County, near Jessamine County. Sealed Response at 7. From 2003 through February 8, 2008, he served on NLC's Board of Directors. *Id.* at 7 (McKinney depo. at pp. 18-19). He was a member of NLC's committee exploring expansion of services in Jessamine County. *Id.* at 7-8 (McKinney depo. at p. 69).

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[1] For ease of reference, the record for appeal number 2010-CA-466, shall be referred to as "RA466;" 2010-CA-467 as "RA467;" 2010-CA-1128 and 2010-CA-1183 collectively as "RA1128;" and 2010-CA-1129 and 2010-CA-1182 collectively as "RA1129." NLC's sealed Response to the Defendants' Motion for Summary Judgment and exhibits, and NLC's Sealed Sur-Reply thereto, shall be referred to as "Sealed Response" and "Sur-Reply," respectively.

For almost a year during that time, Dr. McKinney worked with David Bensema, M.D. ("Dr. Bensema"), a recruiter employed by Appellant Baptist Healthcare System, Inc. ("BHS") to hire physicians for BHS's subsidiary, Appellant Baptist Physicians Lexington, Inc. ("BPL") (collectively, BHS and BPL are referred to as the "Baptist Defendants"), to establish an enterprise to compete with NLC a few miles from VP, across the Jessamine County line. This is now the BPL primary care facility at Brannon Crossing ("BC"). *Id.* at 7. During the same period, Dr. McKinney was working with BHS to form a competitor at BC, he was engaged in discussions at NLC Board meetings about expanding the NLC facility in Jessamine County.

While a NLC Director, Dr. McKinney worked within NLC and with Dr. Bensema to recruit an exodus of VP physicians and staff to this new enterprise. Dr. McKinney first contacted Dr. Bensema in March of 2007, and told him he wanted to discuss employment opportunities for himself, as well as Craig Irwin, M.D. ("Dr. Irwin") and Sibel Gullo, M.D. ("Dr. Gullo"). All were NLC-employed physicians at VP. *Id.* at 8 (Bensema depo. at p. 26). Dr. Bensema was aware that Dr. McKinney was on NLC's Board. *Id.* at 8 (Bensema depo. at p. 102). In the end, Dr. McKinney successfully recruited and BC hired NLC-employed physicians Dr. Gullo, David Gammon, M.D. ("Dr. Gammon") and Phillip Hoffman, M.D. ("Dr. Hoffman"). Dr. Irwin chose not to go to BC. NLC did not pursue claims against Drs. Gullo, Gammon, or Hoffman as none were Directors of NLC.

Drs. Bensema and McKinney decided to pursue opening BC. On June 15, 2007, Dr. McKinney signed a Letter of Intent ("LOI") agreeing to become employed by BPL "and establish a primary care clinic." *Id.* at 9 and Exhibit 3. Drs. Gullo, Gammon and Hoffman executed LOIs in July of 2007. *Id.* at 9. They did not disclose to NLC their

plans to leave and Dr. McKinney remained on NLC's Board until February of 2008, some eight months after he signed his LOI.

In a meeting before Dr. Irwin rejected Dr. McKinney's solicitation to leave, Dr. McKinney indicated why he remained on NLC's Board despite having signed the LOI. When Dr. Irwin's wife, Suzanne Irwin, asked Dr. McKinney if he was planning to resign from NLC's Board, he responded "I don't know, I think I'll need that information." *Id.* at p. 9 (Suzanne Irwin depo. at pp. 95-96; Dr. Irwin's depo. at pp. 218-19).

Later conduct revealed the "information" Dr. McKinney wanted to secure. At least quarterly, NLC CFO, Randy LeMay, provided the NLC Board with financial information regarding all NLC physicians, including billings and compensation calculations. *Id.* at 8. Dr. McKinney was aware that the contents were confidential. *Id.* (McKinney depo. at p. 72). Yet, to induce BPL to offer suitable employment to physicians he was recruiting, he disclosed at least some of it to the Baptist Defendants. On March 30, 2007, for example, Dr. McKinney sent Dr. Bensema an e-mail referring to and disclosing the "wRVUs" (a measure of annual work volume) for all VP doctors (not just those he was recruiting). *Id.* at 8 and Exhibit 2. Dr. McKinney used confidential NLC financial information received because he was on NCL's Board to negotiate higher compensation packages for himself and for the other physicians he was recruiting.

Dr. McKinney met with BHS's Chief IT Officer in May of 2007, to provide "insight regarding the current EMR functionality and use within" NLC, and to discuss issues related to BC. *Id.* at 9 (Tom Carrico depo. at pp. 10, 17) and Exhibit 4. Thus, he was providing details on how BC could compete with VP, and insight into NLC's operations and functionality for this purpose. He also worked with BHS's architect on

BC's facility design. *Id.* at 9 (Skip Alexander depo. at pp. 16, 28).

On July 30, 2007, Dr. Bensema sent a proposed Physician Employment Agreement ("PEA") to Dr. McKinney, with an e-mail stating "**Mr. Sisson would like to meet with you in the very near future before he finalizes the Construction Agreement**" for BC. *Id.* at 9-10 and Exhibit 5 (emphasis added). The lease between BPL and the developer was executed only after BPL secured LOIs from these physicians and they met with BHS CEO, William Sisson. *Id.* at 10.

While the Appellants argue that they should be treated differently under the law because they provide patient care and "not commerce," this was not a charitable effort. No communication produced by Appellants in discovery dealt with patient care; they focused on how much money they were going to make and how much business (patients) they could take from NLC. This is apparent from the Business Plan for BC ("Plan") approved by the BPL Board on November 21, 2007. It authorized BPL to hire four NLC physicians, and confirmed that the Baptist Defendants were concerned with "strong **competition** ... from" NLC. *Id.* at 10 and Exhibits 6 and 7 (emphasis added). The commitments of Drs. McKinney, Gullo, Gammon and Hoffman were central to the Plan because they reduced competition BC would face from NLC, and because they brought established revenues (patients) from NLC. Based on their assurances, secured by the LOIs, the Plan was approved and millions of dollars were committed for BC's construction and operations. *Id.* at 10 and Exhibit 7.

Dr. McKinney continued to push Dr. Bensema for improved compensation packages for himself and the other NLC-employed physicians he had recruited to staff his new practice. Dr. McKinney drafted a letter to Dr. Bensema dated December 22, 2007.

*Id.* at 10-11 and Exhibit 8. Drs. Gullo and Gammon also signed this letter, but confirmed that Dr. McKinney was its sole scrivener, and they did not edit it. *Id.* at 10-11 (Gullo depo. at p. 37; Gammon depo. at pp. 73-74). Confirming that they were targeting NLC patient revenues, Dr. McKinney represented that he and the other physicians would bring patients with them from NLC. This letter was sent to Dr. Bensema on January 1, 2008. *Id.* at 11 and Exhibit 9. Dr. McKinney managed to leverage this into larger guaranteed salaries, bonuses, and an extra year of guaranteed compensation on the terms for all of the physicians. *Id.* at 13 and Exhibit 14 (McKinney depo. at pp. 109-112)

Also while a NLC Director, Dr. McKinney recruited and negotiated the employment of other NLC employees "we would like to bring with us" to BC at "comparable salaries" to what they received at NLC. *Id.* at 11 and Exhibit 9. Dr. Bensema asked Dr. McKinney to provide "the exact titles and degrees required in the employees you are proposing to bring with and their years of service at Lexington Clinic, as well as their hourly compensation." *Id.* at 11 and Exhibit 10. Many of these NLC non-physician employees accepted the BPL employment offers.

In January of 2008, Drs. McKinney, Gammon and Gullo attended a meeting with BHS staff. *Id.* at 12 and Exhibit 11. Dr. McKinney brought his nurse at VP, Marla Hossick, and VP laboratory worker, Carrie Fletcher, to recruit and encourage them to leave NLC to work at BC. *Id.* at 12 (Joyce Moore depo. at pp. 16-18). According to Dr. Gullo, while still a NLC director, Dr. McKinney also asked Marla Hossick, Carrie Fletcher, Marla Sizemore, Elizabeth Kelly and Jennifer Butner, all VP employees, to work at BC. *Id.* at 12 (Gullo depo. at p. 50).

Illustrating an awareness that what he was doing wrong, Dr. McKinney covered

up his activities. For example, he e-mailed confidential NLC financial information from his work computer to his private e-mail account while trying to disguise it as a child's "soccer roster." *Id.* at Exhibit 16. Dr. McKinney also lied to NLC about his intentions and actions, rather than reveal them, when questioned. *See* Argument IX.b., below.

In February of 2008, approximately 11 months after his secret efforts to establish a competitor and staff it with key NLC employees and physicians began; approximately 8 months after he had signed his LOI to be employed by that competitor; and after he had squeezed the last dollar of compensation from BPL through the use of confidential NLC information and promises to take NLC revenues and employees with him, Dr. McKinney gave notice to NLC that he was leaving the Board effective February 8. *Id.* at 13 and Exhibit 12. He delivered a separate notice resigning as a NLC employee. *Id.* at 13 and Exhibit 13. He signed his PEA with BPL the same day. Drs. Gullo, Gammon and Hoffman, and numerous other employees resigned not long thereafter. Dr. McKinney's carefully-orchestrated mass exodus of most of the VP practice had been sprung on NLC.

After these physicians and their staff moved from VP to BC, and as promised by Dr. McKinney, and planned by the Baptist Defendants, numerous patients transferred their records to BC, causing NLC significant loss of income both directly at VP and from loss of ancillary services and care throughout NLC's system. *Id.* at 28 and Exhibit 19. Presumably, this caused correlated gains to accrue to the Appellants, but they wrongfully refused to produce a single document in discovery related to damages.

NLC had physicians and staff from other practice groups cover VP shifts left open by the departure of most of that practice group, causing financial ripples throughout NLC. It also incurred expenses to recruit, hire and train replacement staff and physicians.

While he was actively working to undermine NLC, NLC paid Dr. McKinney $20,000 for his Board membership and over $200,000 for physician compensation. *Id.* at p. 13 and Exhibit 15 (McKinney depo. at pp. 109-112). Dr. McKinney's PEA with BPL provides a salary for three years, most of which is guaranteed, a $15,000 signing bonus, and a share of BC's profits – rewarding him for success in moving revenues from NLC to BC. *Id.* at 13 and Exhibit 14 (McKinney depo. at pp. 109-112).

## II. DRS. COOPER'S AND WINKLEY'S MISCONDUCT

The facts about Appellants, James Winkley, M.D. ("Dr. Winkley") and Gregory Cooper, M.D. ("Dr. Cooper"), are less detailed because the Circuit Court granted summary judgment **without allowing any discovery**. What is known comes primarily from discovery in the case against Dr. McKinney (NLC explored Dr. McKinney's involvement in Drs. Winkley's and Cooper's departures).

