COMMONWEALTH OF KENTUCKY
COUNTY OF FRANKLIN CIRCUIT COURT
CASE NO. 17-CI-1348
DIVISION ONE

JEFFREY C. MAYBERRY, *et al.* PLAINTIFFS

v.

MEMORANDUM IN SUPPORT OF THE TIER 3 PLAINTIFFS' MOTION FOR LEAVE TO FILE A THIRD AMENDED COMPLAINT

KKR & CO., L.P., *et al.* DEFENDANTS

ELECTRONICALLY FILED

* * * * * * * *

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Pursuant to Rule 15.01 of the Kentucky Rules of Civil Procedure, and in conformity with the decretal language contained in this Court's Order of December 28, 2020,[1] Ashley Hall-Nagy, Tia Taylor and Bobby Estes (the "Tier 3 Plaintiffs")[2] respectfully move for leave to file a third amended verified complaint (the "TAC"), attached to the notice of motion, to allege their standing and claims.[3]

I. INTRODUCTION AND OVERVIEW

This action was initially filed in December 2017. A few weeks later, in January 2018, the Original Plaintiffs[4] filed a first amended complaint ("FAC") making a few technical changes. The Original Plaintiffs never amended the FAC.

While the case was on appeal, the Mayberry Plaintiffs moved for leave to file a second amended complaint. Due to the pendency of the appellate proceedings, that motion was never ruled upon. After the Supreme Court issued its ruling, the Mayberry Plaintiffs, joined by the Tier 3 Plaintiffs, again moved for leave to file a second amended complaint. In its December 28, 2020 Order, this Court dismissed the "claims of the Original Plaintiffs … for lack of standing," and denied the "Motion of the Original Plaintiffs to file a Second Amended Complaint." Dec. 28, 2020 Order at 18, ¶ 3. In that

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[1] *Mayberry v. KKR & Co., L.P.*, No. 17-CI-1348, slip op. (Ky. Cir. Ct. Franklin Cnty. Dec. 28, 2020) (Shepherd, J.).

[2] The Tier 3 Plaintiffs are members of Kentucky Retirement Systems ("KRS"), who joined the prior motion for leave to amend the complaint and are referred to on page 18 of the Court's December 28, 2020 Order.

[3] The "Mayberry Plaintiffs" — Jeffrey C. Mayberry, Hon. Brandy O. Brown, Martha M. Miller, Steve Roberts and Teresa M. Stewart — are not named as parties in the proposed TAC.

[4] The term "Original Plaintiffs" is used herein in the same fashion as in the December 28, 2020 Order. It means and includes not only the Mayberry Plaintiffs, but also Ben Wyman, Jason Lainhart and Don Coomer.

same Order, the Court denied "***without prejudice***" the "Motion for Leave to File a Second Amended Complaint, to the extent it seeks to add new claims of the Tier 3 movants (Ashley Hall-Na[gy], Tia Taylor and Bobby Estes), who seek to join in the claims of the original Plaintiffs and assert related claims." *Id*. at 18, ¶ 3 (emphases added).[5]

This Court had issued an Opinion & Order on November 30, 2018, sustaining the pleading sufficiency of the FAC for all but one defendant (*see* Nov. 30, 2018 Opinion & Order at 33),[6] and rejecting all of defendants' legal arguments, including that Plaintiffs lacked standing.

The Supreme Court's opinion recognized that the FAC pleaded "***significant misconduct***," but reversed on the limited (and non-substantive) ground that the Original Plaintiffs had not pleaded facts sufficient to demonstrate "constitutional standing." *See Overstreet v. Mayberry*, 603 S.W.3d 244, 266 (Ky. 2020). All other aspects of this Court's November 30, 2018 Opinion & Order remain undisturbed.

This Court's December 28, 2020 Order likewise recognizes that the FAC alleged "***serious wrong***[***s***]," and "***severe misconduct and breaches of fiduciary duty***" that, if proven at trial, ***demand accountability***. Dec. 28, 2020 Order at 16–17.[7]

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[5] While neither of the second amended complaints previously proposed was ultimately approved or filed, we have styled the attached proposed pleading as a third amended complaint to avoid confusion.

[6] *Mayberry v. KKR & Co., L.P.*, No. 17-CI-1348, slip op. (Ky. Cir. Ct. Franklin Cnty. Nov. 30, 2018) (Shepherd, J.).

[7] The December 28, 2020 Order further stated:

> The intervening Complaint tendered by the Attorney General mirrors the original claims of the Plaintiffs that allege extremely serious violation of fiduciary and other common law duties on the part of certain KRS Board members and advisors and the defendant hedge fund managers engaged by the Board to manage these retirement investments. If those allegations are true, thousands of public employees have had their retirement savings depleted by investments that included self-dealing,

By this motion, the Tier 3 Plaintiffs — who clearly ***do*** meet the constitutional standing test as articulated by the Supreme Court — seek to litigate claims set forth in the TAC for "damages suffered by the Kentucky Retirement Systems." *See*, *e.g.*, KRS § 61.645(15)(f).[8] The Tier 3 Plaintiffs have prayed for and will further seek through this Court's equitable powers to have an appropriate portion of any such KRS recovery allocated (indirectly, through KRS) to the "Accumulated Account Balances" of Tier 3 Members to replace the amount of "upside sharing interest" that would have been credited to such accounts but for the wrongdoing alleged in the TAC. The loss of such "upside sharing interest" amounts has resulted and will continue to result in actual injury to Tier 3 KRS members, as it has depressed and will depress further the amount of pension benefits received by Tier 3 members. For a number of reasons involving, among other things, tax and pension law issues, this kind of recovery must go through the KRS trust funds, not directly to Tier 3 members, and thus the Tier 3 Plaintiffs seek to continue the prosecution of the derivative case on behalf of KRS for all the damages it has suffered from the defendants' misconduct — as prayed for in the TAC.

> exorbitant fees, conflicts of interest, and risky non-prudent investment strategies. Moreover, if the claims can be proven, then the state itself is now on the hook for replenishing the staggering losses of public funds that resulted from those alleged breaches of duties.
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> * * *
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> … Under the law, the hedge fund managers and officers, directors and advisors to the Kentucky Retirement Systems, who allegedly breached their fiduciary duties to the public, must be held accountable. Any party that breached its fiduciary duties and engaged in reckless conduct, conflicts of interest or self-dealing should be held accountable under the law[.]

Dec. 28, 2020 Order at 15–16.

[8] The TAC does not contain taxpayer claims seeking recovery on behalf of the "public as a whole," as the Attorney General will now pursue such relief for the Commonwealth.

It is reasonable and necessary — and consistent with Kentucky law — to permit the Tier 3 Plaintiffs to participate in this case in this fashion. Their claims, though founded largely on the same nucleus of facts, are different and distinct from — and in certain regards conflict with — the claims brought and recoveries sought by the Attorney General. The reasons include the following:

- The Attorney General has appeared in this matter on behalf of the "Commonwealth of Kentucky, as the Intervening Plaintiff." *See* Commonwealth of Kentucky's Intervening Complaint ¶ 1.[9] Where the Attorney General appears on behalf of the Commonwealth, any funds recovered by judgment or settlement must, after reimbursement of the Attorney General's litigation expenses, be "deposited in the general fund surplus account" of the State Treasury. KRS § 48.005. This provision would seem to preclude, or at a minimum raise a serious question about, deposit of funds recovered herein through judgment or settlement into the separate trust fund established under KRS § 61.515, which requires that all KRS funds and assets "be deemed trust funds to be held and applied solely as provided in KRS 61.510 to 61.705."

- The Tier 3 Plaintiffs have an interest in ensuring that some or all of any recovery is allocated to KRS, and that some of that allocation be credited to the Tier 3 accounts to make up for lost "upside sharing interest" amounts over several years (plus earnings thereon). It is hard to see how the Attorney General would or could represent this separate interest as he pursues the broader public interest.

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[9] One of the few changes the Attorney General made when copying and adopting the FAC was to drop any reference to "damages for the losses incurred by KRS" that was in the first paragraph of the FAC. Similarly, the Attorney General took out language contained in the FAC prayer for relief seeking damages for KRS. These changes were deliberate and consequential. The Attorney General has not appeared, or asked to appear, as counsel of record for KRS, which is distinct from the Commonwealth. *See*, *e.g.*, *Commonwealth v. KRS*, 396 S.W.3d 833, 840 (Ky. 2013). ("[T]he Commonwealth may have interests in this litigation that are broader than the administration of state pensions."). Moreover, any recovery by the Attorney General must be deposited in the state's general fund, not the segregated KRS trust funds. The respective interests of the Commonwealth and of KRS (including its Tier 3 members) are thus different and distinct (in some particulars in conflict), and KRS's interests must be represented herein. The Original Plaintiffs, though not constrained by a statutory requirement to deposit all funds in the state's general fund, recognized this potential conflict, and sought this Court's oversight of the distribution of funds received consistent with its equitable powers.

- The Attorney General's Intervening Complaint does not contain the allegations concerning the 2015–16 self-dealing misconduct of Prisma, KKR and others, including the current KRS Executive Director, as alleged in paragraphs 285 through 313 of the TAC.

- The Attorney General is subject to actual and/or apparent conflicts of interest, which would likely be exacerbated if his office attempted to appear for KRS.

II. ARGUMENT

A. The Tier 3 Plaintiffs Have Constitutional Standing

The Supreme Court held that the Original Plaintiffs — all Tier 1 or 2 KRS members or retirees — lacked "constitutional standing" because of their failure to plead that they had "personally … suffered some actual or threatened injury." *Overstreet*, 603 S.W.3d at 252. The Court did not otherwise disturb the conclusions contained in this Court's November 30, 2018 Opinion & Order denying most of defendants' motions to dismiss.

