



that Baptist Health was required but failed to disclose information that adoption of an ECOI Policy may lead to claims against it and did in fact lead to the Underlying Actions. Platte River asserts the following claims in its complaint: that the Underlying Actions are not covered by virtue of Baptist Health's misrepresentations in the applications submitted to Platte River; that the prior knowledge exclusion in the insurance policy bars coverage for any loss, including defense expenses, incurred in connection with the Underlying Actions; and that Baptist Health's retention of defense expenses previously advanced by Platte River in connection with the Underlying Actions constitutes unjust enrichment.

Baptist Health, in turn, has filed a counterclaim seeking a declaration that the insurance policy issued by Platte River is valid and enforceable, that it provides coverage for the Underlying Actions, and that Platte River is obligated to pay defense expenses on a current basis. Baptist Health also seeks reimbursement from Platte River for Baptist Health's defense expenses incurred in connection with the Underlying Actions, claiming that Platte River breached its obligations under the insurance policy by failing to reimburse Baptist Health on a current basis for its defense expenses.

The matter is before the Court on cross-motions of Platte River and Baptist Health for summary judgment [doc.#'s 33, 36]. Responses to these motions have been filed and Baptist Health has filed a reply to Platte River's response to its motion for summary judgment. Having carefully considered the matter, the Court grants Platte River's motion for summary judgment and denies Baptist Health's motion for summary judgment.<sup>1</sup>

---

<sup>1</sup> The Court deferred ruling on these motions pending a settlement conference before a Magistrate Judge that proved unsuccessful. Following that settlement conference, the Court, by Order dated November 25, 2008, granted a motion and supplemental motion of interested parties Dr. Bruce E. Murphy, Bruce E. Murphy, M.D., P.A., Dr. Scott L. Beau, Scott L. Beau, M.D., P.A., Dr. David C. Bauman, David C. Bauman, M.D., P.A., Dr. D. Andrew Henry, D. Andrew Henry, M.D., P.A., Dr.

I.

A.

On May 22, 2003, the Baptist Health Board of Trustees adopted an ECOI Policy, or “economic credentialing policy.” This policy provides that no physician who, directly or indirectly, acquires or holds an ownership or investment interest in a competing hospital shall be eligible to apply for initial or renewed appointment or clinical privileges in the professional staff of any Baptist Health hospital. The policy further requires that physicians disclose such financial interest, treats such interest as a “failure to meet preliminary eligibility requirements” for staff appointment or clinical privileges, and provides that a physician failing to meet such eligibility requirements is not entitled to any hearing or appellate review.

After Baptist Health adopted the ECOI Policy, the following Underlying Actions were filed against Baptist Health challenging the ECOI Policy: *Bruce E. Murphy, M.D. et al. v. Baptist Health*, No. 4:04cv0011 (E.D.Ark.), later refiled as case No. CV-2004-2002, Circuit Court of Pulaski County, Arkansas (the “*Murphy* action”); *Little Rock Cardiology Clinic, P.A. et al. v. Baptist Health, et al.*, United States District Court for the Eastern District of Arkansas, Case No. 4:06cv001594 JLH (the “*LRCC* action”); and *Janet Cathey, M.D. v. Baptist Health*, Circuit Court of Pulaski County, Arkansas, Case No. CV-2005-5701 (the “*Cathey* action”).

The *Murphy* action was filed by a group of cardiologists who held professional staff

---

David M. Mego, David M. Mego, M.D., P.A., Dr. William A Rollefson, William A. Rollefson, M.D., P.A., Dr. Paulo Ribeiro, Paulo Ribeiro, M.D., P.A., and Little Rock Cardiology Clinic, P.A. (the “LRCC defendants”), to unseal Baptist Health’s amended answer and counterclaim and the summary judgment pleadings filed by Baptist Health. The LRCC defendants stated that they intended to file a response to Baptist Health’s motion for summary judgment once it was unsealed and requested 30 days in which to do so. The Court granted the LRCC defendants’ request and accordingly ordered that the LRCC defendants file their response to Baptist Health’s motion for summary judgment within 30 days from the date of entry of Baptist Health’s unsealed motion for summary judgment (as redacted by the Court) on the Court’s public docket, which was December 18, 2008. The LRCC defendants never filed a response to Baptist Health’s motion for summary judgment, however.

appointments at Baptist Health. These cardiologists, Doctors Murphy, Beau, Bauman, Henry, Mego and Rollefson, are shareholders of Little Rock Cardiology Clinic (“LRCC”) and directly or indirectly hold an ownership interest in Arkansas Heart Hospital (“AHH”). As a result of such interest, application of the ECOI Policy to them would result in their not being eligible for staff appointment or clinical privileges at Baptist Health. In their lawsuit, the cardiologists asserted *inter alia* that Baptist Health’s ECOI Policy violated federal anti-kickback and Medicaid statutes, Arkansas Medicaid Fraud and False Claims Act, and constituted tortious interference with their business relationships.<sup>2</sup>

The LRCC itself subsequently filed suit against Baptist Health. The LRCC plaintiffs alleged in their action that Baptist Health and Arkansas Blue Cross and Blue Shield (“Blue Cross”) engaged in anticompetitive acts including *inter alia* removing LRCC physicians from Blue Cross’s provider networks, refusing AHH’s repeated requests to be admitted into the Blue Cross network, and adopting and implementing the ECOI Policy to prohibit the LRCC plaintiffs from retaining staff privileges at Baptist Health.<sup>3</sup>

Dr. Janet Cathey, a gynecologist, filed her action against Baptist Health seeking a declaration that the ECOI Policy was illegal and unconscionable and resulted in tortious interference with contract. Dr. Cathey had been advised by Baptist Health that her staff membership and clinical privileges at Baptist Health would be terminated because of her

---

<sup>2</sup> The *Murphy* action was tried to the state court in March 2008. On February 27, 2009, the court issued a decision finding that Baptist Health’s ECOI Policy violated public policy, tortiously interfered with contracts and business expectancies, and was an unconscionable trade practice under the Arkansas Deceptive Trade Practices Act. The court permanently barred Baptist Health from denying the plaintiff doctors professional staff appointment and clinical privileges on the basis of its ECOI Policy.

<sup>3</sup> The *LRCC* action was dismissed pursuant to [Fed.R.Civ.P. 12\(b\)\(6\)](#) on August 29, 2008, and has been appealed to the United States Court of Appeals for the Eighth Circuit.

husband Dr. Steve Cathey's ownership of an interest in a competing hospital.<sup>4</sup>

B.

Prior to Baptist Health's adoption of the ECOI Policy, Baptist Health's CEO and President, Russell Harrington ("Harrington") was aware that the Office of the Inspector General ("OIG") of the Department of Health and Human Services had in December 2002 issued a request for comments in response to an inquiry by the American Medical Association to issue guidance regarding the legality, under the federal anti-kickback laws, of credentialing practices based on economic criteria. Harrington asked Doug Weeks ("Weeks"), Senior Vice President and the administrator of Baptist Health Medical Center in Little Rock, to research economic credentialing or conflict of interest policies.

By February 2003, this research was underway and Weeks reported on it at a February 11, 2003, meeting of the Executive Committee of the Baptist Health Board of Trustees.

According to the minutes from that meeting:

Mr. Weeks initiated discussion on economic credentialing of physicians investing in specialty hospitals and research that is underway at other healthcare facilities that have instituted e-credentialing, centered around conflict of interest. Physicians who invest in specialty hospitals such as the proposed North Little Rock spine hospital would not be allowed to join the staff at BAPTIST HEALTH.... Prior to any discussion with physicians, e-credentialing must undergo legal review....

As part of his investigation, Weeks specifically obtained information regarding the experiences of several hospitals, including OhioHealth and Sioux Falls (South Dakota) with

---

<sup>4</sup> The *Cathey* action was settled by the parties. Having settled her action, interested party Dr. Cathey was dismissed from this action by Order of the Court pursuant to a stipulation of dismissal. The Court notes that the state court in the *Murphy* action found that Baptist Health's ECOI Policy violated policies that protect the institution of marriage given Baptist Health's attempt to bar Dr. Cathey on the basis of her husband's stake in a competing hospital.

economic conflict of interest policies. Weeks was aware that courts had upheld economic conflict of interest policies adopted by hospitals in other states. Weeks testified that he was aware of “at least four cases throughout the nation which had been challenged in the courts” and “the courts in all four cases had determined that it was the right of the hospital to implement such a policy.” Weeks discussed with Harrington his investigation of other hospitals’ experiences with economic credentialing policies.

In addition to Weeks’ investigation, Baptist Health retained outside counsel, Harold Simpson (“Simpson”), to draft an economic credentialing policy. Weeks provided Simpson with all the materials he had compiled on economic credentialing. Weeks testified that Baptist Health retained outside counsel because one of its concerns was to ensure that any economic credentialing policy adopted by Baptist Health did not violate anti-kickback laws or antitrust laws. Harrington likewise understood that Simpson was retained *inter alia* to undertake a legal review of an economic credentialing policy in the context of the anti-kickback laws.