In 2007, Dr. Winkley was the Vice President and a NLC Board member and Dr. Cooper was on the Board. NLC's sealed Response to Motion for Summary Judgment contained in RA1128, at Exhibit 1. Dr. Winkley was not re-elected to the Board in December, 2007, but remained on the Board until a replacement came into office and was an officer until January, 2008. *Id.* at Exhibits 2 and 3. Dr. Cooper remained a director until he resigned on February 12, 2008. *Id.* at Exhibit 4. Dr. Bensema was aware that Dr. Cooper was a NLC director. *Id.* at 7 (Bensema Depo. at p. 141).

In late December or very early January, Drs. Winkley and Cooper met with Dr. Bensema regarding BPL employment. Around New Year's Day, they met with Mr. Sisson. *Id.* at 7 (Cooper depo. pp. 104-106). They agreed on PEA terms. *Id.* at 7 (Winkley depo. at pp. 76-77). In early to mid-January, 2008, Dr. Bensema prepared a Business Plan

for Baptist Physicians Lexington Neurology Practice. This Plan was presented to the BHS Board and approved on February 6, 2008. *Id.* at 7 and Exhibits 5 and 6 (Bensema depo. at p. 134). It noted that Drs. Winkley and Cooper were being hired to staff the practice and recognized that they would be in competition with NLC. The compensation arrangements for Drs. Winkley and Cooper were provided for, and were supported by their wRVUs, confidential NLC information Drs. Winkley and Cooper had provided to Dr. Bensema. *Id.* at 7-8 (Winkley depo. at pp. 79, 81-82, 83; Dr. Cooper depo. at p. 63). The Plan referred to clinical trials with pharmaceutical companies that were being undertaken by NLC, in which Dr. Cooper was a principal investigator. The Plan provided that the research was coming to BPL ("This [NLC] research department currently produces $400,000.00 in net revenue per year and is expected to continue that success within the BPL system"). *Id.* at 8 and Exhibit 6. It noted that NLC employees, Shannon Robinson and Ben Newsome, were coming with Dr. Cooper. *Id.* at 8 and Exhibit 6. Thus, while NLC Directors (Dr. Winkley also was an officer), Drs. Cooper and Winkley had agreed to leave and take research projects and secured the departures of NLC employees.

Drs. Winkley's and Cooper's PEAs with BPL include bonuses contingent upon the revenue produced by Baptist Neurology. *Id.* at 9 and Exhibits 9 and 10. Both physicians took their nurses from NLC and Dr. Cooper took his clinical trials and their administrators. *Id.* at 9. Many NLC files on patients treated by Drs. Winkley and Cooper subsequently were transferred to Baptist Neurology.

## III. THE LAWSUITS

### A. The Pleadings

NLC sued Dr. McKinney for, *inter alia*, "breach of fiduciary duty." BPL and

BHS were added in an Amended Complaint on aiding and abetting claims (and/or acting in concert with him). RA466 at 2-7, 109-115, 159-50, 834-42.[2]

The Complaint alleged that Dr. McKinney was both a Director and employee of NLC. *Id.* at ¶6. The Complaint alleged that, as a Director, Dr. McKinney owed NLC duties, including obligations of loyalty, faithfulness, honesty and fair dealing. *Id* at ¶ 13. It asserted that these duties were breached. *Id.* at ¶15. It alleged that, before he resigned as Director, he "made arrangements to depart the [NLC] and facilitate the establishment of a new medical practice in Jessamine County, Kentucky that will compete with [NLC]." *Id.* at ¶7. Included in the Complaint and Amended Complaint as "conduct that was detrimental" to NLC was: (1) negotiating and entering into agreements to compete with NLC, (2) actively recruiting and participating in communications and arrangements for other NLC employees and physicians to resign from NLC to practice in competition with NLC, (3) entering into contracts with those staff and physicians to lure them away from and into competition with NLC, (4) sharing financial information from NLC with its competitor, (5) sharing information on NLC's employment contracts with the Baptist Defendants, (6) discussing buyouts of physician non-compete contracts, (7) sharing information received in confidence as a Director, and (8) taking steps designed to cause patients to transfer to the Baptist Defendants. *Id.* at ¶8. The Complaint alleged that Dr. McKinney did not disclose his conduct before resigning and had engaged in disruptive conduct after resigning. *Id* at ¶¶ 9-11. The Complaint and Amended Complaint sought damages and alleged that the conduct justified punitive damages pursuant to KRS 411.184, which means it was undertaken with "oppression, fraud or malice," defined to

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[2]An incorrect entity was added, but the Baptist Defendants were substituted.

include the specific intent to cause NLC harm or reckless or wanton conduct. *Id.*

**B. Discovery**

In the case involving Dr. McKinney, NLC sought discovery of information from all Defendants from which it could determine the "profits accruing" to them (which *Steelvest* provides are recoverable for this sort of breach of duty), and to help quantify NLC's losses (since what NLC lost can be discerned, in part, by looking at revenues generated at BC). The Appellants refused to produce any discovery related to damages. On April 6, 2009, NLC filed a Motion to Compel damages discovery. RA1129 at pp. 178-244. After a hearing, the Circuit Court stayed damages discovery. RA1129 at p. 275.

BPL later demanded damages discovery *from* NLC, and filed a Motion to Compel NLC to produce it (despite its own refusal to produce such discovery and the stay). RA1129 at pp. 430-39. NLC responded that discovery must be mutual, not unilateral; if BPL did not have to produce damages discovery during this phase of litigation, the same should apply to NLC. RA1129 at pp. 522-42. As the preferred alternative, however, NLC filed a Renewed Motion to Compel seeking damages discovery from the Appellants, so that the stay would be lifted and this discovery could proceed as to all parties. RA1129 at pp. 499-519. Given that discovery from the Appellants was necessary for NLC to quantify damages,[3] it made no sense to expect NLC to provide completed damages discovery or a quantification of damages, while deprived of information from these Appellants necessary to do so. *Id.* BPL responded by seeking a stay of all discovery (not

[3] The Appellants claim NLC overstated damages, Appellants' Brief at pp. 12-14, 36-38, quoting arguments in Motions to Compel illustrating relevance of the information sought, and in the Response to the Motion for Summary Judgment illustrating the nature of the damages. Judgment was entered before any deadline for stating or proving damages.

just damages discovery) pending mediation. RA1129 at pp. 63-35. The Court granted this stay. RA1129 at p. 637. After mediation proved unsuccessful, the Circuit Court initially continued the complete stay on discovery until further orders. RA1129 at p. 707. A scheduling conference was held and the Circuit Court lifted the stay and ordered that "[a]ll parties shall respond to all outstanding discovery requests...." RA1129 at p. 711.

Despite lifting the stay, the court continued the bifurcation of liability and damages phases by providing a deadline for concluding liability discovery and filing motions for summary judgment on liability, and deferring establishment of "deadlines for [NLC] to make its expert disclosure on damages, etc." until after resolution of those Motions – the Motions at issue. RA1129 at p. 711.

NLC produced literally thousands of pages of damages discovery to the Appellants, including detailed financial information about the patients lost as a result of the misconduct and the financial impact throughout NLC. Sealed Response at pp. 28-29 and Exhibit 19. The Baptist Defendants, however, flaunted their discovery obligations, the Order that all outstanding discovery requests were to be answered, and refused to provide damages discovery. NLC filed a third Motion to Compel. RA1129 at pp. 954-63.

Judge Clark, Judge in the case involving Dr. McKinney, then recused himself and the matter was re-assigned to Judge Bunnell. RA1129 at pp. 1510-11, RA1182 at p. 1. Without ruling on NLC's pending third Motion to Compel damages discovery or allowing NLC to obtain a single page of or answer related to damages discovery and despite deadlines for NLC to "make its expert disclosure on damages" specifically reserved for a later date, the Circuit Court, per Judge Bunnell, adjudged that the conduct caused NLC no damage. RA1182 at p. 66. She did the same in the case involving Drs.

Cooper and Winkley, RA1183 at p. 58, even though **discovery had not commenced.**

### C. The Summary Judgment Motions

The Motions for Summary Judgment contended that common law fiduciary duties no longer exist in Kentucky for corporate directors and the sole source of director duties is KRS 271B.8-300. NLC responded that the statute does not apply and did not abrogate fiduciary duties. However, it argued that this was academic because the conduct of Drs. McKinney, Winkley and Cooper very clearly violated the statute. Appellants never argued, and the Circuit Court never found, that this conduct, long prohibited at common law, complies with or is allowed by the statute

The Motions also argued that the breaches of duty caused NLC no damage. NLC pointed out that damages discovery had not yet commenced and the Circuit Court had deferred setting a deadline for damages experts, so any ruling on damages was premature. Nonetheless, NLC pointed out several categories of damages caused by the Defendants' conduct and several remedies provided for under Kentucky law, including lost revenues, profits accruing to the Defendants, costs and burdens of covering employee and physician shifts, recruitment costs, and director fees and physician salaries paid during the time when Drs. McKinney, Cooper and Winkley were breaching their duties. NLC also cited cases that explained causation and damages in this context, including that a defendant's gains are a measure of a plaintiff's losses.

### D. The Judgment

The Circuit Court's Order and Judgment ("Judgment") found: (1) while *Steelvest*, and *Aero Drapery of Kentucky, Inc. v. Engdahl*, 507 S.W.2d 166 (Ky. 1974) "may continue to apply in some instances, KRS 271B.8-300 (not the common law) sets the

standard" in any case involving money damages; (2) "the only claims Plaintiff has pursued against the doctors are common law claims;" (3) such claims are "no longer viable as a matter of law, having been supplanted by statute;" and (4) NLC "presented insufficient evidence to suggest that the alleged fiduciary breach was the legal cause of any damages" and had "not articulated or identified any harm to it nor benefit to the Defendants flowing from or attributable to the alleged fiduciary breach." RA1129 at 65-67; RA 1128 at 57-59.

In both cases, NLC filed motions to alter, amend or vacate, and to amend the Complaints to cite KRS 271B.8-300. RA1128 at 69 and 108; RA1128 at 65 and 72. Amendment should not have been necessary since the Complaint and Amended Complaint were sufficient under Kentucky law to state a claim and NLC argued that the statute had been violated, if it applied. Amendment was sought to address the Circuit Court's incorrect finding that the only claim asserted had been abrogated. The motions were denied. RA1129 at 196; RA1128 at 179. These appeals followed.

### E. The Court of Appeals Corrected the Circuit Court's Errors

The Court of Appeals agreed with the Circuit Court that KRS 271B.8-300 applies to all claims against a director seeking money damages. It concluded that its primary effect is to increase the burden of proof to collect money damages. Opinion and Order at p. 11. It reversed the Judgment because NLC's Complaints "set out a general claim for breach of fiduciary duty, which placed the defendants on notice as to the scope of the action, the facts giving rise to the claim, and the nature of the damages sought. While NLC's complaints did not refer to KRS Chapter 271B specifically, they were not required to, and the complaints fell **well within** the liberal policy related to notice pleadings. *See*

*generally Morgan v. O'Neil*, 652 S.W.2d 83 (Ky. 1983)." *Id.* (emphasis added) (also citing CR 8.01 and quoting *Johnson v. Thoni Oil Magic Benzol Gas Station, Inc.*, 467 S.W.2d 772 (Ky. 1971)). It concluded that whether *Steelvest, Aero Drapery* or KRS 271B.8-300 applied, the result is the same: "a genuine issue of material fact exists as to NLC's claim that Drs. McKinney, Cooper and Winkley breached their fiduciary duties to NLC and the Baptist defendants aided them in doing so." *Id.* at p. 12.