Because none of the Original Plaintiffs was a Tier 3 member, the Supreme Court did not address or decide the constitutional standing of Tier 3 members. But Tier 3 members clearly meet the standards identified by the Court: "(1) injury, (2) causation, and (3) redressability." *Id.* As explained in the proposed TAC, Tier 3 members participate in a "Cash Balance Plan" which is a "hybrid plan" because it has characteristics of both a defined benefit and defined contribution plan.[10] A Tier 3 member's ultimate monthly pension benefit is determined by the balance credited to that member's "Accumulated Account Balance" at retirement. A member's Accumulated Account Balance is determined, in part, by the amount of "Upside Sharing Interest" (if any) received each

[10] "A Cash Balance Plan resembles a defined contribution plan because it determines the value of benefits for each participant based on individual accounts. However, ***the assets of the plan remain in a single investment pool like a traditional defined benefit plan***." *See* https://kyret.ky.gov/Members/Tier-3/Pages/Benefit-Calculation.aspx (emphases added).

year of employment. And the annual Upside Sharing Interest calculation is determined based upon the annual performance of KRS's investment portfolio.[11] So (above a modest baseline) Tier 3 members (including the Tier 3 Plaintiffs) receive larger credits to their individual account balances when portfolio returns are good, and less when they aren't. And in subsequent years Tier 3 members are entitled, at a minimum, to 4% annual earnings on their prior balance amounts, so there is a compounding factor that is lost when poor returns result in lower upside sharing amounts. The TAC alleges that portfolio returns were meaningfully — indeed massively — depressed over several years by the defendants' misconduct, and that the Tier 3 members personally suffered (and, with the five-year look-back period built into the formula, *continue* to suffer) actual injury in the form of diminished pension benefits as a result. And even these diminished pension benefits will be imperiled if KRS becomes insolvent, as the Tier 3 members are not protected by a legislative promise of "inviolable" contract. The Tier 3 Plaintiffs have constitutional standing.

As this Court ruled in its November 30, 2018 Opinion & Order, KRS members have standing under KRS § 61.645(15)(e) and (f) to bring claims for damages suffered by KRS. Nov. 30, 2018 Opinion & Order at 8. That ruling still stands. And, as explained by the bi-partisan leadership of the Kentucky Senate and House in the *amicus* brief they filed in the Supreme Court, this standing also extends beyond claims against the Trustees, to claims against other KRS fiduciaries or aiders/abettors. *See* Exs. A–B.[12]

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[11] More specifically, the Upside Sharing Interest — similar to a profit-sharing interest — is determined through a formula that takes into account the "Geometric Average Net Investment Return" of the portfolio over the prior five years.

[12] A true and correct copy of the Kentucky Legislature's *Amicus Curiae* Brief, filed in the Supreme Court on June 12, 2019 in *Overstreet*, is attached as Exhibit A. A true and

Moreover, the reasoning underlying the Supreme Court's rejection of trust law standing for the Original Plaintiffs does not apply to the Tier 3 Plaintiffs. The Supreme Court held that the Original Plaintiffs' "benefits in this case are fixed and will not fluctuate based on the value of the KRS assets," and that "beneficiaries of a defined-benefit pension plan, unlike beneficiaries of a private trust, possess no equitable interest in the plan assets, as the value of those assets has no impact on their right to be paid benefits." *Overstreet*, 603 S.W.3d 244 at 262. But the opposite holds true for the Tier 3 Plaintiffs; their benefits ***do*** fluctuate with and ***will*** be impacted by asset value and portfolio performance — and in particular, as alleged in the TAC, their ultimate pension benefits (like those of other Tier 3 members) have been reduced as a direct and proximate result of the wrongful conduct alleged. Thus, standing based on traditional notions of trust law is available for these plaintiffs.

In sum, the Tier 3 Plaintiffs have standing.

B. The TAC States Claims for Relief and Is Not Futile

The facts alleged and claims stated in the TAC, with some modifications principally (but not only) concerning the identity of the named derivative plaintiffs, the nature of a KRS Tier 3 member's interests, and personal harm, track the allegations and claims contained in the FAC, which were previously reviewed and approved by this Court in its November 30, 2018 Opinion & Order. While defendants might be entitled to challenge the new aspects of the TAC, they should not be permitted to ignore or challenge the rulings the Court has previously made, and they cannot credibly claim at this point that the proposed amendment is futile.

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correct copy of the Law Professors' *Amicus Curiae* Brief, filed in the Supreme Court on June 12, 2019 in *Overstreet*, is attached as Exhibit B.

C. Leave to Amend Should Be Freely Granted to the Tier 3 Plaintiffs

Kentucky's standard for leave to amend is liberal and favors granting leave: "***leave shall be freely given as justice so requires***." KY. R. CIV. P. 15.01 (emphases added). The court "has liberal discretion to allow amendments to pleadings." *Caldwell v. Bethlehem Mines Corp.*, 455 S.W.2d 67, 68 (Ky. 1970). In exercising this discretion, the court "may consider such factors as the failure to cure deficiencies by amendment or the futility of the amendment itself." *First Nat'l Bank of Cincinnati v. Hartman*, 747 S.W.2d 614, 616 (Ky. Ct. App. 1988). Other factors include whether amendment would prejudice the opposing party or would work an injustice. *See Shah v. Am. Synthetic Rubber Corp.*, 655 S.W.2d 489, 493 (Ky. 1983); *see also Ashland Oil & Refining Co. v. Phillips*, 404 S.W.2d 449, 451 (Ky. Ct. App. 1961) (ordering leave to amend on remand based on lack of prejudice).

While this Court decided on a discretionary basis to disallow amendment that would have permitted the Original Plaintiffs to remain in the case, the reasons for that ruling in no way preclude amendment by the Tier 3 Plaintiffs. Indeed, this Court denied their motion to amend *without prejudice*. *See* Dec. 28, 2020 Order at 18, ¶ 3.

As the Court observed in its December 28, 2020 Order, "while this matter proceeded through Kentucky's appellate courts, ***the doctrine of standing was being modified and restricted***" in ways that ultimately resulted in dismissal of the Original Plaintiffs.[13] *Id.* at 4. Under Kentucky standing doctrine as previously understood, the

[13] When this case was originally filed, *Commonwealth Cabinet for Health & Family Services v. Sexton*, 566 S.W.3d 185 (Ky. 2018), had not been decided and thus Kentucky had not yet adopted the *Lujan*-style "constitutional standing" doctrine on which the *Overstreet* opinion turned. The Original Plaintiffs had standing under pre-*Sexton* standing rules.

rights and interests of Tier 3 members were represented and protected by the claims as advanced by the Original Plaintiffs. But that has now changed, and the Tier 3 Plaintiffs should be allowed to step in, as they clearly have standing even in view of the modifications of and restrictions to Kentucky's standing doctrine.[14] Defendants will no doubt assert that Kentucky law embodies in effect a "Catch-22" rule, but they will be utterly unable to articulate how they would be prejudiced by the granting of this motion to amend (especially now that the Attorney General has been permitted to appear herein) or how denial of the Tier 3 Plaintiffs' request to step into the litigation could possibly be fair and equitable.

The federal cases previously cited by defendants for the proposition that dismissal of a derivative case for lack of standing by the original derivative plaintiff necessarily precludes amendment or intervention are neither binding nor persuasive. The First Circuit very recently referred to this line of cases as "formalistic [in] approach" and observed that the "better reasoned authority" permits amendment in these circumstances.[15] *Yan v. ReWalk Robotics Ltd.*, 973 F.3d 22, 36 (1st Cir. 2020). The First Circuit went on to observe that:

> "[w]e … see no reason why this permissiveness does not extend to motions seeking to add a named party asserting the exact same claim that is already

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[14] *See, e.g.*, *In re Extreme Networks S'holder Derivative Litig.*, 573 F. Supp. 2d 1228, 1237 (N.D. Cal. 2008) (holding that after original derivative plaintiff lost standing "***another qualified shareholder can intervene*** on the grounds that their rights are no longer represented") (emphases added); *Malcolm v. Cities Servs. Co.*, 2 F.R.D. 405, 407 (D. Del. 1942) (holding that after original derivative plaintiff lost standing, "[a]ny ***member of the class***, otherwise qualified, ***may intervene*** in this suit on the ground that their rights are no longer adequately protected or even represented") (emphases added).

[15] *Yan* specifically notes disagreement with the "formalistic approach" taken by the Fifth Circuit in *Summit Office Park, Inc. v. U.S. Steel Corp.*, 639 F.2d 1278, 1282 (5th Cir. 1981), which has been relied upon by defendants in this case.

> pleaded in the complaint. *See Allied Int'l, Inc. v. Int'l Longshoremen's Ass'n*, 814 F.2d 32, 34–36 (1st Cir. 1987) (citing the advisory committee's note to the 1966 amendment to Federal Rule of Civil Procedure 15, which states that 'the attitude taken in revised Rule 15(c) toward change of defendants extends by analogy to amendments changing plaintiffs,' and allowing an amendment to substitute the assignee where the original plaintiff had assigned its claims in their entirety, which otherwise would have precluded any recovery)."

Id. at 37.

Derivative cases in particular should not be subjected to the harsh rule defendants advocate, requiring dismissal without opportunity to cure when the original plaintiff loses standing, as the rights to be vindicated in such a case are those of the company or trust, not the individual plaintiffs (even where, as here, the Tier 3 Plaintiffs have been individually harmed by the complained-of conduct). A rule to the contrary would encourage multiple duplicative actions, as shareholders (or other potential derivative plaintiffs) would conclude that they could not safely rely upon a named derivative plaintiff who might later be held to have lost standing. And that is not the rule.

In *Mannato v. Wells*, the derivative plaintiff died and his estate sold his shares in the company for whose benefit the case had been filed, thus depriving the case of a derivative plaintiff with standing. *See* No. 11-cv-4402-WSD, 2013 U.S. Dist. LEXIS 193251, at **4–5 (N.D. Ga. May 6, 2013). Counsel for the deceased derivative plaintiff thereafter sought to publish notice to permit another shareholder to step into the case. *Id*. The court held that such notice should be given because the case otherwise would be dismissed on a non-merits-based technicality that could prejudice the interests of other shareholders who theretofore had been able to rely upon the derivative plaintiff to vindicate the claims of the corporation:

> "[C]ourts have held the notice requirement applies to more than voluntary dismissals under Rule 41(a)(1) and have required notice to

> nonparty shareholders when a corporate claim has not been adjudicated on the merits and dismissal could preclude a nonparty shareholder from reasserting the claim on behalf of the corporation. … The cases discussing the requirement of notice to nonparty shareholders, however, teach that a decision, or the circumstances, of a named shareholder class plaintiff that could result in the dismissal of derivative claims requires that notice be given to other shareholders to afford one or more of them to weigh in before dismissal and, in appropriate cases, to allow a substitute plaintiff to prosecute the claims asserted. Notice is especially important where dismissal may result in a later action being barred because the statute of limitations has run."

Id. at **9–10; *see also Beaver Assocs. v. Cannon*, 59 F.R.D. 508, 511–12 (S.D.N.Y. 1973).