Simpson attended a March 11, 2003, Executive Committee meeting during which the ECOI Policy was discussed and made the Executive Committee aware that courts had upheld economic conflict of interest policies that had been challenged in other jurisdictions.<sup>5</sup> Harrington testified that although the Executive Committee can act on the Board’s behalf, Harrington believed that it was appropriate to submit to the full Board the decision whether to adopt the ECOI Policy because it was a “major” and “significant” policy.

Following the March 2003 Executive Committee meeting, Harrington testified at an April 11, 2003, hearing held by the Federal Trade Commission (“FTC”) and the Antitrust

---

<sup>5</sup> Prior to the Executive Committee meeting, Weeks had seen a written legal review prepared by Simpson.

Division of the Department of Justice. Also testifying at this hearing was Dr. James J. Kane, Jr., CEO of AHH and LRCC. Concerning economic credentialing, Dr. Kane testified as follows:

Apparently word got out we were having this meeting, I got some calls from some of the orthopedic surgeons in town who are planning or have been planning to open an orthopedic specialty hospital, and it's upset, Mr. Harrington and others, to absolutely no end, and I only have one side of the story. The other side of the story is here, but the orthopedic surgeons tell me that the Baptist board has voted that if they open the hospital, they will be de-credentialed at Baptist Hospital. I don't know whether that's true or not, but perhaps we can pursue that.

This has been done in other towns. Here's an article in one of the trade publications from Ohio where doctors opened a single specialty hospital and they were removed from the staff of the community hospital. So, it's not a – it's not Mr. Harrington's idea or the Baptist Hospital's idea, it's been done in other places.

Now, this is how they can exert this sort of pressure. They've been amazingly successful.

Dr. Kane went on to express concern about the relationship or network developed between Baptist Health and Blue Cross and “this trend toward a single payor system that's closely allied with Baptist Hospital”:

[F]rankly, where the B is for Baptist, you could substitute Blue. You might worry a little about what the M means. Now I'm not going to use any of the M words, ... but you have to worry a little bit about how large this system is getting ... We [AHH] worry about the dominance of segments of the market by the BlueCross/Baptist alliance. We fret because we're still excluded from the Arkansas BlueCross BlueShield providers, despite the fact that we have doctors who go to Baptist Hospital every day of the week and we have patients in Baptist Hospital every day of the week. We're concerned because other payors have left the state and ... [w]e're concerned now about what we might call economic credentialing. This is how working at a single specialty hospital might affect the doctor working there in terms of being credentialed at Baptist Hospital....

Harrington, in turn, stated:

... as of today, at least, we don't do economic credentialing, but I'm sure glad that Dr. Kane gave me the idea, because we're going to go back and look at it. I like to think of it more in terms of conflict of interest credentialing, or community

credentialing. I think the purpose of it, as I've studied it, because a number of my colleagues were doing that, and court rulings have been supportive of it and the American Hospital Association has studied it and taken the right position, I believe.<sup>6</sup>

In a letter to Harrington dated April 26, 2003, Dr. John Wayne Smith, a member of Baptist Health's Board of Trustees, expressed concerns regarding the proposed ECOI Policy, including a concern whether the legalities of the ECOI Policy had been explored.<sup>7</sup> Dr. Smith raised a concern that the policy would create a negative relationship between Baptist Health and physicians. Harrington understood Dr. Smith to be objecting to the ECOI Policy. Harrington responded in writing to Dr. Smith's letter, stating: "Of course we have checked the legal status of this proposal. It is being implemented at several hospitals across the country and courts have upheld hospitals' right to implement." Dr. Smith expected that Baptist Health would be sued as a result of the ECOI Policy.

The minutes of the May 13, 2003, Executive Committee state that Harrington reported to the committee the concerns expressed by Dr. Smith and his response. The minutes go on to state that "[o]ther than the reference to Dr. Smith, there have been no real negatives expressed by members of the professional staff in that it has been stated that the policy does not apply to ambulatory centers or diagnostic centers and that the board has no intent for the policy to go beyond that of a competing hospital."

At the May 22, 2003, meeting of the Baptist Health Board of Trustees, Weeks reported to the Board his understanding of the case law on economic conflict of interest policies. The

---

<sup>6</sup> As indicated by his testimony, Harrington did not get the idea of economic credentialing from Dr. Kane but had been studying the issue prior to the FTC meeting and had previously attended meetings where such policies were discussed. Harrington also was aware of litigation that had challenged such policies and been upheld by courts.

<sup>7</sup> Dr. Smith was not an actual voting member of the Baptist Health Board of Trustees when the ECOI Policy was adopted.

minutes from that Board meeting state:

The steps taken in developing the policy were reviewed to include the studies of other institutions across the country where a similar policy has been implemented, legal review to include court upholding, and discussions with members of the professional staff leadership. Members of the professional staff have been assured that the policy does not go beyond that of a competing hospital....

By the time Baptist Health adopted the ECOI Policy at its May 22, 2003, Board of Trustees meeting, Weeks had prepared a document which identified by name a number of physicians who may be affected by the ECOI Policy, including Doctors Murphy, Beau, Bauman, Rollefson, Mego, cardiologists affiliated with LRCC, as well as potential investors in a spine hospital, such as neurosurgeons Steve Cathey and Zach Mason. According to Harrington, Baptist Health adopted the ECOI Policy because it was “the right thing to do.” When asked in the *Murphy* action if Baptist Health adopted the ECOI Policy “knowing that it could result in this lawsuit?,” Harrington answered “Yes, sir.”<sup>8</sup>

Following its adoption of the ECOI Policy, Baptist Health required physicians to complete forms disclosing any ownership interest in any competing hospital. In August 2003, Doctors Beau, Bauman, Rollefson and Mego returned their forms to Baptist Health, indicating that they had read the ECOI Policy and did hold ownership interest in a competing hospital. However, the forms signed by each of these doctors and returned to Baptist Health had blacked out the following statement on the form that they were required to sign and acknowledge:

---

<sup>8</sup> In his affidavit submitted in support of Baptist Health’s summary judgment papers, Harrington states that “[a]t no time prior to the lawsuit filed by Dr. Bruce Murphy against Baptist Health in February 2004 did I believe that it was likely that the ECOI Policy would result in any lawsuit, nor did I have knowledge that any other officer or director of Baptist Health believed that it was likely that the ECOI Policy would result in any Lawsuit.” Harrington Aff. at ¶ 3. Platte River subsequently moved to strike Harrington’s affidavit as contradictory to his testimony given under oath in the *Murphy* action. By Order entered May 16, 2008, the Court denied Platte River’s motion to strike Harrington’s affidavit but stated that “upon consideration of the parties’ motions for summary judgment,” the Court “will take into account Platte River’s contention that Harrington’s affidavit contradicts his sworn testimony and give the affidavit its due weight, if any.”

I understand and agree that, if I hold such an interest [in a competing hospital], I am ineligible to apply for, reapply for, or hold Appointment and Clinical Privileges and, accordingly am not entitled to any hearing or appellate review rights upon denial.

These same doctors filed suit when Baptist Health sought to deny them privileges pursuant to the ECOI Policy.

Harrington and Weeks both testified that Weeks received complaints from certain physicians who had concerns about the ECOI Policy – Weeks testified he specifically recalled two physicians that were not in favor of the ECOI policy – and Dr. Janet Cathey testified that Weeks said Baptist Health was “expecting probably about 20 other lawsuits over . . . [the] policy.” Weeks, however, testified that his “recollection of that comment, based on 20 lawsuits, is that if we didn’t apply that [ECOI Policy] fairly and equally, that certainly the people who had been affected by the policy so far might – you know, might be upset with the fact that we didn’t apply it equally and fairly based on the way the policy was written.”

C.

Before December 16, 2003, Baptist Health had directors and officers liability insurance coverage through Executive Risk Indemnity, Inc. (“Executive Risk”). This policy – Directors, Officers and Trustees Liability Insurance Including Healthcare Organization Reimbursement Policy Number 8168-7661 (the “ERII Policy”) – was issued by Executive Risk to Baptist Health for the coverage period December 16, 2002, to December 16, 2003.<sup>9</sup> Kim Lloyd (“Lloyd”) was the underwriter with the ERII Policy. Lloyd joined Executive Risk in 1998 as an underwriter for

---

<sup>9</sup> Chubb Specialty Insurance Company (“Chubb”) purchased Executive Risk in 1999. Nevertheless, Executive Risk “paper” continued to be used at Chubb.

insurance coverage in the healthcare industry.<sup>10</sup> Ramsey Krug Farrell & Lensing (“Ramsey Krug”) was one of 30 insurance brokers assigned to Lloyd’s geographic territory at Chubb, and Lloyd performed the underwriting function on applications that came to Chubb through Ramsey Krug, including Baptist Health’s applications.