Appellants sought rehearing and an amendment of the Opinion so that it would state that the statute supplanted the common law. The Court of Appeals denied rehearing and clarified that the statute does not supplant common law.

## ARGUMENTS

### I. THE STANDARD OF REVIEW

The grant of summary judgment is reviewed *de novo,* to determine whether "the trial court correctly found that there were no genuine issues as to any material fact and that the moving party was entitled to judgment as a matter of law." *Steelvest, supra.*; *Scifres v. Kraft*, 916 S.W.2d 779, 781 (Ky.App.1996).

### II. THE CLAIM WAS PROPERLY PLEADED

The primary issue that determined these appeals was sufficiency of the pleadings to state a claim. Whether or not KRS 271B.8-300 applies to the claims, summary judgment was not warranted since the pleadings stated claims arising from the breach of the directors' duties and the evidence supported them, statute or no statute (the Appellants never argued that the evidence does not support liability under the statute, merely that no statutory claim was pleaded.).

Pleading standards are liberal. "It is not necessary to state a claim with technical

precision ..., as long as a complaint gives a defendant fair notice and identifies the claim". *Grand Aerie Fraternal Order of Eagles v. Carneyhan*, 169 S.W.3d 840, 844 (Ky. 2005). There is no requirement for a plaintiff to specify whether its claim is premised upon a particular statute or case. To the contrary, "[n]o technical forms of pleadings or motions are required." CR 8.05(1); *Smith v. Isaacs*, 777 S.W.2d 912, 915 (Ky. 1989) ("We no longer approach pleadings searching for a flaw, a technicality upon which to strike down a claim or defense, as was formerly the case at common law"); *Pierson Trapp Co. v. Peak*, 340 S.W.2d 456, 460 (Ky. 1960); *Dotschay v. National Mutual Ins. Co.*, 246 F.2d 221 (5th Cir. 1957) (applying the federal counterpart and holding that a "complaint is not to be dismissed because the plaintiff's lawyer has misconceived the proper legal theory of the claim"); *Johnson, supra.* at pp. 773-74 ("'A pleading which sets forth a claim for relief ... shall contain (1) a short and plain statement of the claim showing the pleader is entitled to relief and (2) a demand for judgment for the relief to which he deems himself entitled. Relief in the alternative or of several different types may be demanded.' ... 'The true objective of a pleading stating a claim is to give the opposing party fair notice of its essential nature, the basis for the claimant's right, the adverse party's wrong, and the type of relief to which the claimant deems himself entitled'"). A plaintiff is permitted to offer alternative, and even inconsistent, theories *Johnson, supra.*; CR 8.01(a); *Bowden v. Sandler*, 2009 WL 1491395 (Ky. App. 2009) (unreported).

The pleadings did not cite a source of the directors' duties one way or the other, merely that they owe duties of "loyalty, faithfulness, honesty and fair dealing" and, at times, referring to the duties as "fiduciary." RA466 at 2-7, ¶ 13, 109-115, 159-50, 834-42; RA467 at 5-17. The pleadings set forth in detail the conduct alleged to violate these

duties and that it warranted punitive damages under the statutory standards of KRS 411.184, requiring oppression, fraud or malice.

KRS 271B.8-300 provides that in performing his or her duties, a director must act in good faith, on an informed basis and in a manner he or she honestly believes is in the best interests of the corporation. To recover money damages, there must be "willful misconduct or wanton or reckless disregard for [NLC's] best interest." The pleaded misconduct cannot possibly be (and was not, in fact) argued to have been undertaken by Drs. McKinney, Cooper or Winkley "in good faith" or with the honest belief that these things were in NLC's "best interest." The conduct was knowingly, intentionally and willfully (more than merely wantonly or recklessly so, but that, too, was pleaded through reference to KRS 411.184) against NLC's interest.

The Court of Appeals was correct that the allegations were "well within" (*i.e.*, this was not even a close call) Kentucky's pleading standards, whether or not the statute applies. Opinion and Order at p. 11. The Appellants were given notice that the claims were for breaches of duties owed to NLC (and aiding and abetting or substantially assisting those breaches), and the facts supporting the claims. NLC was not obliged to cite cases or statutes in its pleadings as the source of the duties or the burden of proof, and was entitled to argue in the alternative, as it did in its Responses and Sur-Replies to the Motions for Summary Judgment.

Although this is the issue that decided the appeals, it is given short shrift by Appellants (it is dealt with primarily in two pages of Argument IV). Appellants contend that NLC "disavowed" a "statutory claim" and that "record was clear that [NLC] did not intend to make any claim under the statute and indeed intentionally sought to *avoid* its

application at all costs." Brief at p. 40. To support these assertions, they parse a couple of words from NLC's arguments (not pleadings), stating that the statute "offers no protection" and "provides no defense."[4]

This game of semantics ignores that the issue is adequacy of the pleadings to state a claim under liberal "notice pleading" standards, not whether the briefs do so under a hyper-technical, punitive and strict reading of arguments. These statements are false, and Appellants' quotes are out of context and incomplete. For example, the Response to the Motion for Summary Judgment argued:

> The statute only protects decisions made "in good faith" that the director "honestly believes are in the best interests of the corporation." Dr. McKinney cannot contend that he thought "in good faith" that it was in NLC's "best interest" to set up BC a few miles from VP, move his practice there, solicit and encourage other physicians to move their practices there, negotiate the terms of these physicians' employment, raid other key VP employees, use NLC's financial information to negotiate contracts, not disclose to NLC's Board that much of NLC's VP practice group was leaving, secretly transfer financial information by disguising it as a child's "soccer roster," meet with BPL representatives to give them

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[4] Whether statutes like KRS 271B.8-300, or the business judgment rule, provide a defense, a standard of review, an initial presumption, a burden of proof, or a "claim," is a much-debated topic. *See, among others,* Rutherford B. Campbell, Jr., CORPORATE FIDUCIARY DUTIES IN KENTUCKY, 93 Kentucky Law Journal 551 (2004-2005), at pp. 576-78 (citing Melvin Aron Eisenberg, Corporations and Other Business Organizations: Cases and Materials 147 (8th ed. 2000)); *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 927 (Del.Supr. 2003) (characterizing the business judgment rule as "a standard of judicial review"); Court of Appeals Opinion and Order (holding that the statute heightens the burden of proof). Post-pleading arguments over such technical matters should not determine whether a claim was properly pleaded in the first instance. Moreover, stating in arguments that the statute provides "no defense" does not mean that no claim is made for its violation. NLC argued that there was "liability for violation" of the statue. Finally, the reference is analogous to a defendant moving for summary judgment on a fraud claim by arguing that the plaintiff did not "rely" on the misrepresentation, and the plaintiff responding that the defendant's argument is "no defense" because he did rely on the misstatement. Only a hyper-technical and punitive reading of the argument would contort this to mean that the plaintiff "did not assert a fraud claim" because he "considers reliance a 'defense,' not part of his claim."

advice on how to utilize space and advise on IT matters, remain on NLC's Board in order to obtain inside information, or while it was studying expansion in Jessamine County where he was simultaneously setting up to compete.

Sealed Response at p. 18. NLC's Sur-Reply argued:

> **I. STATUTE OR NO STATUTE, LIABILITY IS CLEAR**
>
> The attempt to use KRS 271B.8-300 as a basis for summary judgment is without merit. **Whether or not the statute applies** (and it does not), **Dr. McKinney's conduct violated his obligations to NLC**. Really, this is an academic debate in the present context (a Summary Judgment Motion), as the Defendants are not entitled to summary judgment even if they are correct that the statute applies; **the academic question is whether they will be liable under common law breach of fiduciary duty claims or for violation of the statute.**
>
> Rather than address the basic point (made in Argument I.B. of the Plaintiff's Response) that **even if the statute applies, the Defendants are liable**, the Defendants try to side-step this by claiming that the "Plaintiff admits that it has made no case under" the statute. This is not true.
>
> The Plaintiff's position is that the statute does not apply and, therefore, no case needs to be presented under it. *Gundaker/Jordan American Holdings, Inc. v. Clark*, 2008 WL 4550540 (E.D. Ky. Oct. 9, 2008). However, **it does not follow from this argument that if the statute did apply and set the standard for Dr. McKinney's conduct, the Plaintiff has no case**.
>
> The statute requires a director to act in a manner he reasonably believes to be in the best interests of the corporation, and that he act in good faith. KRS 271B.8-300. The claim that a director secretly setting up to compete and negotiating for the employment by a competitor of key physicians and employees, all while lying and covering up these activities, constitutes "good faith" conduct that the director "honestly believes" to be in the best interests of his principal/employer, is groundless.

Sealed Sur-Replies at pp. 1-2 (emphasis added)).

NLC did not "disavow" a statutory claim. It made classic alternative arguments: (1) the statute does not apply, but (2) if it applies, it was violated. That the Appellants

view these alternative contentions as mutually exclusive[5] is not consistent with NLC's arguments and cannot be foisted on NLC as its position.

However strong NLC's conviction that the statute does not apply to these facts, does not mean that no claim was asserted. As the Court of Appeals found, the pleadings were "well within" the pleading standards.

## III. IF TECHNICAL PLEADING REQUIREMENTS APPLY, NLC SHOULD HAVE BEEN ALLOWED TO AMEND

Although NLC's claims were properly pleaded all along, after the Circuit Court incorrectly held otherwise, NLC filed a Motion To Amend. RA1129 at 108. The proposed amendments did not change the duty, the facts, or the breaches, but merely added citation to KRS 271B.8-300. RA1129 at 108, *et seq.*

Permission to amend should be "freely given." CR 15.01. This is especially true where the proposed amendment merely corrects a technical matter, since "the basic principle of our system of justice ... favors deciding cases upon the merits and discourages disposing of cases due to technical defects." *Fisher v. Kentucky Unemployment Ins. Com'n*, 880 S.W.2d 891, 895 (Ky.App. 1994).

The Circuit Court denied the Motion (RA 1129 at 196), even though no trial date had been set, the Defendants had not produced damages discovery, expert disclosure deadlines had not been set, and NLC had no objection to making its witnesses available for further depositions if needed. A similar Motion was denied in the Cooper/Winkley lawsuit (RA1128 at 65, RA1128 at 179) even though discovery had not even started.