Leave to amend is appropriate here, and it should be granted.[16]

D. The Claims Asserted and Remedies Sought by the Tier 3 Plaintiffs Derivatively on Behalf of KRS Are Distinct from the Claims Asserted and Remedies Sought by the Attorney General on Behalf of the Commonwealth

As this Court observed in its December 28, 2020 Order, "Kentucky law has long recognized that there is no wrong without a remedy." Dec. 28, 2020 Order at 16. The intervention of the Attorney General, while certainly appropriate, is no substitute for continued derivative litigation on behalf of KRS, as ***the Attorney General is not in a position to make the Tier 3 members whole*** — to provide through his intervention a remedy for that wrong. The respective interests of the Commonwealth and KRS

[16] If, in the alternative, the Court were to conclude that intervention is the more appropriate procedural device, the Tier 3 Plaintiffs submit that they have presented a sufficient basis for intervention under Rule 24.01(1)(b) or Rule 24.01(2). Intervention of the Tier 3 Plaintiffs would not "unduly delay or prejudice the adjudication of the rights of the original parties." The contents of this motion, and the proposed TAC, substantially fulfill the requirements of Rule 24.01(3).

In addition, The Tier 3 Plaintiffs are also filing a new, separate action — essentially a duplicate of the TAC — as a backstop, belt-and-suspenders step, much as the Attorney General has done.

(especially as regards to Tier 3) are not entirely aligned and in some regards are clearly in conflict.[17]

The Attorney General seeks a recovery for the Commonwealth, not for KRS. Compare paragraph 1 of the Intervening Complaint and paragraph 1 of the FAC, and the prayers for relief in those two pleadings, wherein the Attorney General deliberately cut out the language about damages incurred by KRS.

It is difficult — if not impossible — to imagine how any part of a recovery made by the Attorney General could effect retroactive increases to Tier 3 members' accounts (and subsequent compounded earnings thereon), or protect lost Tier 3 benefits in the event of a KRS insolvency, even if the Attorney General sought to amend the Complaint in Intervention to add KRS claims back in (and even if, in that event, the Attorney General could overcome the other conflicts that move would implicate).[18] Section 48.005 of the Kentucky Revised Statutes requires that whenever the Attorney General "has entered his appearance in a legal action on behalf of the Commonwealth of Kentucky … and a disposition of that action has resulted in the recovery of funds or assets … by judgment or

[17] There are also real and potential conflicts between the Attorney General and the Governor that may well engulf them (and the Court) in contentious litigation that could adversely impact the prosecution of the KRS derivative claims. The Tier 3 Plaintiffs do not want such events to impair the prosecution of the separate derivative claims going forward. When there was a Republican Governor and a Democratic Attorney General, they fought over KRS tooth and nail. Now shoes are on other feet. But it is the same conflict. Whether Beshear *versus* Bevin or Cameron *versus* Beshear, the KRS funds end up in the middle while political spitballs are thrown. Chris Williams, *Just Like Matt Bevin, as Governor, Andy Beshear Is Aggravated with a Capital 'AG,'* WHAS-TV, July 10, 2020. Other disputes between the Attorney General and the Governor have already gone to the Supreme Court of Kentucky. *See* Deborah Yetter, *Kentucky Supreme Court to Hear Dispute Next Month on Beshear's COVID-19 Executive Order*, COURIER JOURNAL, Aug. 7, 2020. There must be independent, separate representatives of KRS's interests.

[18] This problem may become more immediate for certain Tier 3 members after the retirement systems heretofore encompassed by KRS are split up.

settlement, … ***those funds shall be deposited in the State Treasury and the funds or assets administered and disbursed by the Office of the Controller***." KRS § 48.005(3); *see also* KRS § 15.020. Not only that, the monies have to go into the "general fund surplus account" (KRS § 48.005(4)) – and thus become available to pay general obligations of the Commonwealth – a far cry from treatment as the protected and segregated trust funds they would be if recovered on behalf of KRS. A net recovery on the derivative damage claims asserted on behalf of KRS seeking to recover billions of dollars in cash will be an ***asset of KRS*** — "trust funds to be held and applied solely" for the benefit of KRS and its members. *See* TAC ¶¶ 222–223; KRS § 61.515. Those litigating the derivative claims – derivative plaintiffs and their lawyers – have fiduciary duties to KRS to maximize the value, *i.e.*, recovery ***for the KRS funds and its beneficiaries, not the*** "***surplus account***" ***of the Commonwealth***. Moreover, because KRS assets are held in a "single investment pool," not segregated accounts, ***as a practical matter the Tier 3 Plaintiffs can only be made whole through*** (***1***) ***a recovery for KRS as a whole, with*** (***2***) ***retroactive credits to their individual accounts based on such recovery, as approved by the Court***.

The Office of the Attorney General is in a conflict. It is required to take whatever recovery it can garner for the claims it asserts and ***turn the money over to the general fund where politicians can spend it as they please*** (or, in this COVID-infected fiscal climate, where it can pay for general state obligations already incurred). In contrast, the KRS statute mandates its assets — and a lawsuit's net recovery of damages is an asset (albeit a contingent one) — ***be held in trust by its trustees and used solely to benefit KRS***, and not for expenditures favored by politicians.

The Attorney General can do as he sees fit with his taxpayers' claim. But he must not pollute or damage KRS's claims with politics, or arrogate these claims for the State Treasury for politicians to feast on, or even simply use a recovery to fund Kentucky's exploding fiscal deficit. ***KRS's claims are trust assets that belong solely — exclusively — to KRS. They do not belong to the Commonwealth's taxpayers.***

The Attorney General may assume that, because KRS is a state agency, he automatically has the exclusive power to represent it. That assumption is incorrect. He has no such exclusive power. KRS is a separate legal entity, which is distinct from the Commonwealth. *See*, *e.g.*, *Commonwealth*, 396 S.W.3d at 840; KRS § 61.515(1). KRS's board is "granted the powers and privileges of a corporation," including the power "[t]o conduct the business and promote the purposes for which it was formed." KRS § 61.645(2). ***Derivative suits exist to protect the assets of corporate entities like KRS from loss or damage due to failures of their fiduciaries or those who assist or conspire with them to damage the corporate entity***. *See* Ex. B at 4–7. And the Legislature made sure that such remedy would exist to protect KRS by expressly authorizing members of KRS to sue to recover damages on behalf of KRS. *See* KRS § 61.645(15)(e)–(f). Both Houses of the Kentucky Legislature unequivocally endorsed the merits and importance of the prosecution of the derivative claims, and how private enforcement of those claims under KRS § 61.645(15) was consistent with the Legislature's intent and the public interest. *See* Ex. A at 1–2, 11–12.

Nowhere is the Attorney General expressly given the power to represent KRS in litigation — certainly not to the preclusion of other authorized causes of action. KRS § 61.645(11) provides in part that "[t]he Attorney General ***may*** act as … attorney for the

board, and the board may contract for legal services, notwithstanding the limitations of KRS Chapter 12 or 13B."

There is no indication that the KRS Board has asked the Attorney General to represent it in this matter, and in any event as noted above, the Attorney General would face a difficult if not insoluble conflict of interest in that regard.

The Tier 3 Plaintiffs do not dispute the right of the Attorney General's office to intervene. They would, however, object to any (as yet unarticulated) attempt by the Attorney General's office to take over the prosecution of the derivative claims. KRS's assets — including its legal claims for damages — are separate from the Commonwealth and belong to KRS, not the taxpayers. They are trust funds to be used exclusively for KRS trust purposes. KRS and the Commonwealth have a common interest in creating as big a pot as possible but a conflicting interest as to how to divide that pot. And they have many other potential conflicts as well.[19]

[19] The chart below outlines some of these different, conflicting interests.

Commonwealth	**KRS**
Primary interests are future funding and protection of the Commonwealth in connection with potential payments under the inviolable contract protections.	Primary interests are recovering damages including losses in and for past years.
Recovery goes to the State Treasury, specifically, the "general fund surplus account," under KRS § 48.005 (4).	Recovery goes to (and should be appropriately split among) the KRS trust accounts, including the insurance trust(s). *See* KRS §§ 61.515, 61.570, 61.701. This result flows from the "use or be sued" language in KRS § 61.645(2)(a). (Commonwealth's interests — because of the inviolable contract issues — would be in all recoveries going toward pension trust funding, directly or indirectly, not to

There is one more point to be made, and it is a sensitive one. This case is high-profile, with many eyes on it. The process and result must be respected as honest and above-board. The appearance of impropriety must be guarded against. Some of the wealthy defendants are among the largest donors to Republican causes and candidates in the country. Defendant Stephen A. Schwarzman in particular has donated tens of millions of dollars during the 2019–20 cycle, including at least $35 million to the McConnell-related Senate Leadership Fund, and very possibly to "dark money" groups. The *Lexington Herald-Leader* reported on May 6, 2019:

> An independent "dark money" group from Washington reports spending $350,000 to influence the May 21 Republican primary in

	insurance trusts — and not to past year accounts to benefit the Tier 3 members.)
Commonwealth's interests are different than both Tier 3 members, and of Tier 1 and 2 members.	Tier 3 members have an interest in adding to past years' excess pension fund returns, to increase their sharing interests, and to insurance trust. Tier 1 and 2 interests do not conflict with these interests, but Commonwealth's interests do.
Attorney General is not the attorney for KRS unless the KRS Board requests that the Attorney General represent KRS. KRS § 61.645 (11).	Attorney General may act as attorney for the board, but the board can also contract for outside legal services (so the Attorney General is not the exclusive attorney for KRS). KRS § 61.645 (11).
Intervening Complaint ¶ 1: "damages for losses incurred ***by the Commonwealth*** …."	*Mayberry* FAC ¶ 1: "damages for the losses incurred ***by KRS*** …."
Intervening Complaint, Prayer ¶ 2: "Determining and awarding the ***Commonwealth of Kentucky*** the compensatory damages sustained as a result of the violations set forth above …."	*Mayberry* FAC, Prayer ¶ 4: "Determining and awarding to ***KRS and its Pension Funds and the Commonwealth of Kentucky*** the damages sustained by them as a result of the violations set forth above …."

> Kentucky's attorney general race — more money than either candidate has in his own campaign.
>
> The Judicial Crisis Network is promoting Daniel Cameron, former legal counsel to U.S. Senate Republican Leader Mitch McConnell of Kentucky, in his contest against state Sen. Wil Schroder of Wilder.