In August 2003, Lloyd left her employment with Chubb and went to work for Darwin Professional Underwriters, Inc. (“Darwin”) as a senior underwriter for insurance coverage in the healthcare industry. Darwin serves as an underwriter and claims handler for certain insurance companies, including Platte River. When Lloyd went to work at Darwin, it was a start-up company, having been founded in March 2003, less than six months before Lloyd went to work there.

At her previous employment, Lloyd had been one of 150 to 200 underwriters in the company and one of 35 to 40 underwriters in the healthcare area alone. Darwin, however, had only about 16 total employees. Lloyd was the only senior underwriter for healthcare in the entire company, the only other underwriter for healthcare in the company working in connection with medical-malpractice coverage. Only two other employees worked in the healthcare area in any capacity.

Lloyd used rating plans in her previous employment, which she describes as a process of entering in information regarding an account and developing a summary that relates what the premium for insurance coverage should be based on the factors entered regarding the account. The methodology included a combination of manual rates and a computer worksheet. When Lloyd went to work at Darwin, there was no specific training. However, Lloyd states she had

---

<sup>10</sup> Prior to joining Executive Risk, Lloyd worked for six years as a recreational therapist.

five years of experience in health care underwriting at Executive Risk/Chubb and received specific training in Health Care D&O and Managed Care E&O underwriting while there. She states she used a rating plan at Darwin similar to the rating plan used at Executive Risk/Chubb and neither company had any other written underwriting guidelines, directives, or manuals for health care professional lines insurance.

Although Darwin initially had no written underwriting guidelines, Lloyd and another former Chubb employee, Paul Romano (“Romano”), developed rating plans based on the manual rates used at Chubb and did not involve the computer program used at Chubb. Lloyd testified that the rating plans used at Darwin and Chubb were an “industry commonality” and that “[i]t wasn’t an actual technology platform of any sort, it was applying debits and credits based on the underwriter’s call.” It was not until sometime in approximately 2007 that Darwin instituted lengthy written underwriting guidelines.

Darwin hired people to market the new start-up company to brokers and attempt to obtain their business, and Lloyd provided Ramsey Krug’s name to those people. In October 2003, two months after Lloyd went to work at Darwin, Ramsey Krug submitted to Darwin an application for directors and officers insurance coverage on behalf of Baptist Health. Darwin did not initially have its own application for healthcare directors and officers liability insurance company and Baptist Health submitted to Darwin a renewal application for directors and officers insurance from Executive Risk.<sup>11</sup> The submission included the renewal application for directors and officers liability insurance from Executive Risk (the “ERII Application”) and also a copy of the ECOI Policy in response to a question on the ERII Application asking, “Has there been any

---

<sup>11</sup> Darwin did not finish developing its own application for healthcare directors and officers coverage until sometime later in 2004.

change in the Applicant's peer review and credentialing processes within the last year?"

The ERII Application was signed by Harrington on July 28, 2003, and contained the following question and answer:

22. No **Entity** nor any individual proposed for coverage is aware of any fact, circumstance, situation, transaction, event, act, error, or omission which they knew or should reasonably have known may result in a claim that may fall within the scope of the proposed insurance, except as follows. If answer is "None," so state:

**None.**

The ERII Application then set forth a "Prior Knowledge Exclusion":

Without prejudice to any other rights and remedies of the Underwriter, it is agreed that any claim arising from any fact, circumstance, situation, transaction, event, act, error or omission required to be disclosed in response to Question 22 is excluded from the proposed insurance.

Lloyd testified that she would "guess" that the prior knowledge question requires an applicant "to use their judgment as to what's a known circumstance" but that "[she's] not a lawyer" and "can't answer how somebody else interprets the wording that signed the application."<sup>12</sup>

Lloyd states she reviewed Baptist Health's submission (noting that Romano would not have) but that she didn't know how much in detail and was not confident that she read every page of the submission. In this respect, Lloyd cannot recall whether she did any specific evaluation of the risk associated with the ECOI Policy attached to the ERII Application and that the first time she heard the term "economic credentialing" was in this case.

In connection with Baptist Health's application for insurance, Lloyd prepared an

---

<sup>12</sup> Baptist Health represents that Lloyd "*admits* that the prior knowledge question *requires* 'the applicant to exercise the applicant's judgment about what information should or should not be disclosed'" (emphasis added), but Lloyd's testimony, as just noted, was not so unequivocal as Baptist Health represents.

“underwriting worksheet” that reflected the thought process behind her evaluation of the risk associated with providing insurance coverage to Baptist Health. The underwriting worksheet did not reference the ECOI Policy. The “executive summary” section of the underwriting worksheet provided as follows: “Summary of Underwriters thoughts on D&O Risk (include strengths & weaknesses of organization, your assessment of key exposures and the rationale for your proposal”). Lloyd indicated that the Baptist Health application was brokered by Ramsey Krug, with which she had “a great deal of success . . . in the past.” She wrote that Ramsey Krug was frustrated with Chubb and was looking to move all of its business to Darwin, and that Baptist Health was “one of the largest D&O Healthcare accounts” Ramsey Krug had. Lloyd predicted that “[i]f we can get this one they will give us looks at all of their business.”<sup>13</sup>

At the bottom of the underwriting worksheet, Lloyd noted that Darwin was “manuscripting the Chubb expiring policy to match coverage.”<sup>14</sup> Lloyd ultimately determined that Baptist Health was a “good risk” for Platte River, concluding the insurance premium that would be received – nearly \$100,000 – was good from the insurance company’s perspective.

In November 2003, Lloyd provided a quote for Baptist Health’s directors and officers insurance coverage and forwarded to Ramsey Krug the Chubb policy Darwin had manuscripted. Lloyd also sent to Ramsey Krug a blank application Darwin had developed for for-profit organizations, even though Baptist Health was admittedly a not-for-profit organization, because Darwin had no application for non-profit companies.

---

<sup>13</sup> Baptist Health states Lloyd’s executive summary included none of the information called for by the underwriting worksheet but Platte River states the underwriting worksheet speaks for itself and notes as well that Lloyd testified regarding the rating, premium, and other information included on the underwriting worksheet.

<sup>14</sup> As previously noted, Darwin did not have a directors and officers insurance policy it could use and so it incorporated language from the directors and officers policy Chubb previously issued to Baptist Health to create a directors and officers policy to issue to Baptist Health that matched the coverage Chubb provided.

Having received the information in the ERII Application and the materials submitted to Darwin, Platte River provided a premium quotation coverage subject to certain terms and conditions. After communications between Platte River and Baptist Health's insurance broker, Platte River agreed to bind coverage effective December 16, 2003, subject to Platte River's receipt of certain documents, including a completed application by Darwin ("Darwin Application") signed and dated by Baptist Health.

Baptist Health submitted the Darwin Application signed by Allen F. Smith ("Smith"), a Senior Vice President of Baptist Health, on December 31, 2003. The Darwin Application states *inter alia* that the undersigned declares, to the best of his knowledge and belief after diligent inquiry, that the statements set forth in and attached to the Darwin Application are true.

Smith had attended meetings of Baptist Health's Senior Leadership Team, Executive Committee, and Board of Trustees at which economic credentialing and the ECOI Policy were discussed. The Darwin Application contained the following question and answer:

Does anyone for whom insurance is intended have any knowledge or information of any act, error, omission, fact or circumstance which may give rise to a Claim which may fall within the scope of the proposed insurance? Yes  No

The Darwin Application then set forth the following "Prior Knowledge Exclusion":

**IT IS UNDERSTOOD AND AGREED THAT, WITHOUT LIMITING ANY RIGHTS OF THE UNDERWRITER, IF SUCH KNOWLEDGE OR INFORMATION EXISTS, ANY CLAIM ARISING THEREFROM IS EXCLUDED FROM THIS PROPOSED INSURANCE.**

The Darwin Application also states:

**IT IS UNDERSTOOD THAT THE STATEMENTS IN THIS APPLICATION, INCLUDING MATERIALS SUBMITTED TO OR OBTAINED BY THE UNDERWRITER ARE MATERIAL TO THE ACCEPTANCE OF RISK, AND RELIED UPON BY THE UNDERWRITER.**

The ERII Application signed by Harrington was among the materials submitted to Darwin.

Having received the ERII Application and the materials submitted to Darwin, and subject to Platte River's receipt of the Darwin Application, Platte River issued Directors, Officers and Trustees Liability Insurance Including HealthCare Organization Reimbursement Policy Number 0303-0461 (the "Policy") to Baptist Health for the claims made policy period December 16, 2003, to December 16, 2004. This was the first healthcare directors and officers liability insurance policy bound by Darwin.

D.

In February 2004, the *Murphy* action was filed. Approximately two weeks later, by letter dated February 25, 2004, coverage counsel for Platte River, John Duchelle ("Duchelle"), communicated with Baptist Health concerning the *Murphy* action. In his letter, Duchelle *inter alia* acknowledged receipt of the complaint in the *Murphy* action, identified potential coverage issues, and asked to be kept apprised of all significant developments in the litigation.