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[5]Appellants twice quote NLC's heading "KRS 271B.8-300 DOES NOT APPLY." Appellants Brief at p. 17. They may do so a third time in the Reply to this Court because it appears below. As herein, this was *an* argument, not the only one. Appellants give its mere assertion dispositive weight.

Although the Appellants claim that "severe prejudice" would have resulted from amendment, they have never offered an explanation of how this is true. There is nothing about a change in the legal source of a substantively identical duty that impacted how this case proceeded through discovery or, indeed, through trial. The Appellants have never pointed to a single deposition that was unnecessary or that would have to be repeated, a new one that would have to be taken or so much as a single question that would have differed depending on the legal source of the duty– and in the Cooper/Winkley case, there had been no discovery at all. The amendment would have caused no prejudice.

Because the pleadings always stated a claim, no amendment was necessary. However, if the law now requires citation of the statute in the pleadings and does not allow alternative arguments about the legal source of a director's duties, the amendments should have been allowed.

## IV. THE STATUTE DOES NOT APPLY OR ABROGATE COMMON LAW

The following arguments are like those the Appellants point to as meaning that a "statutory claim" was "disavowed" and "avoided at all costs." It seems apparent to NLC that making these arguments herein, as in the courts below, does not mean that the arguments made elsewhere in this Brief do not exist.[6]

### A. Fiduciary Duties

In *Aero Drapery*, Engdahl was a director of Aero Drapery. While still a director, Engdahl met with other Aero Drapery employees to discuss setting up a competing

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[6] In the courts below, these arguments were made first because logic dictates that whether a statute applies should be decided before deciding its effect, if it applies, and the latter before whether the statute was violated, regardless of application and effect. Adequacy of the pleadings to state a claim was addressed first herein because it decided the appeal.

business. On June 4, they decided to do so. Engdahl showed his associates some financial information, and, with these associates, formed a corporation to conduct the business, found a location, and secured an advertisement. On July 10, Engdahl resigned. The three other employees followed suit on August 11. The new company opened on August 13.

The Court held that Engdahl owed Aero Drapery fiduciary duties:

> Directors are bound to exercise nothing short of the *uberrima fides* of the civil law. They must not in any degree allow their official conduct to be swayed by their private interest or welfare, unless that interest be one they have in the good of the company in common with all the stockholders. They must not profit at the expense of the others. This duty results from the nature of their employment or position, and without any stipulation to that effect. Their private interest must yield to the official duty whenever those interests are conflicting. One cannot faithfully or fairly serve two masters or interests with diverse or conflicting claims. The trust imposed upon a director as such must not be exercised for his own private exclusive benefit, nor for the benefit of third persons.
>
> There are numerous instances where a legitimate conflict of interest exists between a fiduciary and his corporation. Whenever a reasonably prudent fiduciary is aware of a conflict between his private interest and the corporate interest, he owes the duty of good faith and full disclosure of the circumstances to the corporation. "If dual interests are to be served, the disclosure to be effective must lay bare the truth, without ambiguity or reservation, in all of its stark significance."

*Id.* at 168-69 (quoting *Reinhardt v. Owensboro Planing Mill Co.*, 215 S.W. 523 (Ky. 1919) and *Wendt v. Fischer*, 154 N.E. 303, 304 (N.Y. 1926)). It held:

> Whenever a fiduciary possesses information and the withholding of that information will damage the corporation, it is his duty to fully disclose these facts to the corporation. The source of the information is not material. Engdahl knew of a forthcoming, simultaneous loss of key employees. A fiduciary could reasonably expect that this loss, without forewarning, would decrease the efficiency of Aero's operation. One of Engdahl's specific duties was the supervision of employee morale, and his failure to report dissatisfactions was a breach of his responsibility to Aero.

*Id.* at 169 (emphasis added). Getting to the heart of the matter, the Court stated:

> It often occurs that a fiduciary resigns and enters or creates a competing

> enterprise. Unless bound by contract, this is permissible, but he cannot, while still a corporate fiduciary, set up a competitive enterprise ..., or resign and take with him the key personnel of the corporation for the purpose of operating his own competitive enterprise.

*Id.* (citations omitted).[7] It concluded that "Engdahl should have terminated his duties as director and treasurer when he first began preparation to directly compete with Aero." *Id.*

Similar circumstances were presented in *Steelvest,* in which Thomas Scanlan, Sr. ("Scanlan"), was employed by Steelvest, Inc. ("Steelvest"), as a director (among other roles). Scanlan was planning to start a steel business in competition with Steelvest. Scanlan sought the advice of counsel, contacted potential investors, and sought financing. By October 14, 1985, he had completed most of the arrangements for setting up his business, including signing documents for the purchase of property. He resigned the next day. He then incorporated Scansteel Service Center, Inc. ("Scansteel"), which opened later. Nine Steelvest employees resigned to work for Scansteel.

Steelvest experienced financial difficulties, filed for bankruptcy and sued Scanlan for breach of fiduciary duty, and investors and a bank under aiding and abetting theories. The *Steelvest* defendants convinced the circuit court to grant them summary judgment.

On Appeal, the Court framed the issue as to Scanlan as "whether Mr. Scanlan, in fact, breached any fiduciary duty to Steelvest by preparing to incorporate his own steel business while still employed with Steelvest." It held:

> Kentucky law has ... recognized that directors and officers of a corporation may not set up, or attempt to set up, an enterprise which is competitive

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[7]Appellants argue that they did not violate a non-compete agreement. This is irrelevant. Breach of duty and breach of contract are different. *Aero Drapery* at 169 ("Unless bound by contract, this is permissible, but he cannot, while still a corporate fiduciary, set up a competitive enterprise..., or resign and take with him the key personnel of the corporation for the purpose of operating his own competitive enterprise").

> with the business in which the corporation is engaged while still serving as directors and officers.... Thus, they should terminate their position/status as directors or officers when they first make arrangements or begin preparations to compete directly with the employer corporation.

*Id.* at 483 (citations omitted).

The Court reversed the summary judgment to Scanlan because the evidence showed that while still with Steelvest, Scanlan "made certain plans, arrangements, and preparations for setting up his own business to compete with Steelvest," "sought legal and accounting advice, made active efforts to acquire bank financing, and recruited investors," "failed to disclose such activities to any representative of Steelvest" and there was "some evidence" that Scanlan had "indicated to prospective investors and to bank personnel that he would bring with him some of the present employees of Steelvest" and that "coincidentally/inferentially, ... shortly after Scanlan resigned from Steelvest, nine office and supervisory employees left the company to work for Scansteel."

Addressing the aiding and abetting claims, the Court stated:

> it has been held that a person who knowingly joins with or aids and abets a fiduciary in an enterprise constituting a breach of the fiduciary relationship becomes **jointly and severally liable with the fiduciary for any profits that may accrue.**

*Id.* at 485 (emphasis added) (citations omitted).

The bank's participation consisted of no more than "some evidence" that it knew of "Scanlan's plan to incorporate a business that was to be directly competitive with Steelvest and that this new business would, to a certain extent, have a detrimental impact on Steelvest's present business." The Court held that this was enough to submit a case to the jury given that the bank "appears to have further understood that by providing financing to Scanlan's venture it would 'substantially impact' upon Steelvest's business

situation" and because the bank made the loan "to reap a profit from the loan arrangement." *Id.* The court also found "a legitimate factual question" as to whether the bank used certain information concerning Steelvest in processing the loan.

The Court also reversed the summary judgment on the aiding and abetting claims asserted against the investors. The evidence against them was only that they "purchased the building, real estate, and equipment for [the] new company," "met Scanlan on many occasions while he was still employed with Steelvest in order to discuss the formation of Scansteel," "made a substantial loan to Scansteel during its formation period as well as obtaining an equity investment in the company" and may have been instrumental to obtaining the bank financing. This was sufficient to present a jury question of liability.

Many of the facts Appellants assert as the basis for their arguments were present in *Steelvest* and *Aero Drapery*, including that the fiduciary was free to resign and compete and no contract would be breached by doing so, the customers (here, patients) were free to move to the competition, the competition did not open for business until after the resignations, and the bank and the investors were entitled to set up and finance a competing business. None of these facts changed the outcome with this Court.

Kentucky is not alone in finding this sort of conduct violates duties directors owe to corporations. *E.g., Bancroft-Whitney v. Glen*, 411 P.2d 921 (Ca. 1966) (which was more friendly to directors than *Aero Drapery* or *Steelvest* as to what is permitted of a director negotiating his own employment, but finding that recruiting employees violated duties); *Security Title Agency, Inc v. Pope*, 200 P.3d 977 (Ariz.App. 2009).

NLC's claims were not a novel legal theory, nor was NLC stretching legal propositions to fit a new scenario. The legal theories are indistinguishable from those in

*Aero Drapery* and *Steelvest*, and the facts are substantively similar to (the conduct was similar, but worse than) those involved in both. Ironically, the Circuit Court granted the Appellants summary judgment under circumstances very similar to *Steelvest*, the "text book case" of when summary judgment is not appropriate. *Steelvest* was ignored in all respects from claim, to remedy, to the requirement that the court view the evidence in the light most favorable to NLC.

### B. The Business Judgment Rule

While directors are held to a high duty, the law recognizes that courts must play a limited role in reviewing the exercise of business judgment. Corporate governance cannot function if directors cannot take business risks and use their best judgment when facing an unpredictable future. The law has developed the "business judgment rule," which established a "presumption that in making a business decision (such as the fixing of salaries or the purchase of use of company vehicles), the corporate directors 'acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" *Allied Ready Mix Co., Inc. ex rel. Mattingly v. Allen*, 994 S.W.2d 4 (Ky.App. 1998) (citing *Aronson v. Lewis*, 473 A.2d 805 (Del.1984)); *Security Trust Co. v. Dabney*, 372 S.W.2d 401 (Ky. 1963) (absent actual or constructive fraud, courts will not interfere in corporate management). These are the same presumptions (along with nuances developed at common law, such as the right to rely on reports prepared by others) codified in KRS 271B.8-300(1)-(4). The business judgment rule also included a strict and limited standard of review for a court faced with a challenge to a corporate decision, and a burden of proof or presumption that a plaintiff had to satisfy to pursue money damages for a breach of duty. This is codified in KRS 271B.8-300(5)-(6).

## C. KRS 271B.8-300 DOES NOT APPLY

This rule has necessary limits to the scope of its application; it does not apply to all actions of a person merely because he happens to be the director of a corporation, no matter how far removed the action is from corporate decisions and functions. At common law, this limit is found in the very title of the rule at issue, the "business judgment rule." It only gives a deferential standard of review in challenges to the exercise of "business judgment," not as to all conduct.

This limit is now found within the text of KRS 271B.8-300(5). The limitation on money damages applies only to claims for "any action taken" or "any failure to take any action" "**as a director.**"[8] Examples of conduct undertaken "as a director" are decisions made by the board of directors, even those involving a conflict of interest, such as raising salaries, granting options, entering into a contract with a business owned by the director, rejecting a tender offer to buy the company that might cause the director to lose his/her job, or to bypass a corporate opportunity. A "failure to act" "as a director" would include, most commonly, a failure to perform due diligence or to investigate before proceeding. In each case, the directors are acting "as directors" and the rule applies by its literal terms.