John Cheves, *'Dark Money' Group Spending Big for McConnell Protégé in KY Attorney General Primary*, LEXINGTON HERALD-LEADER, May 6, 2019.

We do not at this point know whether Mr. Schwarzman or any of the other defendants were involved, and we make no such accusation other than to note the possibility of a conflict, or the appearance of a conflict, of a political nature in the event of settlement or dismissal of claims by the Attorney General — a problem that would be ameliorated, if not entirely avoided, through the co-prosecution of these claims, as we have previously suggested.

III. CONCLUSION

For the reasons set forth above, in the proposed TAC and in Exhibits A and B, the Tier 3 Plaintiffs respectfully urge the Court to grant their motion for leave to amend, to order the TAC filed, and for such other or further relief as may be appropriate.

Dated: December 31, 2020

Respectfully submitted,

s/ Michelle Ciccarelli Lerach
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EXHIBIT A

EXHIBIT A

COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NO. 2019-SC-232

JEFFERY C. MAYBERRY, ET AL.		APPELLANTS
v.	On Appeal from the Kentucky Court of Appeals Case Nos. 2019-CA-000043-OA and 2019-CA-000079-OA (consolidated)	
HON. PHILLIP J. SHEPHERD, JUDGE, FRANKLIN CIRCUIT COURT		APPELLEE
and		
PRISMA CAPITAL PARTNERS, ET AL.		APPELLEES/ REAL PARTIES IN INTEREST

BRIEF ON BEHALF OF *AMICUS CURIAE* OF KENTUCKY SENATE PRESIDENT ROBERT STIVERS, KENTUCKY SENATE MINORITY LEADER MORGAN MCGARVEY, KENTUCKY HOUSE SPEAKER DAVID OSBORNE, AND KENTUCKY HOUSE MINORITY LEADER ROCKY ADKINS FOR APPELLANTS

CERTIFICATE OF SERVICE

My signature below certifies that a true copy of this AMICUS CURIAE BRIEF was served on this 12th day of June, 2019: BY REGULAR U.S. MAIL, postage prepaid, to Clerk of the Franklin Circuit Court, 214 St. Clair Street, P. O. Box 378, Frankfort, Kentucky 40601; Clerk of the Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; and Hon. Phillip J. Shepherd, Franklin Circuit Judge, 48th Judicial Circuit, 214 St. Clair Street, P. O. Box 378, Frankfort, Kentucky 40601; and BY ELECTRONIC SERVICE as specified pursuant to CR 5.02 to the persons further listed below:

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STATEMENT OF POINTS AND AUTHORITIES

STATEMENT OF INTEREST OF *AMICI*

The *amici* are elected leaders of Kentucky's legislative branch of government: Senate President Robert Stivers and Senate Minority Leader Morgan McGarvey; House Speaker David Osborne and House Minority Leader Rocky Adkins. The Commonwealth has a vital interest in ensuring the financial health and viability of its public pension plans; more broadly, the Commonwealth has a vital interest in ensuring that means exist to challenge fiduciary misconduct (and related wrongdoing) involving Kentucky's public pension plans, consistent with the statutory structure that the executive and legislative branches have built. When, as here, the Kentucky Retirement System (KRS) — the Commonwealth's statutorily-designated entity — is unable or unwilling to challenge fiduciary misconduct, KRS's members and beneficiaries must be able to do so on KRS's behalf, consistent with longstanding derivative litigation principles. The Court of Appeals' opinion wrongly thwarts those vital interests, misapplies derivative standing principles, and effectively forecloses challenges to fiduciary misconduct involving KRS. We therefore submit this amicus brief in support of Appellants. We have no individual interest, financial or otherwise, in this litigation.

SUMMARY OF ARGUMENT

It is for the executive and legislative branches to define the scope of any public employee pension plan. Public policy likewise is a legislative judgment. As relevant here, it is for the legislature to allow KRS's members and beneficiaries to challenge fiduciary breaches through derivative lawsuits *on KRS's behalf* when KRS cannot do so itself. The legislature has expressly allowed derivative suits challenging trustees' fiduciary breaches. And it has implicitly allowed derivative suits with respect to others' fiduciary breaches by (1) imposing strict fiduciary standards on officers, employees and others, and (2) passing and repeatedly amending legislation

creating statutes many decades after (and with presumed knowledge that) courts allowed derivative lawsuits as an equitable vehicle to prevent wrongdoing — all without seeking to rein in or alter those common law rules.

This Court — like courts around the nation — has long allowed derivative litigation on behalf of an entity when that entity cannot, or will not, challenge wrongdoing on its own. For purposes of standing, the derivative plaintiff must show injury to the entity — the "true plaintiff," — not individual injury. That is the lesson of *Commonwealth, Cabinet for Health & Family Services v. Sexton*, 566 S.W.3d 185 (Ky. 2018).

The court of appeals misapplied *Sexton*, requiring the Appellants here to show individual injury in order to have standing. Derivative plaintiffs almost never suffer individual injury, nor need they show that injury, because the very nature of derivative litigation is to remedy injury to the entity they represent. Moreover, the appeals court's decision ignores and contradicts the legislative judgments contained in the statutes creating and regulating KRS, ignores KRS's statement in the record that it cannot pursue the litigation that Appellants have undertaken on its behalf, and threatens to create mischief for all future corporate and derivative litigation.

ARGUMENT

I. THE EXECUTIVE AND LEGISLATIVE BRANCHES ENVISIONED ALLOWING KRS'S MEMBERS AND BENEFICIARIES TO CHALLENGE FIDUCIARY BREACHES.

It is for the executive and legislative branches of government — the legislature (by enacting laws) and the executive (by signing and enforcing laws) — to decide whether and how to provide a public pension plan for state and local workers. Section 27 of the Constitution of Kentucky creates three distinct branches of government, and Section 28 precludes one branch from exercising any power belonging to the other branches. Under that constitutional separation

of powers, this Court has "recognize[d] that the legislature makes the laws." *Jones v. Commonwealth*, 319 S.W.3d 295, 299 (Ky. 2010) (brackets added). Public policy likewise is a legislative judgment to be gleaned from the legislature's actions. *See Nelson Steel Corp. v. McDaniel*, 898 S.W.2d 66, 68 (Ky. 1995) ("The public policy must be evidenced by a constitutional or statutory provision.") (quoting *Brockmeyer v. Dun & Bradstreet*, 335 N.W.2d 834, 840 (Wisc. 1983)); *Pyles v. Russell*, 36 S.W.3d 365, 368 (Ky. 2000) ("The enunciation of public policy is the domain of the General Assembly."); *Schork v. Huber*, 648 S.W.2d 861, 863 (Ky. 1983) (same); *Fann v. McGuffey*, 534 S.W.2d 770, 779 (1975) ("the legislative branch of government has the prerogative of declaring public policy").

A. The Statutory Scheme Expressly Permits Beneficiaries to Challenge Fiduciary Breaches in a Derivative Action.

KRS 61.645(15)(e)-(f) expressly allows people to sue to recover "damages suffered by [KRS]" if they can prove by clear and convincing evidence that trustees breached their duties of office by reckless or willful misconduct.

Kentucky's legislature requires KRS's trustees to perform their duties "[i]n good faith, KRS 61.645(15)(a)(1), "[o]n an informed basis," KRS 61.645(15)(a)(2), and "in a manner [that they] honestly believe[e] to be in the best interest of" KRS. KRS 61.645(15)(a)(3) (all brackets added).

The statutory scheme — consistent with longstanding equitable principles, *see* § I.B — then recognizes (and partially alters) derivative claims against trustees for breaches of that duty. KRS 61.645(15)(e) specifically provides when those claims against trustees will fail:

> (e) Any action taken as a trustee, or any failure to take any action as a trustee, shall not be the basis for monetary damages or injunctive relief unless:
>
> 1. The trustee has breached or failed to perform the duties of the trustee's office in compliance with this section; and

> 2. In the case of an action for monetary damages, the breach or failure to perform constitutes willful misconduct or wanton or reckless disregard for human rights, safety, or property.

In other words — converting the textual negative to a positive, — a trustee's actions or inactions *may* warrant relief if the trustee breached or failed to perform statutory duties, and *may* warrant monetary damages if the trustee's breach constituted willful misconduct, or wanton or reckless disregard.

Having thus described trustees' duties, and the standard for imposing liability for their breach, the legislature provided for derivative actions as follows:

> A person[1] bringing an action for monetary damages under this section shall have the burden of proving by clear and convincing evidence the provisions of paragraph (e)1. and 2. of this subsection, and the burden of proving that the breach or failure to perform was the legal cause of damages suffered *by the Kentucky Retirement Systems.*

KRS 61.645(15)(f) (emphasis added). That statutory section clearly creates a right of action, otherwise the provisions governing "an action ... under this section" would be meaningless. *See Brooks v. Meyers,* 279 S.W.2d 764, 766-67 (Ky. 1955) ("a [s]tatute should be construed, if possible," to give effect and meaning to each part of it); *see also Hardin County Fiscal Court v. Hardin County Board of Health,* 899 S.W.2d 859, 861-62 (Ky. App. 1995) (same).

Nor can there be any question that this statutory section provides for derivative litigation: the recovery is for "damages *suffered by the Kentucky Retirement Systems.*" *See* KRS 61.645(15)(f) (emphasis added). This then is a recovery *for* KRS brought by someone *other than those in control,* which is the very definition of a derivative action. *See Ross v. Bernhard,* 396 U.S. 531, 534 (1970) ("The remedy made available in equity was the derivative suit, viewed in

[1] For purposes of KRS 61.150-61.705, the term "person" is defined as "a natural person." KRS 61.510(30). KRS thus is not a "person" for purposes of KRS 61.645(15)(f), meaning that only individuals ("natural persons") may bring an action for monetary damages "suffered by [KRS]" under that section.

this country as a suit to enforce a *corporate* cause of action against officers, directors, and third parties.") (emphasis in original); *see also* Thomas E. Rutledge, *Who Will Watch the Watchers?: Derivative Actions in Nonprofit Corporations* [*Watch the Watchers*], 103 KY. L. J. ONLINE 31 (2014–15).