In August 2004, Baptist Health sought to renew its insurance coverage and Lloyd noted on the executive summary on her underwriting worksheet that "[i]f the account continues to grow and reflect the claim history that it has today we will need to re-evaluate the desire for us to maintain this size of a risk in our book of business." Lloyd stated that Darwin's healthcare directors and officers business had by that time grown to nearly a million dollars but that she was not sure of the exact number. Darwin renewed the Policy for the period December 16, 2004, to December 16, 2005.

In April 2005, the *Cathey* action was filed. As a result of the *Murphy* and *Cathey* actions,

Lloyd notified Baptist Health that the Policy would not be renewed. Lloyd stated that it was because of the claims that the decision was made not to renew the Policy and that this decision was reached in a “roundtable.”

Following the filing of the *Murphy* and *Cathey* actions, Baptist Health and its attorneys communicated with Platte River regarding these actions, including providing Platte River with estimates of expenditures and status updates for the *Murphy* and *Cathey* actions. Baptist Health provided its last update in the *Murphy* and *Cathey* actions to Platte River on June 19, 2006.

By letter dated June 27, 2006, Duchelle notified Baptist Health that there were issues regarding prior knowledge allegedly not disclosed on the applications. Duchelle noted *inter alia* that Platte River had recently been supplied with a copy of the Third Amended Complaint in the *Cathey* action which he stated “demonstrate[d] that Baptist Health was apparently intent on adopting the Conflict of Interest Policy as early as February 2003.” Duchelle further stated that “[w]e also recently learned that Russell D. Harrington, then CEO of Baptist Health, and James J. Kane, Jr., M.D., CEO of Arkansas Heart Hospital and Little Rock Cardiology Clinic, participated in April 2003 in hearings on competition law and policy in the health care industry that were sponsored by the Federal Trade Commission and the Department of Justice” and that “[w]e understand Dr. Kane raised the issue of ‘Economic Credentialing’ during those hearings and that he in fact formally objected to what he described as Baptist Health’s ‘threat’ to employ such a policy against Arkansas Physicians who were considering opening allegedly competing hospitals.” Duchelle stated that “[i]n view of Dr. Kane’s statements during the above-referenced April 2003 hearings, which took place well before the inception of the Policy on December 16, 2003, Darwin respectfully reserves the right to deny coverage for these Claims to the extent any

insured had knowledge or information, prior to December 31, 2003, of the facts and circumstances which could – and ultimately did – give rise to the Claims.”

In November 2006, the *LRCC* action was filed. Baptist Health subsequently submitted to Platte River written requests for reimbursement of defense expenses incurred in the Underlying Actions.<sup>15</sup>

In December 2006, Platte River decided to decline coverage under the Policy for the Underlying Actions but did not communicate that decision to Baptist Health at that time. Rather, Platte River sought a legal review of the ECOI Policy undertaken by Baptist Health that was referenced in the May 22, 2003, minutes of the Baptist Health Board of Trustees that Baptist Health claimed was privileged. Platte River stated that it would be willing to enter into a confidentiality agreement if necessary to obtain the review. Apparently, no such agreement was entered into and Platte River claims that Baptist Health declined to provide a copy of that legal review in whole or in part.

On January 17, 2007, Platte River denied coverage under the Policy for the Underlying Actions and declined to continue to advance defense expenses. Platte River filed this complaint for declaratory judgment that same day after which Baptist Health filed its counterclaim for declaratory judgment and breach of contract.

## II.

Platte River moves for summary judgment on grounds that the Policy is void, or

---

<sup>15</sup> The Policy provides that Platte River “will pay on behalf of the **Insured Entity Loss** from **Claims** first made against it during the **Policy Period**.” The Policy defines “**Loss**” to include “**Defense Expenses**,” and provides that Platte River “shall, upon written request by an **Insured**, pay on a current basis **Defense Expenses** which are otherwise payable under this Policy ...”

alternatively that it has it has no duty to indemnify Baptist Health for the claims asserted against it in the Underlying Actions. Platte River argues Baptist Health made misrepresentations in its application for insurance which were relied upon by Platte River in determining whether to accept the risk and that under Arkansas law, these material misrepresentations render the Policy void as a matter of law and vitiate coverage for the Underlying Actions. Platte River additionally argues that as an independent ground for denying coverage, the prior knowledge exclusion contained in the application and incorporated into the Policy operates to bar coverage for the Underlying Actions, and as a result, Baptist Health was not entitled to payment of defense expenses advanced by Platte River, and must reimburse such advancements to Platte River.

Baptist Health, in turn, moves for summary judgment on the following grounds: the undisputed facts demonstrate that Baptist Health made no misrepresentation and show that Platte River cannot prove that any alleged misrepresentation was material; Platte River cannot establish that the Policy contained a prior knowledge exclusion and, assuming that the prior knowledge exclusion was incorporated into the Policy, the undisputed facts demonstrate that Baptist Health did not have knowledge sufficient to trigger application of the prior knowledge exclusion; as Platte River's misrepresentation and prior knowledge exclusion claims fail, the Policy provides coverage for the Underlying Actions and Baptist Health was entitled to the advancement of defense expenses; and as the undisputed facts show that the Policy provides coverage for the Underlying Actions, Platte River breached the Policy by declining such coverage.

A.

Summary judgment is appropriate when "the pleadings, depositions, answers to

interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” [Fed.R.Civ.P. 56\(c\)](#). As a prerequisite to summary judgment, a moving party must demonstrate “an absence of evidence to support the non-moving party’s case.” [Celotex Corp. v. Catrett](#), 477 U.S. 317, 325 (1986). Once the moving party has properly supported its motion for summary judgment, the nonmoving party must “do more than simply show there is some metaphysical doubt as to the material facts.” [Matsushita Elec. Indus. Co. v. Zenith Radio](#), 475 U.S. 574, 586 (1986). The nonmoving party may not rest on mere allegations or denials of his pleading, but must “come forward with ‘specific facts showing that there is a *genuine issue for trial*.’” [Id.](#) at 587 (quoting [Fed.R.Civ.P. 56\(e\)](#) and adding emphasis). *See also* [Anderson v. Liberty Lobby, Inc.](#), 477 U.S. 242, 256 (1986). The inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. [Matsushita](#), 475 U.S. at 587 (citations omitted). However, “[w]here the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no ‘genuine issue for trial.’” [Id.](#) (citation omitted). “Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment.” [Anderson](#), 477 U.S. at 248. “Factual disputes that are irrelevant or unnecessary will not be counted.” [Id.](#)

## B.

Resolution of the claims in the parties’ motions for summary judgment center on Question 22 on the ERII Application and Question 6 on the Darwin Application and Baptist Health’s answers to those questions. Before addressing those claims, however, the Court first

addresses Baptist Health's argument that the Darwin Application is not part of the Policy and its argument that the prior knowledge questions in the ERII Application and the Darwin Application are ambiguous.

1.

Baptist Health argues that given the documents produced by Platte River in this litigation, it does not appear that the Darwin Application was physically attached to the Policy as the Policy requires and that the Darwin Application therefore was not incorporated into the Policy.

The Policy provides:

The **Insureds** represent that the particulars and statements contained in the **Application** are true and agree that (1) those particulars and statements are the basis of this Policy and are to be considered incorporated into and constituting part of this Policy; (2) those particulars and statements are material to the acceptance of the risk assumed by the Insurer; and (3) this Policy is issued in reliance upon the truth of such representations....

As used in the Policy, "'Application' means the application attached to and forming part of this Policy, including any materials submitted therewith, which are on file with the Insurer and are a part of the Policy, as if physically attached."

Baptist Health acknowledges the Darwin Application is included with the Policy that was filed with the complaint for declaratory judgment and Baptist Health does not identify anything indicating that the submission of the underwriting materials, including the Darwin Application and the ERII Application, in a certain order or Platte River's production of the underwriting materials in a certain order is of any legal significance in these circumstances. Baptist Health knew that prior knowledge was an issue at least as early as the June 2006 Duchelle letter, and it is undisputed that Platte River agreed to bind coverage subject to Platte River's receipt of certain

documents, including a completed Darwin Application signed and dated by Baptist Health, and that the particulars and statements in the Darwin Application are the basis of the Policy and are to be considered incorporated into and constituting part of the Policy. Baptist Health does not contend that it did not already have the Darwin Application it completed, signed and provided to Platte River, and Baptist Health understood that the statements in the Darwin Application, including materials submitted to or obtained by the underwriter, were material to the acceptance of the risk and relied upon by Darwin. Baptist Health thus was on notice that the Darwin Application was to be considered part of the Policy and the Court finds that the Darwin Application and, as well, the ERII Application are in these circumstances incorporated into the Policy. *Cf. Cutter & Buck, Inc. v. Genesis Ins. Co.*, 306 F.Supp.2d 988, 997-98 & n.3 (W.D.Wash. 2004) (where policy stated that “information contained in and submitted with this application is on file with the insurer and along with the application ... is considered physically attached to the policy and will become part of it,” insured had “unequivocal notice” that certain items that were not actually physically attached to the policy were relied upon in issuing policy).<sup>16</sup>

2.