A person can owe duties because he is a director, but violate these duties by conduct that is not undertaken while wearing his hat "as a director," but purely acting as an individual. For example, stealing from the corporate coffers would violate a duties to the corporation, but involve no corporate action or decision, no action or decision of the board, and no action or decision by that person "as a director." KRS 271B.8-300(5)

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[8] In rejecting arguments about the statute's scope, the Court of Appeals focused on the wording that it applies to "*any action*" or "*any failure* to act," Opinion and Order at p. 9, but missed that this is qualified as acts or failures taken or not taken "as a director."

would not apply to this conduct because, though an act of the person who is a director, it involves no act "as a director."

This textual (and logical) limit on application of KRS 271B.8-300 was recognized in *Gundaker/Jordan American Holdings, Inc. v. Clark*, 2008 WL 4550540 (E.D.Ky. 2008) (unpublished). That court went so far as to use the fact scenarios involved in *Steelvest*, and *Aero Drapery* – the scenario involved herein -- to illustrate when the statute does not apply:

> In *Steelvest* ... and *Aero Drapery*..., the Kentucky Supreme Court analyzed claims of breach of fiduciary duty based on the common law. *Steelvest* and *Aero Drapery* differ from the instant case in two important ways. First, the operative facts in both of the earlier cases occurred prior to the enactment of the statutes. **Second, even if the statutes had been in force, they would not have applied. KRS § 271B.8-300(6) and § 271B.8-420(6) [creating the identical rule for officers] apply only to actions "taken as" a director or officer and to "failure[s] to take action" as a director or officer. Neither of the above-cited cases involves actions taken as a director or officer or failures to take action as a director or officer. In both cases, the breach of fiduciary duty was based on the defendant's formation of a competing business. Forming a competing business is not part of a director or officer's official role, and, therefore, cannot be considered to be an action taken as a director or officer or a failure to take action as a director or officer.**

*Id.* at *3 (emphasis added).

Secretly setting up to compete and recruiting a mass exodus of employees to the competitor was not conduct of NLC, of NLC's board, or of Drs. McKinney, Cooper and Winkley acting in their capacities "as [NLC] directors." The conduct violated duties that each owed to NLC because he was a director or officer, but consisted of individual acts for individual ends. Therefore, they are not within the scope of KRS 271B.8-300(5).

For this reason, and supported by *Gundaker/Jordan*, NLC argued and still argues that KRS 271B.8-300 has been misinterpreted and misapplied in this case. However, as

has been consistently agued, this is academic since the conduct at issue very clearly violates the standards set forth in KRS 271B.8-300.

### D. KRS 271B.8-300 Did Not Abrogate Common Law

Assuming the rule applies to individual conduct, not official director conduct, does not lead to the conclusion that the statute in any way abrogated fiduciary duties.

At common law, courts struggled with how to articulate the appropriate standard of care and of review under the business judgment rule. To bring certainty to this area, uniform laws were developed. Among those is ABA Model Business Corporation Act, on which the Kentucky's KRS 271B.8-300(1)-(4)[9] was based.

KRS 271B.8-300 codified existing aspects of these presumptions and standards of review (anyone suing the director for money damages must show that the director's conduct deviated from this standard of care, and that the breach or failure to perform the duty "constitutes willful misconduct or wanton or reckless disregard for the best interests of the corporation and its shareholders"), but this did not bring about any fundamental change in the legal landscape. Indeed, when discussing the statutes on director and officer liability, the Commentary included with the Baldwin's Official Edition of 1988 Acts upon which the Appellants rely (Appellants' Brief at p. 20 and their Appendix 5), states that the "Act contains provisions that were drafted by the KBA Committee consistent with the current Kentucky case law standard." When discussing KRS 271B.8-300 in particular, the Commentary repeats that this provision is written "in a manner consistent

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[9] ABA Model Business Corporations Act §8.30, addressed the standard of care for performance of director duties, but omitted the business judgment rule's qualified immunity from monetary liability if doing so. KRS 271B.8-300(5)-(6) added, the immunity from monetary liability, thus embodying the entire rule.

with the few old Kentucky cases that have been decided" applying the business judgment rule and that the "test for liability for monetary damages is consistent with the test under Kentucky common law...." *Id.* at p. 8.

The creation and evolution of the business judgment rule at common law never meant that fiduciary duties no longer existed or applied. It is a dangerous leap of logic, therefore, to conclude that a statue codifying these standards abrogates fiduciary duties. No known case or authority has reached a similar conclusion based on the common law business judgment rule, or a statute like KRS 271B.8-300, codifying it. In any event, there is nothing "internally inconsistent" with the Court of Appeals declining to reach this conclusion, and finding, instead, (1) that KRS 271B.8-300 creates a burden of proof that must be met in any case where a plaintiff seeks monetary damages for a director's breach of fiduciary duty, but (2) common law fiduciary duties have not been abrogated.[10]

"Repeal by implication has never been looked upon favorably by the courts." *James v. Churchill Downs, Inc.*, 620 S.W.2d 323 (Ky.App. 1981). The "intention [for a statute] to abrogate the common law will not be presumed" and "must be clearly apparent." *Id.* No court below made the findings required to conclude that the statute abrogated or "supplanted" important, long-standing common law fiduciary duties.

The far-reaching holding of abrogation does not flow from the text of KRS 271B.8-300. Indeed, the language of KRS 271B.8-300 does not attempt to establish what

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[10] An analogy is development and evolution of the tort of fraud. It now requires fraud be proved by "clear and convincing evidence." This evolution does not mean that all prior cases setting forth the elements of fraud and fraud by omission, applying the tort to various factual situations, and discussing the factors and evidentiary considerations, are no longer valid or have been "abrogated." Enactment of a statute saying nothing more than that fraud claims must be proved by "clear and convincing evidence" would not "abrogate" this common law, either, but merely codify an existing aspect of it.

duties are owed by corporate directors, much less abrogate long-standing fiduciary ones. Instead, it states that "in discharging those duties" (whatever they may be and whatever their source), a director must act in good faith, on an informed basis and in a manner he honestly believes to be in the best interests of the corporation (the business judgment rule standard for court review of allegations for breach of fiduciary duty).

In *Shenker v. Laureate Education, Inc.*, 983 A.2d 408 (Md. 2009), and *Independent Distributors, Inc. v. Katz*, 637 A.2d 886 (Md.App. 1994), the courts recognized that these statutes (they addressed Md. Code, Corporations and Associations, § 2-405.1 ("CA § 2-405.1"), which is similar in material respects to KRS 271B.8-300[11]), codify the business judgment rule, and its duty of care, but are not intended to set forth all of a director's duties, nor abrogate common law fiduciary duties. Indeed, these states are not even intended to apply to allegations other than breach of the duty of care. *Katz* held:

> Contrary to appellants' assertion, CA § 2-405.1 (the codification of the business judgment rule) does not control. The duty of care and the duty of loyalty are two independent duties directors owe the corporation. The corporate opportunity doctrine is a function of the director's duty of loyalty to the corporation, rather than his duty of care. When the General Assembly codified the business judgment rule "it did not intend to abrogate the fiduciary duty imposed upon a director or officer not to usurp a corporate opportunity." 62 Op. Att'y Gen. 804, 812 (Md.1977).

*Id.* at 895. *Shenker* addressed an appeal from the Maryland Court of Special Appeals

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[11] *Shenker* noted that noted that CA § 2-405.1, like KRS 271B.8-300, is based on and tracks §8.30 of the Model Business Corporation Act. *Id.* at 419. KRS 271B.8-300 and CA § 2-405.1 differ in certain respects, none of which are relevant to this discussion. For example, Kentucky provides that a director must "honestly believe" his or her conduct is in the best interest of the corporation, while Maryland says he or she must "reasonably believe" this, and Kentucky provides that he or she must act on an "informed basis" while Maryland says the conduct must comply with a "reasonable person" standard. As far as immunity from monetary liability, CA § 2-405.1 is absolute, providing that performance in accordance with the statute makes the director immune from liability.

which had found (as Appellants urge this Court to find) that CA § 2-405.1 "is the sole source of directorial duties" in Maryland. The *Shenker* Court disagreed, stating:

> We read § 2–405.1(a) as codifying the duty of care owed by directors when acting in their managerial capacities, rather than as a replacement of all previously recognized common law fiduciary duties of directors owed to the corporation and its shareholders. As such, we hold that § 2–405.1(a) does not provide the sole source of directorial duties, and that other, common law fiduciary duties of directors remain in place and may be triggered by the occurrence of appropriate events.
>
> This view is shared in an opinion authored by the Maryland Attorney General in 1997. See 62 Op. Atty Gen. Md. 804 (Md.1977). There, the Attorney General contended that the statutory standard of care contained in § 2–405.1(a) imposes "separate and distinct obligations upon corporate officers and directors" from other common law duties, such as the duty to refrain from usurping a corporate opportunity. *Id.* at 812. In that opinion, cited favorably by the Court of Special Appeals in cases prior to the present litigation, *see Indep. Distribs., Inc. v. Katz*, 99 Md.App. 441, 461, 637 A. 2d 886, 895 (1994), the Attorney General opined that when the Legislature enacted § 2–405.1(a), "it did not intend to abrogate the fiduciary duty imposed upon a director or officer not to usurp a corporate opportunity." 62 Op. Atty Gen. Md. at 13–14. Although we deal here with directorial duties other than refraining from usurping corporate opportunity, the Attorney General's opinion suggests that, in enacting § 2–405.1(a), the General Assembly did not seek to occupy the entire field of directorial duties owed by corporate directors, but instead intended to codify the duty of care owed by directors in exercising their managerial duties.

*Id.* at 421.

While not addressing the question of abrogation of common law directly, *Lehman v. Superior Court*, 145 Cal.App.4th 109, 51 Cal.Rptr.3d 411 (Cal.App. 2 Dist. 2006), recognized that these statutes do not replace common law claims. In addressing whether a claim against a director for breach of duty is made under a California statute substantively similar (identical as it concerns the language relevant to this issue) to KRS 271B.8-300 or is one at common law, the court recognized that the statutes do not set forth a director's duties, but merely set a standard of care:

> We conclude that Corporations Code section 309 does not give rise to a liability "created by law." For one thing, the statute does not set forth any duties of a director, fiduciary or otherwise. Rather, it establishes a standard of care and accords directors immunity from liability if they comply with that standard.... *see also* Corp.Code, § 7231 [setting forth standard of care identical to section 309].) **The statute dictates how a director's duties-whatever they may be-are to be performed if liability is not to attach.... The duties themselves must be found elsewhere....**

*Id.* at 418 (emphasis added) (citations omitted). Thus, the claim is properly one for breach of fiduciary duty, not violation of the statute.