While KRS 61.645 *provides* for derivative actions, it does not *create* them, as detailed in § I.B. *See also Watch the Watchers*, 103 KY. L. J. ONLINE at 31 n.5 ("The first Kentucky statute recognizing the right to bring some form of derivative action was not adopted until 1946, significantly subsequent to the first appearance of the 'derivative action' in Kentucky law."). Rather, Kentucky statutes providing explicitly for derivative actions either codify or supplement the common law, as described in § I.B. That common law has long allowed derivative actions alleging breach of fiduciary duties.[2] Consistent with that common law, KRS 61.650(1)(c) imposes strict fiduciary duties on any KRS "trustee, officer, employee, or other fiduciary." KRS 61.645(15)(e) and (f) then modify the standards for obtaining monetary damages from trustees, while leaving intact common law derivative action standards and remedies against all others.[3] *See Watch the Watchers*, 103 KY. L. J. ONLINE at 32 ("equity will provide the rules applicable when the organizational statute does not specify the rules governing derivative actions").

B. Legislation Enacted in the Face of Longstanding Legal Principles Allowing for Representative Lawsuits Implicitly Codifies Those Principles.

As the Appellants have argued [App. Br. at 25-29], Kentucky's courts have long recognized representative or derivative standing. Over a century ago, this Court described the

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[2] The Appellants' First Amended Complaint fully alleged how each defendant had fiduciary duties to KRS and its members, and the trial court properly — for CR 12.02(b) purposes — deemed those allegations true.

[3] While the statute is silent about why it modifies derivate action standards for trustees, but not for other fiduciaries, it might simply recognize the need to induce people to serve as unpaid volunteers. Those volunteering to serve as trustees are assured that they bear no personal financial risk from fiduciary breaches absent "willful misconduct or wanton or reckless disregard ..." KRS 61.545(15)(e)(2).

doctrine's provenance: "exceptions to the general rule that the acts of the directors are the acts of the corporation, and cannot be interfered with by the courts at the complaint of stockholders" are "as well established perhaps as the rule itself." *Pittsburg, C., C. & St. L. Ry. Co. v. Dodd*, 72 S.W. 822, 827 (1903). Equity allows courts to permit minority shareholders' suits seeking to hold corporate directors accountable for wrongdoing. *Id.* Were it not for derivative litigation, stakeholders would have no means to prevent directors and majority stakeholders from committing wrongs. *See id.* at 828 (rejecting alternatives that would effectively "turn over to a possible wrongdoer the adjudication of his own case").[4] And, as one commentator has noted, Kentucky's courts have recognized the doctrine (even if not by name) for nearly 150 years. *See Watch the Watchers*, 103 KY. L. J. ONLINE at 35-37 (citing *Jones v. Johnson*, 73 Ky. (10 Bush) 649, 660 (Ky. 1874), *Collier v. Deering Camp Ground Ass'n,* 66 S.W. 183, 183 (Ky. 1902), *Dodd*, 72 S.W. 822, and *Reinecke v. Bailey*, 112 S.W. 569, 570 (Ky. 1908)).

The derivative action — initially a court-created equitable action — thus affords standing to an entity's members who have not been individually injured, even though the entity as a whole has been. *See, generally, Watch the Watchers*, 103 KY. L. J. ONLINE 31. The entity's members may sue on the entity's behalf, thereby holding those in charge accountable for breaches of their fiduciary duties. *See Barrett v. S. Conn. Gas Co.*, 374 A.2d 1051, 1055 (Conn. 1977) ("If the duties of care and loyalty which directors owe to their corporations could be enforced only in suits by the corporation, many wrongs done by directors would never be remedied."); *Ross v. Bernhard*, 396 U.S. 531, 534 (1970) ("The remedy made available in equity was the derivative

[4] Nor must a derivative plaintiff bring individual claims along with the derivative claim (although Dodd did). *See Sahni v. Hock*, 369 S.W.3d 39, 47 (Ky. Ct. App. 2010), *abrogated on other grounds*, 436 S.W.3d 189 (Ky. 2013) (dismissing individual claims because alleged injury was mere diminution in stock value (which is an injury derivative of the corporation's injury), but allowing derivative claims on the corporation's behalf). Simply put, individual injury is not required for, nor an element of, a derivative claim. Derivative actions exist because — regardless of individual injury — the individual has a real stake in protecting the interest of the business entity. *Watch the Watchers*, 103 KY. L. J. ONLINE at 38-39.

suit, viewed in this country as a suit to enforce a *corporate* cause of action against officers, directors, and third parties.") (emphasis in original).

As discussed above, Kentucky's courts had allowed derivative lawsuits for more than fifty years before KRS's creation, and more than one hundred years since the latest statutory amendments. *See Pittsburg, C., C. & St. L. Ry. Co. v. Dodd*, 72 S.W. 822, 827 (1903). Had the legislature intended to bar KRS members and beneficiaries from filing derivative lawsuits alleging wrongdoing by those in charge of KRS, it presumably "would have so specified in language explicitly ..." *McDaniel*, 898 S.W.2d at 69. It did no such thing. On the contrary, it explicitly provided *for* derivative lawsuits against trustees. *See* § I.A (citing KRS 61.645(15)(e) and (f)). And it imposed strict fiduciary duties upon any KRS "trustee, officer, employee, or other fiduciary," knowing that the common law allowed derivative actions for breach of those fiduciary duties. KRS 61.650(1)(c).

A legislature is presumed to act with knowledge of existing judicial decisions, and the laws it passes are presumed to be in harmony with those decisions unless the legislature provides to the contrary. The legislature created KRS more than sixty years ago, *see* 1956 Ky. Acts, ch. 110, sec. 28, and has amended the governing statute dozens of times.[5] At no time has it sought

[5] *See* 2017 Ky. Acts ch. 12, sec. 3, effective March 10, 2017; 2013 Ky. Acts ch. 120, sec. 65, effective July 1, 2013; 2012 Ky. Acts ch. 75, sec. 8, effective April 11, 2012; 2010 Ky. Acts ch. 127, sec. 1, effective July 15, 2010; 2009 Ky. Acts ch. 77, sec. 19, effective June 25, 2009; 2008 (1st Extra. Sess.) Ky. Acts ch. 1, sec. 21, effective June 27, 2008; 2004 Ky. Acts ch. 36, sec. 23, effective July 13, 2004; 2003 Ky. Acts ch. 169, sec. 10, effective March 31, 2003; 2002 Ky. Acts ch. 52, sec. 11, effective July 15, 2002; 2000 Ky. Acts ch. 385, sec. 23, effective July 14, 2000; 1998 Ky. Acts ch. 105, sec. 15, effective July 15, 1998; ch. 154, sec. 59, effective July 15, 1998; and ch. 246, sec. 2, effective July 15, 1998; 1996 Ky. Acts ch. 167, sec. 17, effective July 15, 1996; and ch. 318, sec. 29, effective July 15, 1996; 1994 Ky. Acts ch. 406, sec. 3, effective July 15, 1994; and ch. 485, sec. 21, effective July 15, 1994; 1992 Ky. Acts ch. 240, sec. 40, effective July 14, 1992; and ch. 437, sec. 1, effective July 14, 1992; 1990 Ky. Acts ch. 299, sec. 1, effective July 13, 1990; ch. 489, sec. 6, effective July 13, 1990; and ch. 496,sec. 39, effective July 13, 1990; 1988 Ky. Acts ch. 349, sec. 24, effective July 15, 1988; and ch. 351, sec. 3, effective July 15, 1988; 1986 Ky. Acts ch. 90, sec. 20, effective July 15, 1986; 1984 Ky. Acts ch. 232, sec. 2, effective July 13, 1984; 1982 Ky. Acts ch. 448, sec. 65, effective July 15, 1982; 1980 Ky. Acts ch. 186, sec. 13, effective July 15, 1980; and ch. 246, sec. 8, effective July 15, 1980; 1978 Ky. Acts ch. 110, sec. 100, effective January 1, 1979; 1976 Ky. Acts ch. 321, secs. 29 and 40; 1974 Ky. Acts ch. 128, sec. 26; 1972 Ky. Acts ch. 116, sec. 48; 1962 Ky. Acts ch. 58, sec. 19; 1960 Ky. Acts ch. 165, Part II, sec. 14; 1956 (1st Extra. Sess.) Ky. Acts ch. 7, Art. XV, sec. 1.

to constrain or limit derivative or representative claims by KRS members or beneficiaries, except as provided in KRS 61.645(15)(e) and (f) (which, as detailed in § I.A, expressly authorizes derivative actions against trustees without supplanting derivative claims against any others).

McDaniel, 898 S.W.2d 866, provides the guiding principle and applies fully here. *McDaniel* was the fourth in a series of cases developing this Court's "wrongful discharge" jurisprudence. The first three had established a cause of action for wrongful discharge when an employee "was fired for filing or pursuing a worker's compensation claim," but not for fraternizing with a fellow-employee, in purported violation of the right to "freedom of association." *McDaniel*, 898 S.W.2d at 868-69 (characterizing *Pari-Mutual Clerks' Union v. Ky. Jockey Club*, 551 S.W.2d 801 (Ky. 1977), *Firestone Textile Co. Div. v. Meadows*, 666 S.W.2d 730 (Ky. 1983), and *Grzyb v. Evans*, 700 S.W.2d 399 (Ky. 1985)).

McDaniel followed those three cases. There, the employee sought an expansion of *Firestone*, arguing that statutory changes reflected additional "public policy" limits on the at-will employment doctrine. *McDaniel*, 898 S.W.2d at 68-70. This Court disagreed. It found centrally important that the statutory amendments came *after* the *Firestone* decision:

> If the legislative purpose was to expand upon the cause of action as stated in the text of the *Firestone* opinion, we assume the General Assembly would have so specified in language explicitly stating the broader coverage it intended to provide. Presumably the General Assembly was aware of the *Firestone* case and enacted the statute in language intended to codify the decision, not to expand it.

McDaniel, 898 S.W.2d at 69. *See also Tenney v. Brandhove*, 341 U.S. 367, 376 (1951) (holding that federal civil rights statutes did not silently abrogate common law immunities existing at the time of enactment); *Imbler v. Pachtman*, 424 U.S. 409, 418 (1976) ("immunities 'well -grounded in history and reason' had not been abrogated 'by covert inclusion in the general language' of" the applicable statute) (characterizing *Tenney*). Thus, the legislature must be presumed to act

with knowledge of common law derivative actions when it crafted KRS's fiduciary duty statutes.