The Court now turns to Baptist Health’s argument that the two prior knowledge questions – Question 22 on the ERII Application and Question 6 on the Darwin Application – are ambiguous. Baptist Health seemingly is making two separate, although related, arguments

---

<sup>16</sup> Ark. Code Ann. § 23-79-119(a) requires that an insurance contract is to be construed “according to the entirety of its terms and conditions as set forth in the policy and as amplified, extended, or modified by any rider, endorsement, or application made part of the policy.” See *American Pioneer Life Ins. Co. v. Allender*, 18 Ark.App. 234, 713 S.W.2d 249, 251-52 (1986).

concerning ambiguity: first, that the language differs significantly between the two prior knowledge questions making it uncertain what level of probability is required to trigger a duty to respond affirmatively to one or both of these questions; and second, Question 6 of the Darwin Application contains subjective language (unlike Question 22 on the ERII Application) and the Court therefore should apply a subjective standard to the question. The Court will address these arguments in turn.

i.

Claiming that the language differs significantly between the two applications – “which they knew or should reasonably have known may result in a claim” (Question 22 on the ERII Application) and “may give rise to a claim” (Question 6 on the Darwin Application) – Baptist Health argues that the language is susceptible to more than one interpretation and, thus, ambiguous. Baptist Health argues the Court should therefore interpret the application questions to ask whether the insured knows a claim “likely” or “probably” will result.

If language of the policy is unambiguous, courts will give effect to the plain language of the policy without resorting to the rules of construction. *Elam v. First Unum Life Ins. Co.*, 346 Ark. 291, 57 S.W.3d 165, 169 (2001). On the other hand, if language of the policy is ambiguous, courts will construe the policy liberally in favor of the insured and strictly against the insurer. *Id.* “Language is ambiguous if there is doubt or uncertainty as to its meaning and it is fairly susceptible to more than one reasonable interpretation.” *Id.* The intent of the parties is to be determined from the whole context of the agreement, and the courts must consider the instrument in its entirety, not merely disjointed or particular parts of it. *Nash v. American Nat.*

*Property & Cas. Co.*, 98 Ark.App. 258, 254 S.W.3d 758, 760 (2007). Whether language of the policy is ambiguous is ordinarily a question of law to be decided by the court. *Castaneda v. Progressive Classic Ins. Co.*, 357 Ark. 345, 166 S.W.3d 556, 561 (2004).<sup>17</sup>

The Court determines that the prior knowledge questions in the ERII Application and Darwin Application do not contain significantly different language from one another, thereby creating uncertainty as to what level of probability is required to trigger a duty to respond affirmatively. Rather, both questions ask for knowledge of any facts or circumstances that “may result in a claim” (the ERII Application) or “may give rise to a claim” (the Darwin Application). The prior knowledge inquiry in each question is clear and is followed by a plainly worded statement that any claim resulting from Baptist Health’s knowledge of facts or circumstances is excluded from coverage. The Court does not, as argued by Baptist Health, interpret these questions to create confusion as to when disclosure is required, for example when claims “possibly may result,” “likely may result,” or “probably may result,”<sup>18</sup> and other courts have determined that policy provisions requiring notice of occurrences that “may result in” or “may give rise” to a claim are not ambiguous. *See, e.g., LaForge v. American Cas. Co. of Reading, Pennsylvania*, 37 F.3d 580 (10<sup>th</sup> Cir. 1994) (provision requiring written notice of an occurrence

---

<sup>17</sup> However, when the parties go beyond the contract and submit disputed extrinsic evidence to support their proffered definitions of the term, this is a question of fact for the fact finder and summary judgment is not proper. *McGrew v. Farm Bureau Mut. Ins. Co. of Arkansas, Inc.*, 371 Ark. 567, 268 S.W.3d 890, 896 (2007). Here, both parties agree that the question of ambiguity may be resolved by the Court on summary judgment.

<sup>18</sup> In support of this assertion, Baptist Health cites *Stratford School District v. Employers Reinsurance Corporation*, 105 F.3d 45 (1<sup>st</sup> Cir. 1997). In *Stratford*, the ambiguity was the result of contrasting language in the policy (“could in the future result”) and in the application (“probability of a claim or action”). 105 F.3d at 47. The First Circuit determined that reading the policy along with the application questionnaire, it was unclear what matters were excluded: those that *possibly* could result, those that *reasonably* could result, or those that *probably* could result. *Id.* (emphasis in original). There is no such contrasting language in the Policy in this action, however, and *Stratford* thus is distinguishable. Baptist Health also argues the policy language could be interpreted to require disclosure when claims “reasonably may result” but that question goes more to whether the prior knowledge questions are to be judged under an subjective or objective standard, which will be addressed below.

“which may subsequently give rise to a claim being made against the Directors and Officers ... for a Wrongful Act” not ambiguous); *Elrod v. P.J. Pierre Marine, Inc.*, 663 So.2d 859 (La.App. 1995) (policy provision requiring prompt notice by the insured to the insurer of any “occurrence which may result in a claim under this Policy” not ambiguous); *Morgan and Bro. Manhattan Storage Co., Inc. v. GRE Ins. Group*, 632 N.Y.S.2d 17 (N.Y.A.D. 1 Dept. 1995) (plaintiff’s obligation to give defendant written notice of “every loss, damage or occurrence which may give rise to a claim under this policy” is not rendered ambiguous by policy provision authorizing plaintiff to itself adjust any claim for less than \$750). Accordingly, the Court rejects Baptist Health’s argument that the language is susceptible to more than one interpretation and, thus, ambiguous.<sup>19</sup>

ii.

The question remains whether the prior knowledge questions are to be judged under an objective or subjective standard. Most of the courts considering the issue have adopted the objective approach. *American Special Risk Management Corp. v. Cahow*, 286 Kan. 1134, 192 P.3d 614, 624 (2008) (collecting cases). “Generally, these decisions focus upon the fact the ‘prior knowledge’ clause includes the phrase ‘reasonably foreseeable,’ ‘reasonably believe,’ or

---

<sup>19</sup> Baptist Health also cites *International Surplus Lines Ins. Co. v. University of Wyoming Research Corporation*, 850 F.Supp. 1509 (D.Wyo. 1994), *aff’d* 52 F.3d 901 (10<sup>th</sup> Cir. 1995), in arguing this Court should “interpret the phrases ‘may result in’ and ‘may give rise to’ in the prior knowledge questions ... as ‘likely to result in’ and ‘likely to give rise to.’” The court in *International Surplus* did note that “may” is defined as “in some degree likely to.” *Id.* at 1522 (citing Websters Third New International Dictionary, at 1396). But this definition by its terms presupposes something that is less than likely, *i.e.* “some degree,” and the terms “may” and “likely” thus are not synonymous as Baptist Health argues. In this respect, stating that something “may” happen is “used to express possibility,” *see* Websters Unabridged Dictionary (2<sup>nd</sup> ed.) at 1189, which common sense dictates is less certain or forceful than something that is “likely” to happen, “likely” being defined as “probably or apparently destined” or “seeming like truth, fact, or certainty.” *See id.* at 1114. For this reason, Baptist Health’s alternative argument that the Court should interpret the application questions to ask whether the insured knows a claim “likely may result” or “probably may result” *would* arguably render those questions ambiguous.

similar language.” *Id.* Some courts, however, have applied the objective standard even without any reasonably foreseeable language in the insurance policy. *Id.* (citing *International Ins. Co. v. Peabody Intern. Corp.*, 747 F.Supp. 477, 482 (N.D.Ill.1990) (question on insurance application asking whether insured was “‘aware of any circumstances, occurrence or condition ... which may result in the ... assertion of a claim’” was deemed to be objective, not subjective); *Ratcliffe v. Int'l Surplus Lines Ins. Co.*, 194 Ill.App.3d 18, 550 N.E.2d 1052 (1990) (prior knowledge clause providing for disclosure of “any circumstances which might give rise to a claim being made ...” held to require “disclosure of any facts which, objectively considered, might have given rise to a claim, regardless of the applicant's subjective belief”)).

“Despite the widespread use of the objective standard, more recently some courts have chosen to apply exclusionary provisions according to an ‘intermediate’ standard utilizing a two-prong, subjective-objective test.” *Id.* Under this inquiry, courts first ask the subjective question of whether the insured knew of certain facts and then ask the objective question of whether such facts could reasonably have been expected to give rise to a claim. *Id.* Cf. *Westport Ins. Corp. v. Lilley*, 292 F.Supp.2d 165, 171 (D.Me. 2003) (whether defendants could have reasonably foreseen malpractice claim is an objective test that can be determined as a matter of law, but it must be determined based only on those facts and circumstances that the defendants were subjectively aware of).