Consistent with this, the Official Comments to Model Business Corporations Act §8.30 (the act upon which KRS 271B.8-300(1)-(4) is based) show that director duties are found outside this provision and are "fiduciary:"

> [A]t the core of [§8.30's] mandate is the requirement that, when performing directors' duties, a director shall act in good faith coupled with conduct reasonably believed to be in the best interests of the corporation. This mandate governs all aspects of directors' duties: the duty of care, the duty to become informed, the duty of inquiry, the duty of informed judgment, the duty of attention, the duty of disclosure, the duty of loyalty, the duty of fair dealing and, finally, **the broad concept of fiduciary duty that the courts often use as a frame of reference when evaluating a director's conduct.**

*Id.* at §8.30, commentary at 8-44 (Appendix at 1(emphasis added); *see also People's Bank of N. Ky., Inc. v. Crowe Horwath*, 2012 WL 2892352 at *7 (Ky.App. July 13, 2012) (not final) ("KRS 271B.8–300 provides general guidelines regarding a director's duties").

While not dealing with the issue of abrogation of common law directly, post-statutory case law and other authorities discussing Kentucky law continue to refer to director duties as "fiduciary" and cite common law cases as support and precedent. For example, in 2009, the Court of Appeals cited *Steelvest* and *Aero Drapery* and recognized that directors still owe fiduciary duties to their corporations "even in the absence of a statutorily imposed duty." *Patmon v. Hobbs*, 280 S.W.3d 589, 593-94 (Ky. App. 2009).

*Sahni v. Hock*, 369 S.W.3d 39 (Ky.App. 23, 2010), upheld a corporation's judgment for "breach of fiduciary duty" (as will be discussed below). Rutheford B. Campbell, Jr., wrote an article discussing Kentucky's corporate statutes, including KRS 271B.8-300, referring to fiduciary duties in the very title: CORPORATE FIDUCIARY DUTIES IN KENTUCKY, 93 Kentucky Law Journal 551 (2004-2005). R. Keats, 4A Kentucky Practice section 14:57 continues to cite *Steelvest* as it concerns director duties. Granting a defendant summary judgment merely because a plaintiff referred to a director as owing "fiduciary duties," without citing the statute (or any other law) in the pleadings (especially where both are argued as alternative violations in the briefs) is an extremely harsh reaction to the an argument that the common law still governs and has not been abrogated, and is not supported by Kentucky law or authority.

The Appellants claim that *Sahni* supports abrogation and a finding that pleadings for breach of a director's duties must cite to KRS 271B.8-300 or else be dismissed (they cite *Patmon, supra.*, and *Gundaker/Jordan, infra.*, as well, which is addressed above and below and which support NLC, not Appellants) . They materially misrepresent or omit the facts and holding of *Sahni* in making these arguments. In *Sahni*, the plaintiff asserted claims in different capacities. Among these was a derivative claims on behalf of the corporation, "EMS," and a direct (non-derivative) claims as a shareholder. At trial, a judgment was entered in favor of EMS for $58,300 and Hock, individually, for $118,000.

The Appellants correctly state (Brief at p. 22) that Hock "filed a derivative shareholder's action and claimed that Sahni had breached his fiduciary duty in various ways, but did not plead a statutory cause of action." *Id.* at 43 ("In count two, Hock alleged Sahni and O'Leary breached their fiduciary duty to EMS and its shareholders....").

However, the Appellants incorrectly connect this corporate (derivative) claim for breach of fiduciary duty to a portion of the decision that had nothing to do with that claim in order to misstate that this corporate judgment was reversed with "directions to dismiss the claim" because of a failure to assert a statutory claim. Appellants' Brief at p. 22. Contrary to this misrepresentation, the judgment on the corporate breach of fiduciary duty claim was not reversed with "directions to dismiss" it. It was affirmed, the lack of a "statutory claim" notwithstanding. *Id.* at 47 ("we reverse the judgment in favor of Hock individually and remand this matter to the trial court with instructions to dismiss Hock's direct action claim. Our holding has no impact on the judgment in favor of EMS against Sahni."). *Sahni* does not support a conclusion that a corporation must plead a claim by referring to KRS 271B.8-300, but the exact opposite.

In addition, the *Sahni* court did not hold that the judgment on the individual claims was invalid because the statute "supplanted" fiduciary duties. Indeed, affirming the corporate judgment established that no abrogation has occurred. Rather, the court found that Hock's individual claims were improper because they alleged harm to the corporation and no duty to Hock as shareholder. *Id.* at 47. The problem was not that the common law had been abrogated, but that Hock had no common law claims to bring.

In response to her inability to bring a common law claim, Hock "counter[ed] that such direct claims are permitted by KRS 271B.8-300." *Id.* at 47. Thus, it was not a director who claimed that KRS 271B.8-300 abrogated common law duties, nor was abrogation supported by the decision (had abrogation occurred, EMS's judgment for breach of fiduciary duty would have been reversed, not affirmed), but the claimant who asserted that the statute created a new claim. The *Sahni* court never concluded whether a

statutory claim exists, but merely rejected the plaintiff's attempt to save the individual judgment by relying on a different supposed statutory claim.[12]

To find abrogation of fiduciary duties owed by corporate directors is a novel and dangerous premise. It would throw director duties into uncertainty. Kentucky would be starting from scratch to define and develop director duties in the myriad circumstances where existing law has provided rules and guidance, with only KRS 271B.8-300 as a guide. It would stand alone in this regard.

## V. THE MISCONDUCT CAUSED DAMAGES

### A. The Defendants' Arguments On "Causation" Are Incorrect

Although they phrase the argument differently, the Appellants' primary "causation" argument is that the losses NLC suffered from the establishment of a competing practice and the defections of the physicians and the staff were not caused by the breaches of duty, since they could have resigned, negotiated for employment, departed for the competitive practice and then negotiated for the employment of the other physicians and staff and, had they done these things, no breach of fiduciary duty would have occurred, but the end result or damages might have been the same. Thus, the breach is not the *sine qua non*, or indispensable and essential action causing NLC's economic losses. These arguments are legally insufficient for several reasons.[13]

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[12]On the issue of whether a "statutory claim" was asserted, the *Sahni* court did not analyze a mere lack of citation to the statute in the complaint as dispositive. It looked at the factual allegations to determine if they violated the statutory standards, if true. This is the analysis performed by the Court of Appeals herein. It just reached a different conclusion based on materially different facts and pleadings- facts and pleadings that show an intentional disregard of NLC's best interests.

[13] Appellants contend that the Judgments are "intact" as they concern the findings on

First, "causation" is a question of fact for the jury, not a legal question for the court. *Ball v. Stalnaker*, 517 F.Supp.2d 946 (E.D.Ky. 2007) ("[L]egal causation is a question of fact for the jury, and can become a question of law only when 'the facts are undisputed and susceptible of but one inference'"). Thus, the Circuit Court's grant of summary judgment overstepped its role and the Court of Appeals' Opinion that "genuine issues of material fact remain for adjudication" was correct.

Second, similar "causation" arguments were rejected in *Security Title Agency, Inc v. Pope*, 200 P.3d 977 (Ariz.App. 2009), which illustrated the simple and obvious "causal" link between the conduct constituting this tort and damages through the loss of customers. Indeed, *Security Title* is the only cited or known case to analyze what is meant by and required to prove "causation of damages" in this context. *Security Title* involved a fiduciary who recruited employees to work for a competitor and the former employer lost customers thereto. Arizona law on liability is more favorable to the fiduciary than *Steelvest* or *Aero Drapery*, allowing her to negotiate for her own employment while a director, just not recruit employees. Therefore, the claims in *Security Title* related solely

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causation of damages and that NLC was required to seek discretionary review of the reversals for the Judgments to remain reversed. Appellants' Brief at p. 30. This makes no sense. The Judgments were reversed, not affirmed in whole or in part. A failure to explain why to Appellants' satisfaction does not convert the reversals into affirmations. The Court of Appeals addressed and summarily rejected the damages finding in any event, stating that "[i]t is noteworthy that the actions were dismissed in the midst of discovery as to damages arising from Dr. McKinney's alleged breach and before any discovery whatsoever was undertaken as to the claims against Drs. Cooper and Winkley" and that "counsel for NLC noted that discovery was bifurcated in an attempt to protect the parties' financial information, and many discovery items were sealed my mutual consent." It found that "genuine issues of material fact remain for adjudication," without stating or implying that this concerned only issues of liability, not causation of damages. Indeed, this finding is more pertinent to causation of damages than to liability arguments, since the liability issue was decided as a matter of adequacy of the pleadings to state a claim and the Appellants never argued a lack of evidence supporting liability under the statute.

to the recruitment, which also is involved in this case. Even with this more-limited liability, the judgment was $6.3 million, measured by the revenue generated by these recruited employees while at the competitor (and punitive damages).

As to "causation" (but replacing the parties), *Security Title* held:

> the jury reasonably could conclude the NLC employees who joined BPL left NLC because of Dr. McKinney's wrongdoing.... [T]o prove causation, NLC is not required to prove that all of the patients who transferred their business to the Baptist Defendants did so due to relationships they had with employees other than Dr. McKinney. NLC only is required to prove that Dr. McKinney's breach of his fiduciary duty caused some harm to NLC. Sufficient evidence supports a conclusion that Dr. McKinney improperly solicited NLC employees, those employees left NLC and moved to BPL and their patients moved to BPL with them, thereby causing harm to NLC.

*Id.* at 993. This is consistent with *Steelvest*'s holding that a plaintiff is entitled to recover all profits accruing to the defendants. Those profits are more than a prophylactic remedy, they are a measure of damages caused by the misconduct.

Although it is the only cited case to directly address causation in this context, Appellants relegate their discussion of *Security Title* to footnote 21. Therein, they fail to point to anything that distinguishes this case from *Security Title* or explain how its logic does not apply. The lost revenue herein was linked to the departing employees and physicians in the same manner as in *Security Title*.

Third, *Steelvest* specifically held that "a person who knowingly joins with or aids and abets a fiduciary in an enterprise constituting a breach of the fiduciary relationship becomes jointly and severally liable with the fiduciary for any profits that may accrue." *Id.* at 485 (citations omitted). The Circuit Court ignored this remedy.