Analogous principles govern representative lawsuits by a trust's beneficiaries on the trust's behalf.[6] While Kentucky's courts have not reached the issue, the Sixth Circuit, applying Kentucky law in *Osborn v. Griffin*, 865 F.3d 417 (6th Cir. 2017), predicted that this Court would adopt the "correct rule set out in the Restatement of Trusts," permitting a trust beneficiary to bring claims on behalf of the trust when the trustee refuses or neglects to act. *Id.* at 447. *Osborn* is consistent with Kentucky's long history involving derivative actions, consistent with the Restatement of Torts, and consistent with law throughout the nation. *See Tzolis v. Wolff*, 10 N.Y.3d 100 (2008) (noting that derivative lawsuits date back to at least 1832). Courts, using their equitable powers, allow a trust's beneficiary to sue a third party when "the trustee is unable, unavailable, unsuitable, or improperly failing to protect the beneficiary's interest." Restatement (Third) of Trusts (2012), § 107(2)(b). *See Bowen v. United States Postal Service*, 459 U.S. 212, 243 (1983) (recognizing rule); *see also Wolf v. Mitchell, Silberberg & Knupp*, 76 Cal. App. 4th 1030, 1037 (Cal. App. 1999) (same); *City of Dubuque v. Iowa Tr.*, 519 N.W.2d 786, 790 (Iowa 1994) (same); *Garcia v. Suda*, 94 Va. Cir. 246 (Va. Cir. 2016) (same).

Had the legislature intended to bar KRS members, as beneficiaries of the pension fund,[7]

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[6] These Appellants did not seek any individual damages in the trial court; indeed, they disclaimed any individual relief. *See., e.g.*, First Amended Complaint, ¶ 33 (complaint "does not assert any harm to KRS members or beneficiaries individually and it does not seek any relief for them individually"). Rather, the Appellants sued for the benefit of the pension fund in which they are stakeholders. In doing so, they invoked two doctrines: (1) equitable standing applicable to suits brought by equity holders on behalf of business entities (the "derivative action"); and (2) the doctrine that permits trust beneficiaries to sue on behalf of a trust when the trustee fails to act (the "beneficiary action").

[7] KRS is unquestionably a trust. By statute, the funds administered by the KRS Board are "deemed trust funds." KRS 61.515(2) (referring to the Kentucky Employees Retirement Fund); KRS 16.510 (State Police Retirement Fund); KRS 78.520 (County Employees Retirement Fund); 61.701 (insurance trust fund). And the legislature has repeatedly said that the KRS Board "shall be the trustee" of the funds at issue. KRS 61.650 (referring to all four funds); KRS 16.642 (State Police Retirement Fund); KRS 78.790 (County Employees Retirement Fund). The court of appeals' conclusion [Opinion at 18] that KRS is not a trust because it is not governed by the Uniform Trust Act, KRS 386B.1-010, ignores that other statutes — they ones that do apply to KRS — all deem KRS to be a trust.

from filing suit against KRS trustees, it likewise "would have so specified in language explicitly ..." *McDaniel*, 898 S.W.2d at 69. It did no such thing. Rather, it explicitly authorized them to sue the trustees on the trust's behalf. *See* § I.A (citing KRS 61.645(15)(e) and (f)).[8]

II. THE COURT OF APPEALS' DECISION MISAPPLIES STANDING LAW, IGNORES KRS'S EXPRESS AGREEMENT THAT IT CANNOT FILE THIS LAWSUIT, AND UNDERMINES THE EXECUTIVE AND LEGISLATIVE BRANCHES' LEGISLATIVE SCHEME.

Commonwealth, Cabinet for Health & Family Services v. Sexton, 566 S.W.3d 185 (Ky. 2018), adopted formally for Kentucky law the federal test for analyzing constitutional standing.[9] *Id.* at 196 (following *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992)). *Sexton* held that, in representative litigation, constitutional standing required analysis through the lens of the "true plaintiff" — the person or entity being represented in the lawsuit. This was rooted in Kentucky's constitutional requirement that courts hear only "justiciable causes." Sexton, 566 S.W.3d at 192 (emphasis omitted). Thus, to satisfy constitutional standing in a representative lawsuit, the "true plaintiff" must establish *Lujan*'s three elements: injury, causation, and redressability.

The Court then analyzed whether the true plaintiff — Sexton — had standing, and found that she did not, because she suffered no injury (having received the medical care that she sought, for which the representative plaintiff — the hospital — sought payment). *Id.* at 197 ("We emphasize the crucial determinative fact — because Sexton, not [the hospital], is the true

[8] Allowing members and beneficiaries to file *derivative* lawsuits will not flood the courts with minor disputes about the amount or timing of retirees' benefits. On the contrary, those individual claims are resolved through the normal administrative process. They thus differ fundamentally from a derivative lawsuit filed *on behalf of* KRS — a lawsuit authorized by statute and with a long lineage in the case law. Moreover, by definition, because a derivative lawsuit is filed on behalf of the entity, not the individual, it seeks no individual relief. Nothing in this brief is intended to discuss when, if, or how KRS's members and beneficiaries can assert individual claims.

[9] The Court made clear that it had applied *Lujan* informally in earlier cases.

plaintiff ..., we must examine the standing requirement through the lens of Sexton's, not [the hospital's], purported satisfaction.")

Here, the Court of Appeals got *Sexton* backwards. Rather than assessing whether the true plaintiff (KRS) had standing, it asked whether the representative plaintiffs (the Appellants) had standing.[10] That simply isn't the *Sexton* inquiry. Nor is it consistent with *Sahni*, 369 S.W.3d at 47, which dismissed individual claims for lack of injury, but allowed derivative claims on the corporation's behalf. Simply put, the appeals court either misunderstood *Sexton*, misunderstood the difference between individual and representative claims (and the law governing them), or both. Its decision cannot be permitted to stand, without doing great mischief as detailed in Appellants' brief.

Moreover, KRS agrees that it cannot and will not file this lawsuit, nor engage in the protracted litigation that it requires, despite the case's substantive merit. In its Joint Notice (attached as Ex. 3 to Appellant's Brief), KRS agrees that the Appellants' claims "have merit, ... and ... could have a significant impact on the financial well-being of KRS and its member employees and retirees." [Joint Notice at 2.] Despite that, KRS "will not pursue the claims asserted" ... "would not have been in a position to pursue these claims" had the Appellants brought them to KRS before filing suit, and thus "believes that it is in the best interest of KRS for Named Plaintiffs to continue their pursuit of these claims on a derivative basis on KRS's behalf." [Joint Notice 1-2.]

In other words, by KRS's own admission, it cannot protect its members from its trustees' and others' wrongdoing. If these Appellants, on KRS's behalf, cannot do so, then no one can (and the trustees' and others' wrongdoing will escape free from all scrutiny). But that is

[10] The appeals court relied solely on *Bacigalupo v. Kohlhepp*, 240 S.W.3d 155, 158 (Ky. App. 2007), for its conclusion that the Appellants must have individual standing here. [*See* Opinion at 12-13.] But *Bacigalupo* involved the continuous ownership rule, which has no bearing on this case.

precisely why courts have fashioned, in equity, the derivative lawsuit. *Watch the Watchers*, 103 KY. L.J. ONLINE 31. No one other than these plaintiffs — as beneficiaries of the KRS trust, and derivatively on behalf of KRS's members — can challenge that wrongdoing. The appeals court's decision runs afoul of that underlying equitable notion: derivative claims are a mechanism to prevent a failure of justice, allowing stakeholders (like these Appellants) to assert claims when those in charge (like KRS) cannot or will not do so.

The appeals court's decision also undermines the legislative scheme. As described in § I, the executive and legislative branches are empowered to create, and sculpt the contours of, Kentucky's public pension plans. They have done so, and the legislature — acting within its power to promote and define public policy — has expressly authorized KRS's members and beneficiaries to file suit against wrongdoing by KRS's trustees.[11] And it has implicitly authorized KRS's members to file suit against wrongdoing by other KRS fiduciaries, by expressly imposing strict fiduciary duties on them, and by legislating in the face of, and without altering the content of, longstanding derivative lawsuit principles.

CONCLUSION

For these reasons, and those contained in the Appellants' and *amici*'s briefs, the Court should reverse the decision below, vacate the writ of prohibition, reinstate the trial court's Opinion and Order (denying, in large part, dismissal motions), and allow the trial court to conduct further consistent proceedings.

[11] That statutory provision answers questions about prudential standing. But that grant would be meaningless if, as the court of appeals wrongly held, KRS's beneficiaries who suffered no individual injury lacked constitutional standing to assert derivative claims.

Dated: June 12, 2019

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EXHIBIT B

EXHIBIT B

COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NO. 2019-SC-232

PRISMA CAPITAL PARTNERS, ET AL.		PETITIONERS/ APPELLEES
v.	On Appeal from the Kentucky Court of Appeals Case Nos. 2019-CA-000043-OA and 2019-CA-000079-OA (consolidated)	
HON. PHILLIP J. SHEPHERD, JUDGE, FRANKLIN CIRCUIT COURT		RESPONDENT/ APPELLEE
JEFFERY C. MAYBERRY, et al.		REAL PARTIES IN INTEREST/ APPELLANTS

AMICUS CURIAE BRIEF ON BEHALF OF LAW PROFESSORS AND FACULTY SUPPORTING APPELLANTS

CERTIFICATE OF SERVICE

My signature below certifies that a true copy of this AMICUS BRIEF, was served on this 12th day of June, 2019: BY REGULAR U.S. MAIL, postage prepaid, to Clerk of the Franklin Circuit Court, 214 St. Clair Street, P. O. Box 378, Frankfort, Kentucky 40601; Clerk of the Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, Kentucky 40601; and Hon. Phillip J. Shepherd, Franklin Circuit Judge, 48th Judicial Circuit, 214 St. Clair Street, P. O. Box 378, Frankfort, Kentucky 40601; and BY ELECTRONIC SERVICE as specified pursuant to CR 5.02 to the persons further listed below:

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STATEMENT OF POINTS AND AUTHORITIES

I. PURPOSE AND INTEREST OF *AMICUS CURIAE*

We Professors Mary J. Davis, Dennis R. Honabach, Lawrence A. Hamermesh, Jonathon C. Lipson, and Robert B. Thompson, are Professors and faculty members at various Kentucky and other law schools. We respectfully submit this brief as amicus curiae in the appeal of *Prisma Capital Partners, et al. v. Hon. Phillip Shepherd, et al.* This amicus brief sets forth our views regarding the detrimental impact of the Court of Appeals' opinion to the future of derivative litigation in Kentucky. To that extent, we submit this amicus brief in support of Appellants. We have no interest, financial or otherwise, in this litigation.