Here, Baptist Health’s knowledge of the facts pertinent to this action is essentially undisputed. Accordingly, the Court need not consider application of the intermediate, subjective-objective test, but need only determine whether the prior knowledge questions should be judged under a subjective or objective standard.

Baptist Health argues that Question 6 on the Darwin Application asks subjectively whether “anyone for whom insurance is intended ha[d] any knowledge or information of any act, error, omission, fact or circumstance which may give rise to a Claim....” Baptist Health argues that no language in this prior knowledge question raises the specter of an objective, reasonable person, and that the Court therefore should apply a subjective standard to the question.

It is true that some courts have held that language similar to that of Question 6 on the Darwin Application is judged under a subjective standard. *See, e.g., Chicago Ins. Co. v. Lappin*, 1998 WL 1181164 (Mass.Super. 1998) (application question asking “[H]ave any new claims or circumstances which may result in a claim arisen in the past policy period?” cannot be construed as calling for more than an opinion, or a statement to the best of the applicant’s knowledge and belief); *First American Title Ins. Co. v. Lawson*, 177 N.J. 125, 827 A.2d 230 (2003) (question asking whether an applicant “is aware of any circumstances which may result in a claim being made against the firm” called for subjective information). As previously noted, however, other courts have held that such language is judged under an objective standard. *International Ins. Co.*, 747 F.Supp. 477; *Ratcliffe*, 550 N.E.2d 1052. Having considered the matter, the Court will in these circumstances follow the majority position and apply the objective approach.

Baptist Health does not dispute that Question 22 on the ERII Application contains objective “knew or should reasonably have known may result in a claim” language and Question 6 on the Darwin Application asks for the same information – that which “may give rise to a claim” – and should be judged under an objective standard as well. Question 6 calls for “any” knowledge or information of “any” act, error, omission, fact or circumstance which “may give rise to a claim,” following which it is provided that if such knowledge or information exists,

“any” claim arising therefrom is excluded from the proposed insurance. The plain language of the application, then, excludes coverage for *any* claim, regardless of merit, that an applicant could have reasonably foreseen at the time the policy issued and the policy language thus invokes an objective standard of foreseeability. *Cf. Culver v. Continental Ins. Co.*, 11 Fed.Appx. 42 (4<sup>th</sup> Cir. 1999) (question for malpractice coverage asking “Does any attorney for whom coverage is sought know of any circumstance, act, error or omission that could result in a claim or suit against the applicant or any predecessor or any of the former or current members of the applicant?” excluded coverage for *any* claim, meritorious or otherwise, that an applicant could have reasonably foreseen at the time the policy issued, thereby invoking an objective standard of foreseeability).<sup>20</sup> Accordingly, even were the Court to consider the language in Question 6 on the Darwin Application without reference to the objective language in Question 22 on the ERII Application, and it will not, *see Nash*, 98 Ark.App. 258, 254 S.W.3d at 760 (courts must consider the instrument in its entirety, not merely disjointed or particular parts of it); *Stratford*, 105 F.3d at 47 (“it makes business sense here to construe the exclusion clause together with the application questionnaire”), the Court would apply an objective standard to Question 6. *Cf. Home Indem. Co. Manchester, New Hampshire v. Toombs*, 910 F.Supp. 1569 (N.D.Ga. 1995) (answer to question asking “Does any lawyer ... know of any circumstances, acts, errors or omissions that could result in a professional liability claim against any attorney of the firm, the firm or its predecessors?” judged under objective standard); *Mt. Airy Ins. Co. v. Thomas E. Angst & Assoc., P.C.*, 954 F.Supp. 1040 (E.D.Pa. 1997) (same).

The Eighth Circuit’s decision in *Citizens Bank of Jonesboro, Arkansas v. Western*

---

<sup>20</sup> The term “could,” like “may,” is “used to express possibility.” Webster’s Unabridged Dictionary (2<sup>nd</sup> ed.) at 460.

*Employers Ins. Co.*, 865 F.2d 964 (8<sup>th</sup> Cir. 1989), does not dictate a contrary result. In *Citizens Bank*, the applicant had responded “No” to a question on the policy application asking if he was “aware of any fact, circumstance or situation which he has reason to believe might result in any future claim which would fall within the scope of the proposed insurance[.]” 865 F.2d at 965. The Eighth Circuit noted that in calling for the applicant’s “belief” about whether any known fact or circumstance might give rise to a future claim, the question contained “a judgmental component and implicitly acknowledge[d] the lack of absolute certainty in the answer.” *Id.* at 966. The Eighth Circuit focused on the fact that the question required a statement of personal belief, a statement which would be inherently subjective, and determined that “when a question calls for an answer based on an interpretation of known facts and circumstances, as distinguished from a simple disclosure of historical facts, the response is measured under Arkansas law by whether the individual answering the question was justified in the belief expressed.” *Id.*

In *Citizen’s Bank*, there was no language raising the specter of an objective, reasonable person, *i.e.* the classic objective standard, *see American Special Risk*, 286 Kan. 1159, 192 P.3d at 624, whereas in this action, Question 22 on the ERII Application contains such objective language. Although Question 6 on the Darwin Application does not explicitly contain “reasonable person” language, it nevertheless does not call for a statement of personal belief or an “interpretation” of known facts as did the question at issue in *Citizens Bank*. Rather, Question 6, as previously noted, simply calls for disclosure of “any” knowledge or information of “any” act, error, omission, fact or circumstance which “may give rise to a claim,” thus invoking an

objective standard of foreseeability. *Culver*, 11 Fed.Appx. at 45-46.<sup>21</sup> Accordingly, the Court finds *Citizen's Bank* to be distinguishable in these circumstances and it is an objective standard that will be applied to the prior knowledge questions.

3.

Having resolved the question of ambiguity, the Court now turns to Platte River's claim that coverage for the Underling Actions is barred based on misrepresentations in Baptist Health's Application materials, specifically Baptist Health's answer "None" to Question 22 on the ERII Application and "No" to Question 6 on the Darwin Application. To prevail on its claim that Baptist Health's answers were misrepresentations, Platte River has the burden of proving that Baptist Health made misrepresentations of material facts, the knowledge of which would have caused Platte River to decline to issue the Policy. *Ferrell v. Columbia Mut. Cas. Ins. Co.*, 306 Ark. 533, 816 S.W.2d 593, 597 (1991); *Brooks v. Town & Country Mut. Ins. Co.*, 294 Ark. 173, 741 S.W.2d 264, 265 (1987). Under Arkansas law, material misrepresentations made in an application for an insurance policy and relied upon by the insurance company will void the policy. *Countryside Cas. Co. v. Orr*, 523 F.2d 870, 872 (8<sup>th</sup> Cir. 1975). *See also Neill v. Nationwide Mut. Fire Ins. Co.*, 355 Ark. 474, 139 S.W.3d 484, 487 (2003) (an insurance

---

<sup>21</sup> *Cf. International Surplus Lines Ins. Co. v. Wyoming Coal Refining Systems, Inc.*, 52 F.3d 901 (10<sup>th</sup> Cir. 1995) (clause providing that "No person proposed for insurance is cognizant of any fact, circumstance or situation which said person has reason to suppose might afford valid grounds for any future claim against said person and/or the Organization" is unambiguous and calls for a simple disclosure of facts indicating the probability of a covered claim; it calls for an objective assessment regardless of the subjective belief of the insured) (citing *Evanston Ins. Co. v. Security Assurance Co.*, 715 F.Supp. 1405, 1414 (N.D.Ill.1989)). *But cf. James River Ins. Co. v. Hebert Schenk, P.C.*, 523 F.3d 915 (9<sup>th</sup> Cir. 2008) (question calling for circumstances of which lawyers were aware "may result" in a malpractice action fairly viewed as a matter of opinion) (citing *Citizen's Bank* as addressing "similar" language); *Shaheen, Cappiello, Stein & Gordon, P.A. v. Home Insurance Company*, 143 N.H. 35, 719 A.2d 562 (1998) (provision in lawyer's professional liability policy requiring disclosure of any incident, act or omission which "might reasonably be expected to be the basis" of a claim or suit ambiguous in that it does not indicate whether notice to the insurer is required when all elements of a malpractice claim are present, or when, based on the parties and the circumstances, a malpractice claim on the merits is likely).

company may retroactively rescind a policy because of fraud or misrepresentation of the insured). “A misrepresentation is a statement of fact that is untrue or a failure to disclose a fact in response to a specific question.” *Shiple v. Arkansas Blue Cross and Blue Shield*, 333 F.3d 898, 904 (8<sup>th</sup> Cir. 2003). The insurance company has no duty to investigate the accuracy of the facts set forth in the application and the good faith or lack of knowledge by the insured of the misrepresentations is irrelevant. *Twin City Bank v. Verex Assur. Inc.*, 733 F.Supp. 67, 71 (E.D.Ark. 1990). See also *Countryside*, 523 F.2d at 873.