Fourth (and consistent with *Steelvest*), the law is clear that the victim of a breach of fiduciary duty need not suffer or be able to prove a single penny of loss "caused" by

the breach before it is allowed to recover from the fiduciary as a matter of restitution. For example, in *Blackburn's Adm'x v. Union Bank & Trust Co.*, 108 S.W.2d 806 (Ky. 1937) (citations omitted), the court stated that "the rule that an agent may not use his position to obtain a personal profit without the consent of his principal is so well and so thoroughly settled as to make a comprehensive collection of authorities unnecessary." RESTATEMENT (THIRD) OF AGENCY section 8.01 provides at comment (d)(1) (emphasis added) that "[t]he law of restitution and unjust enrichment also creates a basis for an agent's liability to a principal when the agent breaches a fiduciary duty, **even though the principal cannot establish that the agent's breach caused loss to the principal.**" This also is provided in *DSG Corp. v. Anderson*, 754 F.2d 678, 682 (6th Cir. 1985) (applying Kentucky law), which held that "an employee-fiduciary may be liable to the employer for any gain derived by establishing a competing interest without full disclosure to the employer, even if the employer has suffered no loss." The same rule was applied in *Hoge v. Kentucky River Coal Corp.*, 287 S.W. 226, 227 (Ky. 1926); *see also Conklin v. Joseph C. Hofgesang Sand Co.*, 407 F.Supp. 1090 (W.D.Ky. 1975); *Stewart v. Kentucky Paving Co.*, 557 S.W.2d 435 (Ky.App. 1977). This ensures that defendants do not engage in tortious conduct like that involved herein and escape consequence for their actions by arguing a lack of quantifiable injury "caused" by it. Thus, even in the absence of "causation," NLC is entitled to recover in restitution.

Fifth, courts relax the standard for "causation" in this sort of case. *American Fed. Group, Ltd. v. Rothenberg*, 136 F.3d 897, 908 n.7 (2d Cir.1998) ("where ... the remedy being sought is a restitutionary one to prevent the fiduciary's unjust enrichment as measured by his ill-gotten gain, the less stringent 'substantial factor' standard may be

more appropriate."); *RSL Communications PLC v. Bildirici*, 649 F.Supp.2d 184, 209 n.15 (S.D.N.Y. 2009) ("The substantial factor test of factual causation ... is analytically distinct from the issue of whether, in general, a less stringent substantial factor causation requirement applies in a breach of fiduciary duty case such as this one.... Under the latter, less stringent causation standard referenced by Plaintiff,... the plaintiff does not have to show either but for or proximate causation, but only that the [defendant's] breach was a substantial factor contributing to her injury." (internal quotation marks omitted)). Thus, a plaintiff need not show that "but for" the breaches, the harm would not have occurred, but only that the breaches were a "substantial factor" in causing the harm.

Sixth, courts have rejected the logic that there is no "causation" if a party might have been able to accomplish the same result in a legal manner. For example, in *Monette v. AM-7-7 Baking Co., Ltd.*, 929 F.2d 276 (6th Cir. 1991), Monette, purchased bread from a bakery and re-sold it to retail outlets. The bakery owner, Malandruccolo, told Monette that he wanted an employee to accompany Monette on his truck during deliveries to help Monette increase sales. In truth, Malandruccolo had his employee compile a list of Monette's customers. After obtaining the list, Malandruccolo refused to sell to Monette and established direct sales to the customers. Monette's business failed and he sued.

The jury found the bakery liable for intentional interference with prospective economic advantage and awarded damages. In an appeal, the bakery argued that Monette's economic downfall was not caused by the wrongful conduct, but by the bakery selling to the customers directly, which it could do in the absence of any tortious conduct. Indeed, the bakery could have accomplished the same result in a far less attenuated way than the speculation engaged in by the Appellants in this case. All the bakery owner had

to do was follow Monette's truck in another vehicle while it was on deliveries and write down the customers. The Sixth Circuit rejected this logic:

> the acts of Defendants in fraudulently procuring Monette's customer list **were an active step** in the Defendants' process of eventually soliciting and acquiring Monette's retail customers. **Defendants' treatment of Monette in this case greatly tainted their otherwise rightful process of terminating relations with Monette and establishing direct supply lines to retail customers**. If Defendants had simply refused to sell to Monette, there would be no cause of action.... If Defendants had utilized other, proper means besides duplicity to end their relationship with Monette and engage in free enterprise competition, no tort would have been committed. **However, "[d]efendants cannot be heard to say that they should not be held liable for the injury caused plaintiff by their unlawful acts merely because they could have caused the same injury by a lawful act."**... The deceit, combined with use of the fruits of that deceit, *i.e.*, the customer list, to interfere effectively with and end Monette's business, forms the basis of this tort violation.

*Id.* at 283 (emphasis added); *Wilkinson v. Powe*, 1 N.W.2d 539, 543 (Mich. 1942) ("Defendants' refusal to accept further deliveries of milk by plaintiff was wrongful in the light of the evidence in the instant case because it was done to accomplish an unlawful purpose, *i.e.*, to bring about a breach of contract. It therefore follows that the problem of proximate cause disappears from consideration in the case. Defendants cannot be heard to say that they should not be held liable for the injury caused plaintiff by their unlawful acts merely because they could have caused the same injury by a lawful act").

Seventh, the Appellants' arguments are an exercise in defense through speculation. To be successful, the Court must ignore what is known to have occurred and the losses directly attributable to the illegally-established and -staffed BC facility (and neurology practice for Coopers and Winkley), and find **as a fact** that the Appellants would have successfully accomplished exactly the same things without committing any tort. That would require the Court to find as a fact all of the following: (1) that Dr.

McKinney (and Cooper and Winkley in the other case) would have left NLC and (2) gone to BPL if (3) he had first resigned from the Board of NLC, and (4) he could have persuaded BPL to give him the same favorable contract (5) without using NLC's inside salary and work information and (6) if not for the leverage presented to him by coming as part of a package with the other physicians and staff, (7) the other physicians would have joined him after he left, and (8) the other staff would have as well. This is an argument built on a very shaky foundation, with inference piled upon inference, speculation upon speculation. It can never be known whether the Appellants could have accomplished the same results non-tortiously. This is merely one of a number of possible outcomes.

There also is evidence that rebuts the Appellants' speculation that these same results could have been accomplished non-tortiously. For example, the evidence shows that BPL was not inevitably going to open up the BC practice and only agreed to move forward on that project after Dr. McKinney and the other NLC physicians signed LOIs, were presented with PEAs approved by BPL and BHSI, and Sisson met with them. Indeed, this was required before Sisson would sign the lease for or commit to any construction on BC. Similarly, the plan for BC identified each of the physicians and the staff they were bringing over (by description, omitting names); these exact staff members were integral to BPL and BHSI agreeing to open BC. The evidence also shows that Dr. McKinney repeatedly used inside financial information and the leverage that came with negotiating for four physicians to gain the contract incentives he needed to come on board with BPL. The end result was that Dr. McKinney was offered an agreement that was far different than the contracts BPL typically offered, including a guaranteed compensation package for three years, along with bonus incentives. Even so, Dr.

McKinney testified that the decision to leave was a close call, claiming that he did not know he was going to leave until he was literally driving to BPL to sign his employment contract. The evidence also will show that when Ms. Irwin asked Dr. McKinney if he should resign from the NLC Board given his plans to set up a competing practice, he responded that he could not do that because he needed the information he received as a Director. To claim that without Dr. McKinney's breaches, such as recruiting other physicians, and negotiating their compensation as a package, he would have received a sufficiently favorable deal to lure him into defecting is inconsistent with the evidence. Moreover, if Dr. McKinney, BPL and BHSI could have accomplished these results non-tortiously, why did they commit the tort?

Eighth, in *Steelvest*, *Aero Drapery*, and *Security Title*, which specifically addressed causation of damages, the fiduciary at issue was free to leave and compete, the employees were free to leave to work for the competitor, and the customers were free to transfer their business to the new enterprise. Indeed, these arguments are likely available in virtually every existing or imaginable case involving a fiduciary setting up to compete while still employed by the principal (otherwise, the action would be for breach of contract, not breach of fiduciary duty). If this meant that losses were not "caused" by the breaches, *Steelvest*, *Aero Drapery*, *Security Title* – and probably every other plaintiff's verdict in this context – would have been decided differently. The rule against fiduciaries setting up to compete would be swallowed by this argument. Yet, the Appellants have never cited a single case where this defense has worked.

Ninth, a "faithless servant forfeits any right to compensation after the breach occurs...." *Harmeling v. Nat. Marketing Corp.*, Inc., 2005 WL 564101 (Ky.App. 2005)

(unpublished). All of these physicians were paid both a salary and compensation specifically as a director, during the period in which they were working against NLC to establish a competitor. These payments are yet another category of damages caused by their faithless conduct which were completely ignored by the Circuit Court.

The Appellants are simply wrong to claim that "THE LACK OF A CAUSAL LINK WAS UNDISPUTED." Appellants' Brief at p. 36. "Causation" was heavily argued and NLC supported its arguments with numerous cases that directly address causation in this context and that are simple and direct, as is illustrated by *Security Title*. The Appellants had no cases that discussed causation in this context, and their arguments were built upon speculation.

To defeat summary judgment (particularly since damages discovery had not commenced in earnest before judgment was granted), was illustrate a basis for a jury to award one dollar in damages (or any remedy for these breaches). The Judgments finding no damages caused by this misconduct was not supported by any case or other authority and was contrary to the law and the logic underlying the rules the cases apply. [14]

**B. NLC Suffered Losses, and Appellants Accrued Gains**

Although NLC had been deprived of damages discovery, the evidence established

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[14] In support of the argument that there is no proof of causation, the Appellants rely on *Hinton Hardwoods, Inc. v. Cumberland Scrap Processors Transp., LLC*, 2008 Ky.App. Lexis 18 (2008) (unpublished), which involved a transaction that fell apart after it was discovered that property had no easement to a road. An agent was sued for breach of duty because he was involved in a later sale of property. The lack of causation was clear, as the agent's alleged breach had nothing to do with the deal falling apart. The breaches at issue herein were central to the establishment of BC, and the departure of income-producing employees. The Appellants also rely on the unpublished *Fox Valley Thoractic Surgical Associates v. Ferrante*, 747 N.W.2d 527 (Wisc. 2008) (unpublished). It is inapposite. In *Fox Valley*, the finding was that surgeon did not owe a fiduciary duty.

the causal link set forth in *Security Title*. NLC CFO, Randy LeMay, testified:

> I can ... tell you that revenues that we had in the past, we don't have anymore.... We no longer have the professional revenue from patients that Dr. McKinney saw and cared for at Lexington Clinic. We no longer have ancillary revenues for services provided for his patients. We no longer have referrals to other physicians within Lexington Clinic that those patients in the past have had. We no longer have additional services that those patients may have needed in the future.

Sealed Response at p. 28-9; RA1129 at 257 and sealed Exhibit H at pp. 9-10. Dr. Irwin testified that the revenue at the Veteran's Park practice took "a dip." RA466 at p. 1315, Sealed Exhibit E, Dr. Irwin Depo. at pp. 146-48, and Appellees' Brief to the Court of Appeals at pp. 8-9 and Appendix F.[15] Likewise, NLC produced thousands of pages of documents identifying patients who transferred their care from NLC to the Baptist Defendants, as well as the revenues generated at NLC from these patients. Sealed Response as Exhibit 19. NLC produced the Baptist Plans, which included taking this revenue as a goal. Sealed Response at Exhibits 6 and 7; RA1128 Sealed Response to Motion for Summary Judgment at Exhibits 5 and 6. Finally, NLC produced evidence on the amounts paid to Dr. McKinney that also must be disgorged while he was breaching his duties. Sealed Response at Exhibit 15.