Amici have considerable familiarity with the history and importance of representative and derivative litigation as a means of remedying wrongs under business organization law. It is black letter law in Kentucky and nationally that in order to institute and maintain a derivative action, a Plaintiff must demonstrate two basic requirements: (1) constitutional standing, *i.e.*, injury, causation, and redressability, on the part of the entity being represented ("Constitutional Standing"); and (2) that the plaintiff had and continues to have, at all times in the litigation, a proper interest in entity she seeks to represent ("Representative Interest"). In its opinion below, the Kentucky Court of Appeals added a third, untenable requirement – that the plaintiff show a personal injury directly to herself in addition to an injury to the represented entity. That third requirement is a fundamental misunderstanding and misapplication of centuries of law on derivative actions.

Constitutional Standing under Kentucky law was closely examined in *Commonwealth Cabinet for Health & Family Services v. Sexton*, 566 S.W.3d 185 (Ky. 2018) . There, this Court formally adopted, after years of Kentucky Courts informally following, the federal *Lujan* test for

analyzing Kentucky constitutional standing, thus requiring a showing of: (1) injury; (2) causation; and (3) redressability.[1] Crucially, *Sexton* held that in representative litigation, constitutional standing must be analyzed from the lens of the "true plaintiff," *i.e.*, the entity being represented in the lawsuit, not the named representative plaintiff. Thus, to satisfy constitutional standing in a derivative lawsuit, the showing of injury required by *Lujan* relates only to the injury of the entity, not any direct injury on the part of the individual, representative plaintiff.

The requirement of a Representative Interest is set forth in *Bacigalupo v. Kohlhepp.*[2] There, the court explained that the plaintiff shareholder in a corporate derivative action must remain a shareholder at all times in the litigation to maintain the lawsuit. The plaintiff in *Bacigalupo* lost his ownership shares during the pending litigation consequent to a merger effective in accordance with Kentucky law. Because the plaintiff no longer had a Representative Interest, the suit was dismissed.

Here, the Court of Appeals confused these two issues, finding that the individual plaintiffs must show not only *Lujan* standing for the entity they represent, but also for themselves. In other words, the Court of Appeals found that the individual plaintiffs must show a personal injury in addition to an injury to the entity they seek to represent. This is likely because of the confusing use of the word "standing" to describe the Representative Interest requirement. *See* Court of Appeals Opinion at 13, *citing Bacigalupo.*[3] Regardless of the reasoning behind the Court of Appeals' mistake, by requiring individual injury on the part of the derivative plaintiffs

[1] *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560 (1992)

[2] 240 S.W.3d 155 (Ky. App. 2007).

[3] The use of the word "standing" in the context of the Representative Interest requirement is a reference to the notion of "prudential standing," rather than constitutional standing. It is not the function of this brief to examine the tortured history of prudential standing or its place in the current legal framework. Suffice it to say, in the recent *Lexmark Int'l v. Static Control Components, Inc.* case, the U.S. Supreme Court described the term "prudential standing" as "misleading," a "misnomer," an "inapt" label, and a "a doctrine not derived from Article III." 572 U.S. 118, 126-27 & n.3 (2014).

in a derivative action, the Court of Appeals drastically changed Kentucky law in a way that severely limits the availability of representative litigation in Kentucky. Individuals that bring derivative lawsuits typically cannot establish an individual injury and, if they could, they would likely assert their own individual claims rather than bring derivative claims. If representative litigation is no longer viable under Kentucky law, future wrongdoing that injures entities controlled by the wrongdoers will go unchecked and unremedied.

Moreover, the Court of Appeals' ruling pushes Kentucky out of line with the vast majority of jurisdictions that allow representative litigation. This Court should vacate the Court of Appeals' writ of prohibition, preserve the viability of representative litigation in Kentucky, and underscore that in representative litigation, constitutional standing under Kentucky law is analyzed through *only* the lens of the "true plaintiff."

II. ARGUMENT

In the action below, Plaintiffs did not seek any individual damages; they affirmatively disclaimed any individual relief. *See., e.g.*, First Amended Complaint, ¶ 33 (complaint "does not assert any harm to KRS members or beneficiaries individually and it does not seek any relief for them individually"). Plaintiffs brought suit for the benefit of the Kentucky Employee Retirement System pension fund in which they are stakeholders. To do so, Plaintiffs invoked two well-established procedural doctrines. First, Plaintiffs invoked equitable standing principles applicable to derivative cases brought by stakeholders on behalf of business or other entities (most commonly, the shareholder derivative action). Second, Plaintiffs invoked the doctrine that permits trust beneficiaries to bring suit on behalf of a trust when the trustee fails to act. Both procedural doctrines are widely accepted under American and Kentucky jurisprudence.

A. Courts created representative litigation through their equitable powers to hold those in charge of entities accountable for their wrongdoing.

The history of derivative actions is important because it shows that the Court of Appeals' opinion here takes the entire reason derivative actions arose and fundamentally turns it on its head. Derivative actions arose in order to permit individual stakeholders of an organization to pursue a remedy for injury to the organization when those governing the organization cannot or will not pursue such a remedy.[4] In other words, contrary to the logic of the Court of Appeals, derivative actions arose precisely because the individual constituent ***was not personally injured***. In those situations, constituents need the ability to bring suit on behalf of the entity to hold those in control accountable to their fiduciary duties.[5] Courts created derivative standing with their equitable powers to assure that a procedural mechanism existed to police entity leaders that committed wrongdoing to the detriment of the entity.[6] Courts have recognized derivative standing in this country since at least 1832,[7] and it is firmly entrenched in the jurisprudence throughout the country.

Courts also used their equitable powers to create the rule that a beneficiary of a trust can bring suit against a third party when "the trustee is unable, unavailable, unsuitable, or improperly

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[4] *See, e.g.*, Thomas E. Rutledge, *Who Will Watch the Watchers?: Derivative Actions in Nonprofit Corporations*, 103 KY. L. J. ONLINE 31, 33-34 (2014–2015).

[5] *See Barrett v. S. Conn. Gas Co.*, 374 A.2d 1051, 1055 (Conn. 1977) ("If the duties of care and loyalty which directors owe to their corporations could be enforced only in suits by the corporation, many wrongs done by directors would never be remedied.").

[6] *See, e.g.*, *Tzolis v. Wolff*, 884 N.E.2d 1005, 1006 (2008) ("[The derivative action] was not created by statute, but by case law."); *Ross v. Bernhard*, 396 U.S. 531, 534 (1970) ("The remedy made available in equity was the derivative suit, viewed in this country as a suit to enforce a *corporate* cause of action against officers, directors, and third parties.") (emphasis in original).

[7] *Tzolis*, 884 N.E.2d at 1006 (2008) ("[t]he derivative suit has been part of the general corporate law of this state at least since 1832," and that "[i]t was not created by statute, but by case law").

failing to protect the beneficiary's interest."[8] The United States Supreme Court [9] and numerous other jurisdictions also recognize this rule.[10]

Thus, in a derivative action, the representative plaintiff's constitutional standing is derived from that of the entity.[11] "This is so because a representative steps into the shoes of the entity and brings a suit belonging to the entity."[12] Whether the representative herself has suffered injury is irrelevant to determining standing in a derivative action.

B. Kentucky law on representative actions historically mirrors the country's jurisprudence on representative actions.

The history of derivative actions in Kentucky is quite similar to the history of derivative actions across the country. Over a century ago, the then Court of Appeals articulated Kentucky law on derivative standing:

> The first question naturally presented is the right of minority stockholders of a corporation to maintain suit on its behalf. Generally, such a suit cannot be so maintained...*But there are admitted exceptions* to the general rule that the acts of the directors are the acts of the corporation, and cannot be interfered with by the courts at the complaint of stockholders, *which are as well established perhaps as the rule itself.*[13]

The Court stated that it may use its equitable powers to allow a minority shareholder to bring suit and hold the directors of a corporation accountable for wrongdoing.[14] Absent derivative

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[8] See RESTATEMENT (THIRD) OF TRUSTS § 107(2)(b) (AM. LAW INST. 2012). This rule was previously incorporated in the RESTATEMENT OF TRUSTS § 282 (AM. LAW INST. 1935), and RESTATEMENT (SECOND) OF TRUSTS § 282 (AM. LAW INST. 1957).

[9] *Bowen v. United States Postal Service*, 459 U.S. 212, 243 (1983).

[10] See, e.g., *Wolf v. Mitchell, Silberberg & Knupp*, 76 Cal. App. 4th 1030, 1037 (Cal. Ct. App. 1999); *City of Dubuque v. Iowa Tr.*, 519 N.W.2d 786, 790 (Iowa 1994); *Garcia v. Suda*, 94 Va. Cir. 246 (Va. Cir. 2016).

[11] *Roth v. Scopia Capital Mgmt. LP*, 16CV6182LTSHBP, 2017 WL 3242326, at *4 (S.D.N.Y. July 28, 2017)(citing *Donoghue v. Bulldog Inv. Gen. Pshp.*, 696 F.3d 170, 179 (2d Cir. 2012)).

[12] *Id.* (citing *Phillips v. Tobin*, 548 F.2d 408, 411 (2d Cir. 1976)).

[13] *Pittsburg, C., C. & St. L. Ry. Co. v. Dodd*, 72 S.W. 822, 827 (Ky. 1903) (emphasis added).

[14] *Id.*

litigation, there would be no procedural vehicle to prevent directors and majority stakeholders from committing wrongs to the corporation.[15]

The fact that individual injury on the party of the representative plaintiff is not required has been borne out by subsequent case law. In *Sahni v. Hock*,[16] a plaintiff brought individual claims and a shareholder derivative claim. The court dismissed plaintiff's individual claims because her alleged injury was merely diminution in value of stock, which is not a direct personal injury sufficient to sustain a direct cause of action.[17] Rather, diminution in value of stock is an injury that is derivative of the corporation's injury.[18] Despite lacking a direct injury to sustain a direct cause of action, the court allowed plaintiff to pursue her derivative claims on behalf of the corporation because the corporation had allegedly been injured.[19] Thus, Kentucky law is clear that individual injury is not required. Derivative actions exist because, regardless of whether or not the individual constituent has been injured, the individual still has a real stake in protecting the interest of the business entity of which she is a part.[20]

With regard to lawsuits brought by beneficiaries on behalf of trusts, while Kentucky courts have not yet opined on the issue, the Sixth Circuit, applying Kentucky law in *Osborn v. Griffin*,[21] predicted that this Court would likely adopt the "correct rule set out in the Restatement

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[15] *See id.* at 828 ("To close the doors of the courts to a single stockholder in such a case upon the theory that the majority must rule, and that, having embarked in a common enterprise with them, he must abide the judgment of the majority, would be to turn over to a possible wrongdoer the adjudication of his own case. In such an unequal struggle between duty and interest, it would more frequently happen that 'duty would be overborne in the conflict.'").