Baptist Health was specifically aware of the following facts and circumstances when it answered “None” to Question 22 on the ERII Application and “No” to Question 6 on the Darwin Application:

- Baptist Health knew of legal challenges to at least four hospitals’ economic credentialing policies and had investigated other hospitals’ experiences with economic credentialing policies.
- Baptist Health was aware of OIG’s solicitation of public comments on economic credentialing policies, which specifically sought comments regarding the legality of such policies under federal anti-kickback statutes – one of the grounds upon which the physicians eventually challenged Baptist Health’s ECOI Policy.
- Baptist Health retained outside counsel to conduct a “legal review” of economic credentialing policies, which included research regarding the legalities of such a policy under federal and state law, including anti-kickback and antitrust laws, and courts upholding of other hospitals’ policies.
- Baptist Health knew that Dr. Kane of LRCC and AHH expressed concerns about economic credentialing and the threat posed to LRCC by the ECOI Policy and the monopoly on the market he perceived to exist as the result of an allegiance between Blue Cross and Baptist Health.<sup>22</sup>

---

<sup>22</sup> Baptist Health states that nothing Dr. Kane said at the FTC hearing threatened litigation or raised concerns in Harrington’s mind regarding the ECOI Policy. Dr. Kane did, however, clearly express concern about economic credentialing and Baptist Health’s Board of Trustees voting to dec credential certain surgeons if they opened a specialty hospital. Dr. Kane’s

- Baptist Health considered the ECOI Policy to be a “major” and “significant” policy such that it was appropriate to send it to the entire Baptist Health Board of Trustees for a vote rather than the Executive Committee.
- Concern was expressed to the Baptist Health Board of Trustees by Dr. Smith that the ECOI policy would create a negative relationship between members of the professional staff and the Board. Harrington viewed this concern as an objection to the Policy.
- Baptist Health had received complaints from certain doctors who had concerns about the ECOI Policy and Baptist Health had identified the doctors, including the *Murphy* plaintiffs, who would be affected by the ECOI Policy. Several of those same doctors blacked out any agreement or acknowledgment of the ECOI Policy’s attempt to abrogate their review and hearing rights regarding credentialing decisions.

Given these facts and circumstances known to Baptist Health, the conclusion that Baptist Health’s answers to Question 22 on the ERII Application and Question 6 on the Darwin Application were misrepresentations seems inescapable. Baptist Health adopted the ECOI Policy knowing that similar policies adopted by other hospitals had led to litigation. A reasonable person would foresee that adoption of Baptist Health’s ECOI Policy in these circumstances may or might result in or give rise to a claim. Claims were indeed filed and Harrington acknowledged that the ECOI Policy was adopted knowing that a claim could result. Baptist Health was not required to predict the precise nature of any such claim or specifically by whom the claim would be brought but it was required to notify Platte River that a claim may result in or arise out of its adoption of the ECOI Policy. *Tewell, Thorpe & Findlay, Inc. v. Continental Cas. Co.*, 64 Wash.App. 571, 825 P.2d 724, 728 (1992). This, Baptist Health failed

---

expression of concern certainly does not appear to have been idle thought given the involvement of AHH and LRCC in the *Murphy* and *LRCC* actions, and Harrington later testified in the *Murphy* action that Baptist Health adopted the ECOI Policy knowing it “could” result in that lawsuit, even if he stated in his affidavit that at no time prior to that lawsuit did he believe it was “likely” that the ECOI Policy would result in any lawsuit. In any case, the standard here is not what Harrington subjectively believed, but whether a reasonable person would foresee that adoption of the ECOI Policy “may” result in or give rise to a claim.

to do. As the particulars and statements contained in the applications were by the terms of the Policy “material to the acceptance of the risk assumed by the Insurer” and acknowledged as such by Baptist Health’s Senior Vice President (at least in terms of the Darwin Application, Smith stating he understood that Darwin would rely on the statements therein and materials submitted to or obtained by Darwin), Baptist Health’s misrepresentations in Question 22 on the ERII Application and Question 6 on the Darwin Application were material to the acceptance of the risk and to the hazard assumed by Platte River. *Multi-Craft Contractors, Inc. v. Perico, Ltd.*, 96 Ark.App. 133, 239 S.W.3d 33, 42 (2006). *See also* Ark. Code Ann. § 23-79-107(a) (“[m]isrepresentations, omissions, concealment of facts, and incorrect statements shall not prevent a recovery under [a] policy or contract unless either: (1) Fraudulent; (2) Material either to the acceptance of the risk or to the hazard assumed by the insurer; or (3) The insurer in good faith would not have issued the policy or contract or would not have issued a policy or contract in as large an amount or at the same premium or rate or would not have provided coverage with respect to the hazard resulting in the loss if the facts had been made known to the insurer as required by the application for the policy or contract or otherwise”).<sup>23</sup>

Platte River also argues Baptist Health falsely answered “No” to Question 11 on the ERII Application that asked, “Within the last year, has the **Applicant** closed or restricted staff admissions to any patient service department for reasons other than professional competence?”

---

<sup>23</sup> Baptist Health argues that if it had subjectively believed that a claim would “likely” result from the ECOI Policy, reason dictates it would have reported that claim to Executive Risk under the following provision: “If during the Policy Period an insured first becomes aware of any circumstances which may subsequently give rise to a Claim against any Insured and, as soon as practicable thereafter but before the expiration or cancellation of the Policy, gives the Underwriter written notice by certified mail of such circumstances with full particulars of the specific Wrongful Act involved, then any Claim subsequently made against an Insured arising out of such Wrongful Act shall be deemed made during the Policy Period.” Again, however, the standard here is not what Baptist Health subjectively believed, but whether a reasonable person would foresee that adoption of the ECOI Policy “may” result in or give rise to a claim. Baptist Health certainly was aware of such circumstances, regardless of whether Baptist Health thought any such claim would fail.

and falsely answered “No” to Question 16 on the ERII Application asking, “Has any **Entity** proposed for insurance retained outside counsel to provide an opinion as to whether or not a certain course of conduct would be in violation of ... the [Physician Ownership and Referral Law \(Stark Self-Referral Law\)](#) (42 U.S.C. § 1395 nn); the Medicaid/Medicare Civil Money Penalties (including false claims and kickbacks) (42 U.S.C. § 1320a-7a))....” Although Questions 11 and 16 on the ERII Application are not a central focus of the parties’ motions for summary judgment, Baptist Health’s answers to these questions are reflective of an apparent tendency on the part of Baptist Health to contort language to its own purposes.

Concerning Question 11, Baptist Health argues that it was justified in answering “No” to this question because *inter alia* Baptist Health did not deny any application for privileges under the ECOI Policy until February 2, 2004, after the question had been answered. But when Question 11 was answered, Baptist Health had already adopted the ECOI Policy and had identified those doctors that would be affected by it. Baptist Health’s explanation of its answer to Question 11 on this point is disingenuous.

Concerning Question 16, Baptist Health argues it was justified in answering “No” to this question because it referenced specific statutes, not generalized concepts like “anti-referral laws” and “anti-kickback statutes.” But Weeks testified that Baptist Health retained outside counsel because one of its concerns was to ensure that any economic credentialing policy it adopted did not violate anti-kickback laws or antitrust laws, and Harrington likewise understood that outside counsel was retained *inter alia* to undertake a legal review of an economic credentialing policy in the context of the anti-kickback laws. Certainly, the statutes referenced in Question 16 would fall within the rubric of the matters for which outside counsel was retained to review, and Baptist

Health's defense of its answer to Question 16 reflects a parsing of language that might properly be characterized as a misrepresentation.

Baptist Health, however, argues that any alleged misrepresentation was not material to the acceptance of risk. Noting that it provided the ECOI Policy to Platte River when it answered "yes" to a question asking "Has there been any change in the Applicant's peer review and credentialing process within the last year?," Baptist Health points out that Lloyd cannot recall whether she reviewed the ECOI Policy and stated that the first time she heard about economic credentialing was in this case. Baptist Health argues the ECOI Policy did not even register to Lloyd as an issue in her underwriting process and that Platte River was more interested in making sure it gained Baptist Health's business than in assessing the risk of insuring Baptist Health.

Regardless of Lloyd's alleged lack of underwriting experience or that Darwin was a "start-up" company when she went to work there, the fact remains that Baptist Health selected Platte River for coverage, which in turn issued insurance to Baptist Health based on inaccurate and false information provided by Baptist Health.<sup>24</sup> Baptist Health states that nothing prevented Platte River from researching economic credentialing policies or inquiring about Baptist Health's ECOI Policy which it disclosed to Platte River, but there is no affirmative duty in Arkansas upon an insurance carrier to make an independent investigation to ascertain the truthfulness of the facts as set forth in an insured's application, *Countryside*, 523 F.2d at 873; *Twin City Bank*, 733 F.Supp. at 71, and Lloyd had not heard of such policies until this litigation. It was Baptist Health's responsibility, as set forth in the prior knowledge questions, to alert Platte

---

<sup>24</sup> Of course, Lloyd's underwriting judgment cannot be considered without reference to the information which Baptist Health denied her.