NLC established damages; it merely had not yet quantified them (because damages discovery had just been opened and the Appellants had refused to produce damages discovery, and the deadlines for damages experts had not even been set) before

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[15] The Appellants cite this and testimony about morale improving after Dr. McKinney left as establishing a lack of damages. Appellants' Brief at pp. 7-8. That some employees were glad Dr. McKinney left does not indicate that NLC suffered no damage. In addition, the dip is evidence of damage. This is analogous to arguing that a person physically injured had no lost earnings, because he testified that his earnings "dipped" while he was in the hospital, but returned to normal after returning to work. Finally, VP's revenues were supported at the expense of other NLC practice groups, as Randy LeMay testified.

the Circuit Court granted judgment finding none.

## VI. NLC DID NOT KNOW ABOUT DR. McKINNEY'S MISCONDUCT

### A. Dr. Irwin's Knowledge Was Not NLC's

An issue raised in the Appellants' Brief, but not decided in their favor below, is that the misconduct is excused (and *Steelvest* and *Aero Drapery* are distinguishable) because NLC knew and allowed what was occurring. This is based primarily on Dr. Irwin's knowledge of some of Dr. McKinney's conduct. Dr. Irwin was not a NLC Director. In addition, in obtaining his knowledge, Dr. Irwin was collaborating with Dr. McKinney and acting in his self interest. He testified:

> We sort of made a decision that maybe we really would break away. And then we decided - after that, nobody really had any good grasp of what was this going to cost us and be - you know, it was exciting, but what's the reality of it, was the next question, as far as capital. So then we started exploring that.... So she and I just started looking at pricing rented space and how to go about opening a practice, what kinds of things we needed to explore. So we started making a business plan.

Sealed Response at pp. 24-25 (Irwin depo. at pp. 34-35, 36-39). While planning to leave with Dr. McKinney, Dr. Irwin had discussions about Dr. McKinney's contacts with an architect and building firm. *Id.* (Irwin depo. at p. 40). Drs. Irwin, McKinney and Gullo prepared and reviewed a financial analysis which included a name for a new practice. *Id.* (Irwin depo. at pp. 41-43; Mrs. Irwin Depo., Exh. 1). During these collaborations, the physicians also discussed leaving NLC to join BPL. *Id.* (Irwin depo. at p. 62). Dr. Irwin attended meetings with Drs. Bensema, McKinney, Gullo, Hoffman and Gammon, and reviewed blueprints of the planned facility. *Id.* (Irwin depo. at pp. 70-72. Drs. McKinney and Irwin had frequent discussions about leaving NLC up until close in time to Dr. McKinney's announcement of his departure (in February 2008). *Id.* (Irwin depo. at p. 68).

The Appellants' arguments are misplaced because an agent's knowledge is not imputed to a principal when the agent is acting in his own interest and contrary to that of the principal. *Wilson v. Paine*, 288 S.W.3d 284, 287-88 (Ky. 2009) ("knowledge is not imputed if the agent is acting in a manner adverse to the interests of the principal."); *Owsley Co. Deposit Bank v. Burns*, 244 S.W. 755, 756 (Ky. 1922) (imputation of knowledge of agent to principal "has no basis when the transaction relates to personal matters of the agent, and where his interests are adverse to those of his principal"). Since Dr. Irwin was acting adverse to NLC and for his own interests in colluding with Drs. McKinney, Gullo, Hoffman, Gammon, BPL, BHSI and Dr. Bensema about leaving NLC, his knowledge of their activities is not imputed to NLC.

**B. No NLC Officer Or Director Knew Of These Activities**

The Defendants also misstate that other NLC officers and directors knew that Dr. McKinney was leaving. That NLC directors and officers speculated about Dr. McKinney's morale and the possibility that he might leave, is not the same thing as knowing that he is leaving, much less to a competitor a couple miles away which he is helping design and equip, and is staffing with NLC employees and physicians, using confidential NLC financial information to aid these efforts.

Moreover, NLC followed up on its concerns about Dr. McKinney's morale by asking him about his plans, and Dr. McKinney lied about them. For example, Dr. Sartini asked Dr. McKinney if he was leaving. Dr. McKinney did not reveal that he had already signed a Letter of Intent to work for BPL, but replied to the question of whether he is leaving by saying merely "Well, not really. But I am weighing my options." Sealed Response at pp. 14-15. Both Fred Michel, M.D. (the NLC Medical Director) and Michael

Eden, M.D. (who was then President of NLC) specifically asked Dr McKinney if he was leaving. Their conclusions from his responses were that he was not. *Id.* Dr. Arthur Henderson, who was President of the NLC Board in 2008, met with Dr. McKinney on January 17, 2008, to talk to him about the operations of NLC. He was told by Dr. McKinney that he was "fully engaged" (which Dr. Henderson confirmed in a Memo on that date). *Id.* and Exhibit 17 thereto.

Indeed, Dr. McKinney's co-conspirator, Dr. Gullo, confirmed that Dr. McKinney was lying to NLC in a contemporaneous e-mail to Dr. Bensema on September 27, 2007. She said several NLC physicians had asked if Dr. McKinney was leaving and assured him that Dr. McKinney ("Mike" in the e-mail) was lying -- "Mike has denied his resignation is imminent." *Id.* at Exhibit 18.

The same is true with respect to Drs. Cooper and Winkley. The only testimony was that Dr. Henderson knew that Drs. Cooper and Winkley were" very disappointed" about Dr. Winkley's loss in a board election, and "might leave." Appellees' Brief to Court of Appeals at pp. 11-12. That is not knowledge that they are leaving, or recruiting a practice group to move to a competitor.

NLC did not know that Drs. McKinney, Cooper and Winkley were leaving, nor that they were actively recruiting mass exoduses of physicians and employees to staff competitive enterprises. This is no defense to the misconduct.

## VII. PHYSICIANS ARE NOT ABOVE THE LAW

Although they also did not prevail on this argument before the Circuit Court, the Appellants argue that they are "above the law" and need not comply with director/fiduciary duties, because they are physicians. Appellants' Brief at pp. 34-36.

Absent from the Appellants' Brief is any case that supports the existence of such a remarkable exception. To the contrary (although what is allowed by a fiduciary differs depending on the jurisdiction – Kentucky's law is set forth in *Steelvest* and *Aero Drapery*), cases in which physicians' fiduciary duties in setting up to compete were at issue in *Efird v. Clinic of Plastic and Reconstructive Surgery, P.A.*, 147 S.W.3d 208 (Tenn.App. 2003), *Total Care Physicians, P.A. v. O'Hara*, 798 A.2d 1043 (Del.Super. 2001), *Setliff v. Akins*, 616 N.W.2d 878 (S.D. 2000), and *Physician Specialists in Anesthesia, P.C. v. MacNeill*, 539 S.E.2d 216 (Ga.App. 2000). Moreover, if there was a policy against limiting physician movement, non-compete agreements would be banned. They are not. *Lareau v. O'Nan*, 355 S.W.2d 679 (Ky. 1962).

Likewise, the assertion that medical care "is not commerce" is shallow given Appellants' contemporaneous communications. The physicians did not leave NLC to treat patients in an under-served area. They moved a few miles to treat the same patients with the stated goal of taking revenue from NLC and increasing their compensation.

Arguments about patient care also miss that NLC has never sought to limit a patient's right to choose a physician. Patients are free to go wherever they please. Indeed, NLC has never sought to prevent these physicians from practicing medicine at BPL or BHSI. That one of the remedies is measured by reference to the profits accruing to the Appellants does not restrict physician movement or patient choice any more than a monetary judgment in any other case or measured in another way. The law just required the Appellants to conform their conduct to basic notions of fairness in the process, and hold them liable if they fail to do so. Enforcement of duties is not onerous and is necessary for corporate governance.

## CONCLUSION

There is nothing in KRS 271B.8-300 that has made the conduct at issue in *Aero Drapery* and *Steelvest* legal. This misconduct breached director duties then and it breaches them now. No one has even argued otherwise.

The Circuit Court's Judgment, therefore, required it to find not only that KRS 271B.8-300 applies AND that it has supplanted common law on fiduciary duties (which the Appellants focus on in their Brief to this Court), but also that NLC never pursued a claim that KRS 271B.8-300 was violated. The Circuit Court's finding that no such claim was pursued was not based on the pleadings, which do not cite a source of director duties, one way or the other, nor on the arguments, which have always been in the alternative that (1) the statute does not apply, but (2) was violated if it does. NLC merely contended that the directors had duties to it (an indisputable and undisputed proposition) and breached those duties (no one contended otherwise and would be hard pressed to do so), regardless of whether the source was common law, KRS 271B.8-300, both or neither. The Circuit Court's ruling ignored Kentucky's liberal pleading standards, since NLC pleaded the existence of the duties and facts giving rise to their breach, all of which, taken as true, set forth a violation of the Directors' duties, statute or no statute. The Court of Appeals was correct in reversing the judgment on this basis.

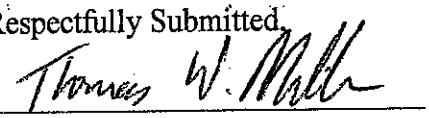
The issues of statutory application and effect, though having a more wide-ranging impact on Kentucky law and being the focus of Appellants' Brief, ended up being secondary to the pleading issue in the disposition of this appeal.

KRS 271B.8-300 does not apply to the situation presented by its terms or its intent. It applies to those decisions made by a director "as director." A person acting

individually without corporate knowledge is not acting "as a director."

KRS 271B.8-300 does not abrogate common law fiduciary duties in any event. Indeed, it does not even attempt to define the duties owed by directors, merely set forth certain standards for their performance and a burden of proof on a plaintiff seeking monetary damages. The duties, themselves, are left for other law (as the ABA comments state), including cases like *Steelvest* and *Aero Drapery*. Those cases define, refine and apply these duties to numerous factual situations. It would set a dangerous precedent to toss out an entire body of law developed over decades to protect corporations and their constituents based on a statute that does not, by its letter, require this result. No cited case from any jurisdiction supports such a drastic finding.

Respectfully Submitted,



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## APPENDIX

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|---|---|
| Exhibit A | Excerpts from ABA Model Business Corporations Act |
| Exhibit B | *Bowden v. Sandler*, 2009 WL 1491395 (Ky. App. 2009) (unpublished) |
| Exhibit C | *Gundaker/Jordan American Holdings, Inc. v. Clark*, 2008 WL 4550540 (E.D.Ky. Oct. 9, 2008) (unpublished) |
| Exhibit D | *Security Title Agency, Inc v. Pope*, 200 P.3d 977 (Ariz.App. 2009) |
| Exhibit E | *Harmeling v. Nat. Marketing Corp.*, Inc., 2005 WL 564101 (Ky.App. 2005) (unpublished) |