[16] 369 S.W.3d 39 (Ky. Ct. App. 2010), *abrogated on other grounds*, 436 S.W.3d 189 (Ky. 2013).

[17] *Id.* at 47.

[18] *Id.*; *see also Turner v. Andrew*, 413 S.W.3d 272 (Ky. 2013) (lost profits suffered by LLC were not suffered by LLC's sole member); *Gross v. Adcomm, Inc.*, 478 S.W.3d 396, 400 (Ky. Ct. App. 2015); *Watkins v. Stock Yards Bank & Tr. Co.*, 2011-CA-000228-MR, 2012 WL 2470692, at *5 (Ky. Ct. App. June 29, 2012), opinion not to be published (Aug. 21, 2013).

[19] *Id.*

[20] *See, e.g.*, Rutledge, *Who Will Watch the Watchers, supra* at 38-39.

[21] 865 F.3d 417 (6th Cir. 2017).

of Trusts," presently articulated in § 107(2)(b) of the Restatement (Third) of Trusts, [22] permitting a trust beneficiary to bring claims on behalf of the trust when the trustee refuses or neglects to act.[23] The Sixth Circuit reasoned this Court had relied on the Restatement of Trusts in many instances in fashioning Kentucky jurisprudence, and would likely do so with respect to this issue.[24] In *Osborn* , the Sixth Circuit held that the beneficiaries of a family trust had representative standing to sue certain of its trustees and a related business entity, and affirmed the trial court's judgment in their favor. Nothing in Kentucky law suggests that Kentucky would not adopt the majority rule that provides beneficiaries standing to sue on behalf of trusts.

C. ***Sexton* did not change Kentucky law on standing in representative lawsuits.**

Although the Court of Appeals places considerable reliance on the *Sexton* opinion, the reality is that *Sexton* did not change Kentucky law, and certainly did not change Kentucky law on derivative standing. Rather, *Sexton* reaffirmed that the only Constitutional Standing analysis in a representative action is the standing of the entity or person being represented, not the standing of the individual seeking to represent them.

Sexton is a representative lawsuit in which a hospital brought claims for reimbursement for medical treatment, purportedly as a representative of a patient (Sexton) who actually received the treatment. The issue before the Court was the status of constitutional standing in Kentucky jurisprudence.[25] In reaching its opinion, this Court formally adopted the three-part *Lujan* test for constitutional standing: (1) injury; (2) causation; (3) redressability.[26] However, the Court recognized that Kentucky courts had already judicially created a standing requirement similar to

[22] The court considered § 282 of the RESTATEMENT (SECOND) OF TRUSTS (AM. LAW INST. 1959) , which does not differ in substance from the more recent iteration in § 107 of the RESTATEMENT (THIRD) OF TRUSTS (AM. LAW INST. 2012).

[23] *Id.* at 447.

[24] *Id.*

[25] *Sexton*, 566 S.W.3d at 188.

[26] *Id.* at 195.

federal constitutional standing rooted in the Kentucky Constitution's limit on the courts' judicial power to hear only justiciable causes.[27] To determine if a case is "justiciable," the Court previously used the three elements of the *Lujan* test.[28] Thus, "[t]o provide clarity to Kentucky's standing doctrine, [the Court] formally adopt[ed] the *Lujan* test as the constitutional standing doctrine in Kentucky as a predicate for bringing suit in Kentucky's courts."[29] It is clear that adopting the *Lujan* test was not meant to change general standing principles as they already existed under Kentucky law.

The Court then analyzed constitutional standing in the context of a representative lawsuit. The Court explained that Sexton, the individual that the named plaintiff sought to represent, was the "true plaintiff," so her status was determinative for purposes of the standing inquiry:

> We emphasize the crucial determinative fact — because Sexton, not [the hospital], is the true plaintiff in this case, we must examine the standing requirement through the lens of Sexton's, not [the hospital's], purported satisfaction.[30]

The Court held that the hospital lacked standing to bring the reimbursement claim because Sexton (the true plaintiff) "has not and will not suffer an 'injury' in this case" because she already received the medical treatment and would not be called on to pay for those services.[31]

Sexton's holding is consistent with the history of representative actions in Kentucky and across the country. Representative lawsuits are meant to remedy injury to the represented entity. For constitutional standing purposes, therefore, injury to the entity, *i.e.* the "true plaintiff," is all that matters. *Sexton* did not in any way limit representative actions under Kentucky law, which has never required individual injury to bring a representative lawsuit. Rather, *Sexton* makes it clear that it is the

[27] *See id.* at 194 ("Kentucky courts have seemingly created a judicially—as opposed to constitutionally—imposed standing requirement.").
[28] *Id.* at 195-96.
[29] *Id.* at 196.
[30] *Id.* at 197.
[31] *Id.*

status of the represented entity, not the individual plaintiff, that must be considered in deciding Constitutional Standing.

D. The Court of Appeals' Opinion Misapplies *Sexton* and the Representative Interest requirement in a Manner That Sharply Limits the Viability of Representative Lawsuits in Kentucky.

Despite the clear language of *Sexton*, the Court of Appeals held below that ***both*** the entity being represented and the individual purporting to represent it must show the three elements of *Lujan* standing, including personal injury to the named representative plaintiff. If allowed to stand, the Court of Appeals' opinion essentially precludes litigants from bringing derivative lawsuits in Kentucky.

The Court of Appeals relied on *Bacigalupo v. Kohlhepp*[32] for the proposition that an individual bringing a representative claim must also show individual injury to establish "standing." That analysis, however, is a misreading of *Bacigalupo*, a case that did not involve Constitutional Standing. Rather, as explained above, *Bacigalupo* involved the Representative Interest rule, which requires a derivative plaintiff to own shares in an entity at all material times to maintain the derivative lawsuit.[33] There, the plaintiff's shares were cancelled during the pendency of the lawsuit due to a corporate merger. As a result, the plaintiff could not satisfy the Representative Interest rule and her suit was dismissed.[34] Of course, the Representative Interest rule makes sense – if the named plaintiff no longer has an interested in the entity she seeks to represent, she should no longer be able to maintain a lawsuit on behalf of that entity.

The confusion for the Court of Appeals here seems to arise from the *Bacigalupo* court's use of the word "standing" to refer to the Representative Interest requirement. The court in

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[32] 240 S.W.3d 155 (Ky. App. 2007).
[33] *Id.* at 157.
[34] *Id.* at 158.

Bacigalupo indicated that the plaintiff must maintain "standing" via maintaining a Representative Interest in the entity to continue the lawsuit.[35] In this context, the use of the word "standing," which is in reference to the old rules of "prudential standing," has nothing to do with Constitutional Standing.[36] Once this fundamental misunderstanding of the use of "standing" to apply to the Representative Interest requirement is understood, it is clear that *Bacigalupo* has nothing to do with the issues before this Court because the plaintiffs here have been and remain KRS members or beneficiaries at all relevant times.

In fact, the *Sexton* Court made clear that it was not adopting any prudential standing principles from federal jurisprudence to change Kentucky law. It cannot be the case that a pre-*Sexton* opinion on the Representative Interest requirement suddenly deprives a party of constitutional standing post-*Sexton.* Even *Bacigalupo* never required the plaintiff to show that it had individual injury. On the other hand, cases like *Sahni* illustrate that a representative plaintiff who lacks individual injury is clearly able to bring a representative claim under Kentucky law.[37] Perhaps most importantly, *Sexton* itself stated in no uncertain terms that it is the entity, not the representative, that must be examined with respect to the three elements of *Lujan* standing.

At bottom, Kentucky law has never required an individual plaintiff bringing a representative lawsuit to also establish individual injury to maintain standing. And for good reason. In a traditional shareholder derivative suit, an individual likely cannot establish personal

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[35] *Id.*

[36] *In re Facebook IPO Derivative Litig.*, 797 F.3d 148, 156 (2d Cir. 2015)("Failure to satisfy the contemporaneous ownership requirement of Rule 23.1 does not, of course, raise a jurisdictional issue under Article III. Rather, it means that the putative derivative plaintiff does not have standing to represent the interests of the nominal defendant in a derivative capacity."). Prudential standing does not require a plaintiff to have an individual injury before it can assert a representative claim. *See Dismas Charities, Inc. v. U.S. Dept. of Justice*, 401 F.3d 666, 674 (6th Cir. 2005).

[37] 369 S.W.3d at 47.

injury because the shareholder's injury is typically an unrealized loss, *i.e.*, devaluation of unsold stock.[38] Likewise, a beneficiary bringing suit on behalf of a trust likely could not show individual injury to confer standing because the beneficiary has no legal title to the corpus of the trust.[39] If these individuals could establish personal injuries, they would seek redress for those injuries to their direct benefit, not redress of the entity's injury which only inures to their benefit indirectly.

Here, the Court of Appeals misapplied and misinterpreted clear law on derivative actions. In doing so, it created a new and unworkable standard for standing in derivative lawsuits that sharply limits, if not does away with, the viability of representative lawsuits in Kentucky, which are generally available in all other state and federal courts. The Court should not allow Kentucky courts to become an outlier jurisdiction that limits or discourages representative lawsuits.

III. CONCLUSION

For the foregoing reasons, and the reasons stated in the Appellants' briefs, this Court should vacate the Court of Appeals' writ of prohibition entered April 23, 2019, and reinstate the Circuit Court's November 18, 2018 Opinion and Order denying (in principal part) the Defendants' motions to dismiss.

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[38] Devaluation of unsold stock is not sufficient to establish a personal injury. *See Sahni*, 369 S.W.3d at 47; *see also Turner v. Andrew*, 413 S.W.3d 272, 277 (Ky. 2013).

[39] *Pillsbury v. Karmgard*, 22 Cal. App. 4th 743, 753 (Cal. Ct. App. 1994); *Saks v. Damon Raike & Co.*, 7 Cal. App. 4th 419, 427 (Cal. Ct. App. 1992).

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