River to the fact that such a policy may result in or give rise to a claim based on the circumstances surrounding the adoption of the ECOI Policy. Instead, Baptist Health denied having any knowledge or information of circumstances that may result in or give rise to a claim and its answers to Question 22 on the ERII Application and Question 6 on the Darwin Application (and, likely, its answer to Question 16 on the ERII Application) thus were misrepresentations and material to the acceptance of risk.<sup>25</sup> Accordingly, the Policy is void *ab initio* and rescinded as if it were never in effect. *Ferrell*, 306 Ark. 533, 816 S.W.2d at 597; *Douglas v. Nationwide Mut. Ins. Co.*, 323 Ark. 105, 913 S.W.2d 277, 279 (1996).<sup>26</sup>

4.

Even if the Court determined that Baptist Health's answers to Question 22 on the ERII Application and Question 6 on the Darwin Application were not misrepresentations, the Court would determine that the prior knowledge exclusion incorporated into the Policy operates to bar coverage for the Underlying Actions. Specifically, because Baptist Health had knowledge of facts and circumstances that a reasonable person would foresee may give rise to or result in a claim – regardless of Baptist Health's belief, unfounded as it turns out, that no claim would be filed or, if one were, that it would fail –, the failure to disclose those facts and circumstances

---

<sup>25</sup> “Applications and information obtained from potential insureds may, out of practicality, be limited in scope,” and “[u]nderwriters may strike a balance between gathering endless volumes of detailed information, on the one hand, and limiting initial information requests so as to be accessible and easy to work with, on the other. *Cedar Hill Hardware and Construction Supply, Inc. v. Insurance Corporation of Hannover*, No. 07-1026, slip. op. at 30-31 (8<sup>th</sup> Cir. Apr. 17, 2009). “As such, insurers and underwriters are entitled to rely upon the responses and information provided by potential insureds and to presume the insured has provided responses that are true and complete.” *Id.* at 31 (decision under Missouri law).

<sup>26</sup> Were the Court to conclude that the prior knowledge questions asked whether Baptist Health knew of circumstances that “likely” or “probably” would result in a claim, and were the Court to apply a subjective standard to those questions, the Court, based on the same facts and circumstances set forth above, would determine that Baptist Health did in fact know of facts and circumstances that likely or probably would result in a claim and that Baptist Health was not justified in the belief expressed to the contrary.

triggered the prior knowledge exclusion providing that any claim resulting from Baptist Health's knowledge of facts or circumstances required to be disclosed is excluded from coverage.

*American Special Risk*, 286 Kan. 1159, 192 P.3d at 630. See also *Professional Managers, Inc. v. Fawer, Brian, Hardy & Zatzkis*, 799 F.2d 218 (5<sup>th</sup> Cir. 1986) (finding policy language providing that "no insured had knowledge of any circumstance which might result in a claim" at the effective date of the policy to be unambiguous and pointing out that "some information may be so clearly sufficient to instill knowledge to a party that a verdict to the contrary cannot stand").<sup>27</sup>

5.

The Court now turns to Platte River's claim that Baptist Health's retention of defense expenses previously advanced by Platte River in connection with the Underlying Actions constitutes unjust enrichment. Unjust enrichment is an equitable doctrine that allows a party to recover benefits conferred on another. *Ashley County, Ark. v. Pfizer, Inc.*, 552 F.3d 659, 665 (8<sup>th</sup> Cir. 2009). To find unjust enrichment, a party must have received something of value, to which he was not entitled and which he must restore. *Guaranty Nat. Ins. Co. v. Denver Roller, Inc.*, 313 Ark. 128, 854 S.W.2d 312, 317 (1993). There must also be some operative act, intent or

---

<sup>27</sup> Baptist Health argues that most rational persons would not pursue costly litigation to mount a challenge that would probably fail and, given that courts uniformly had upheld economic conflict of interest policies in other states, Baptist Health reasonably did not anticipate any legal challenge here. But each action depends on facts and legal theories unique to it and the Court cannot say that the Underlying Actions were irrational simply because courts in other states have upheld economic conflict of interest policies. Certainly, the *Murphy* action cannot be said to have been pursued irrationally given the success achieved by the plaintiffs in that action. Moreover, actions that could be characterized as irrational or frivolous are routinely filed in courts and the prior knowledge questions at issue here ask for "any" knowledge or information which "may" result in or give rise to a claim, not just those claims that Baptist Health believes to have merit. In any case, the good faith or lack of knowledge by the insured of the misrepresentations is irrelevant, see *Twin City Bank*, 773 F.Supp. at 71, and Baptist Health's claim that it did not reasonably anticipate any legal challenge here is of no consequence. See *American Special Risk*, 286 Kan. 1159, 192 P.3d at 630 ("it is not necessary that the Bank have actually formed an expectation that a claim would be filed"); *Mimm. Lawyers Mut. Ins. Co. v. Hahn*, 355 F.Supp.2d 104 (D.D.C. 2004) (failure to give insurer notice of a letter identifying potential claim "cannot be excused by a well-founded belief in non-liability").

situation to make the enrichment unjust. *Id.* Unjust enrichment is restitutionary in nature and focuses on the benefit received. *Pfizer*, 552 F.3d at 665.

Although it is rudimentary that one who is free from fault cannot be held to be unjustly enriched merely because one has chosen to exercise a legal or contractual right, *Denver Roller*, 313 Ark. 128, 854 S.W.2d at 317 (internal quotation marks and citation omitted), the advancement of defense expenses to Baptist Health was pursuant to a contract that was based on misrepresentations. As such, the Policy is void *ab initio*; Platte River had no duty to Baptist Health under the Policy, including the advancement of defense expenses, and Baptist Health's retention of those defense expenses would be unjust. Accordingly, Platte River is entitled to recover the amount of defense expenses advanced to Baptist Health under the Policy for the Underlying Actions.<sup>28</sup>

In addition, although the parties do not address the issue, the Court determines in these circumstances that because the Policy is void *ab initio* and rescinded as if it were never in effect, Baptist Health is entitled to a refund of the premiums tendered to and received by Platte River. *Cf. Monarch Life Ins. Co. v. Donahue*, 708 F.Supp. 674 (E.D.Pa. 1989) (where insurance policy was voided for misrepresentations in application, insurer was obliged to refund premium and interest earned on the premium); *Douglass v. Nationwide Mutual Ins. Co.*, 323 Ark. 105, 913 S.W.2d 277, 282 (1996) (rescission of a contract at law occasioned by fraud may be

---

<sup>28</sup> Baptist Health cites *Medical Liability Mut. Ins. Co. v. Alan Curtis Enterprises, Inc.*, 373 Ark. 525, — S.W.3d —, 2008 WL 2205868 (2008), as barring Platte River from recouping defense expenses already reimbursed to Baptist Health. In *Medical Liability*, the Arkansas Supreme Court held that an insurer who obtained a declaratory judgment that it owed the insured no duty to defend or pay any judgment could not rely on its unilateral reservation of rights letter to the insured to recoup attorney fees and costs that it expended in defense of suit against the insured absent statutory rule or authority allowing an insurer to recoup attorney fees under a unilateral reservation of rights, of which there was none. The Arkansas Supreme Court in *Medical Liability* was not addressing an insurance contract that was void *ab initio* as a result of misrepresentations in procuring the policy. *Medical Liability* thus has no application to this case.

accomplished without court action by prompt restoration of benefits to the contracting party and by a clear statement that rescission is intended).

6.

Finally, the Court denies Baptist Health's motion for summary judgment on its counterclaim seeking a declaration that the Policy is valid and enforceable, that it provides coverage for the Underlying Actions, and that Platte River breached the contract in connection with defense expenses incurred in the Underlying Actions. For the reasons stated previously, the Court determines that the Policy is void *ab initio* thus precluding Baptist Health's counterclaim; the Policy is rescinded as if it were never in effect. *Ferrell*, 306 Ark. 533, 816 S.W.2d at 597; *Douglas*, 323 Ark. 105, 913 S.W.2d at 279.

### III.

For the foregoing reasons, the Court grants Platte River's motion for summary judgment [doc.#33] and denies Baptist Health's motion for summary judgment [doc.#36]. Platte River is entitled to recover the amount of defense expenses advanced to Baptist Health under the Policy for the Underlying Actions and Baptist Health is entitled to a refund of the premiums tendered to and received by Platte River. Judgment will be entered accordingly.<sup>29</sup>

IT IS SO ORDERED this 17<sup>th</sup> day of April 2009.

---

<sup>29</sup> Although Platte River does not specifically move for summary judgment on Baptist Health's counterclaim, today's decision necessarily renders the counterclaim as without merit. Accordingly, the Court *sua sponte* dismisses Baptist Health's counterclaim for the above reasons.

/s/Susan Webber Wright  
UNITED STATES DISTRICT JUDGE