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

JEFFREY C. MAYBERRY, *et al.* PLAINTIFFS

vs.

The Tier 3 Plaintiffs' Brief in Opposition to the Attorney General's Motion to File Amended Intervening Complaint and in Further Support of the Tier 3 Plaintiffs' Motion to Intervene

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

ELECTRONICALLY FILED

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I. INTRODUCTION

On May 24th the Attorney General ("AG") filed a motion seeking leave to file his long-promised Amended Intervening Complaint ("AIC"). While the AIC goes to great lengths to block the Tier 3 Plaintiffs and their counsel from any role in this litigation, the Tier 3 Plaintiffs must nevertheless be permitted to intervene because ***the AG does not and cannot adequately represent the interests of Tier 3 Plaintiffs and Kentucky Retirement Systems*** ("***KRS***") ***Trust/Plan members***.

The Tier 3 Plaintiffs oppose the filing of the AIC. Whether the AG is appearing as a party (*i.e.*, as the embodiment of the Commonwealth), or as a lawyer attempting to represent the interests of the Commonwealth or KRS or the People or the Tier 3 Plaintiffs or anyone else, or as the lawyer for all, he is not exempt from the rules prohibiting simultaneous representation of divergent, conflicting interests. In fact, as a public official where integrity is the polar star, it is all the more so.

The AG asserts that he represents the Commonwealth — as both party and attorney — but overreaches by attempting to include ***competing and conflicting interests*** within his remit.[1] Specifically, the AG seeks to "assume complete control" of all claims on

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[1] A state attorney general occupies a unique position in our system of government. Not only does she provide legal counsel and services to defined state officials or agencies, she also has in some circumstances the ability to initiate or appear in a case without a separate "client" — on her own, as representative "of the people." This aspect of attorney general practice is known as the "*parens patriae*" power. In this *parens patriae* role, the attorney general is said to ***act as the party***, ***as well as her own attorney***. *See generally* Margaret H. Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 HARVARD L. REV. 486, 491 (2012). *Parens partiae* is often a useful and powerful tool, but it is not a super power, and it can be rife with conflicts and agency problems of its own. Professor Lemos goes on:

> [C]onflicts of interest are all but unavoidable in public aggregate litigation. First, there may be intraclass conflicts in a *parens patriae* action just as there are in private class litigation. … State agencies and state residents will share in any recovery, but will they share evenly? Should they? …

behalf of the "Commonwealth or KRS, including … any claims that might otherwise be brought "derivatively" by Commonwealth taxpayers, citizens, pension fund beneficiaries (regardless of whether such beneficiaries are classified as Tier 1, Tier 2, ***or Tier 3***)." AIC ¶ 3.[2]

But the Commonwealth and KRS are not one and the same.[3] KRS is a state agency, but it is more than that; its Board is the ***trustee*** of trust funds, ***required to act*** "***solely in the interest of the members and beneficiaries***." That "***sole***" interest is inimical to the broad duty of the AG to act in the "***best interests***" of the Commonwealth and ***all*** of its citizens.[4] The Tier 3 members and beneficiaries have unique interests and uniquely valuable legal claims. This stems from the hybrid plan design, with its "Upside Sharing" feature, from the absence of any "Inviolable Contract" protection plus their uniquely

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> The problem is not limited to cases in which the attorney general effectively serves two different clients, but extends to those in which she asserts only a representative claim on behalf of injured citizens. The attorney general has a duty to represent the public interest — the interest of the state qua state and the collective interests of the state's citizens. It should be clear, however, that the public interest may clash with the rather more narrow interests of the members of the *parens patriae* group. … The consumers who populate the *parens patriae* group will have an interest in maximizing the amount of recovery. But suppose that the attorney general concludes that a large recovery would risk putting the defendant out of business, with a resulting loss of jobs and tax revenue. One need not adopt a cynical view of the motivations (political or otherwise) of attorneys general in order to appreciate the potential for a conflict of interest. The difficulty is that the attorney general may have to sacrifice the interests of the individuals whom she represents in order to vindicate the larger public interest — or *vice versa*.

[2] Unless otherwise noted, all emphases in quoted texts are added.

[3] The AG and his new outside counsel do not appear for KRS — only for the Commonwealth, meaning in practical effect only in the *parens patriae* role.

[4] *See Commonwealth ex rel. Hancock v. Paxton*, 516 S.W.2d 865, 868 (Ky. Ct. App. 1974) (KRS § 15.020, "in stating at the outset that the Attorney General is 'the chief law officer of the Commonwealth,' intends that in case of a conflict of duties the Attorney General's primary obligation is to the Commonwealth, the body politic, rather than to its officers, departments, commissions, or agencies")

valuable claims anchored by § 61.645(15)(f) and their trust-beneficiary claims, which only they have standing to assert in a derivative format, immune for imputation/*in pari delicto* defenses. As a result, their interests lie in achieving the ***highest possible recovery*** and in directing ***all of it to the KRS trust funds***, while in contrast the Commonwealth's citizens and taxpayers are principally interested in the recovery going into the ***state treasury*** (where the AG is statutorily bound to direct any recovery he makes).[5]

A. The AG Cannot Adequately Represent the Tier 3 Plaintiffs' Interests and Claims

The principal bases for the Tier 3 Plaintiffs' assertion of inadequate representation in the context of the AG's AIC are:

- The AG and his newly retained outside lawyers would face irresolvable conflicts, if permitted to represent all of the competing interests, to the presumed (and actual) detriment of the Tier 3 members and beneficiaries;[6]
- The AG/Commonwealth cannot simultaneously act in the "best interests" of ***all*** of its citizens and in the "***sole interests***" of the Tier 3 members;
- Kentucky's statutory scheme neither requires nor authorizes the AG to step into the position of the KRS Board in its role as Trustee and thus become, in effect, a conflicted Trustee;
- The Commonwealth may lack standing to pursue at least some of the claims as it is questionable whether and the degree to which fiduciary duties were owed by KRS trustees, officers or other fiduciaries (such as the Hedge Fund Sellers)

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[5] *Compare* KRS § 15.020 and § 48.005(4) (net funds recovered by AG must be deposited in the Commonwealth's "general fund surplus account") *with* KRS § 61.515(2) (all assets of the retirement system to be held in trust funds and "applied solely as provided in KRS 61.510 to 61.705").

[6] While some accommodation may be permissible in view of the unique role of the office, a "state attorney general is, like all attorneys, prohibited from representing a client if the representation of that client is directly adverse to the representation of another client." 7A *Corpus Juris Secundum*, Attorney General § 46. "In the case of the attorney general's conflicting representational duties in civil proceedings, the attorney general's primary obligation is to the state rather than to its officers or agencies." *Id.* (citing *Paxton*, 516 S.W.2d at 868). Kentucky ethical rules are to the same effect. *See* KY. SUP. CT. R. 3.130 (1.11).

directly to the Commonwealth, a defense that will likely be tested via motion practice. Moreover, the Commonwealth may be hard-pressed to articulate damages that are ripe and non-speculative. In contrast, the Tier 3 Plaintiffs have constitutional standing and the already-adjudicated right to pursue statutory and common-law claims for these breaches of duty and associated aiding and abetting claims.

- The Tier 3 member/beneficiary plaintiffs will be able to avoid serious affirmative defenses (imputation of Trustee misconduct/*in pari delicto* and statute of limitations) that are expected to be interposed — and may be effective — against the Commonwealth;

- The AIC conspicuously omits the allegations contained in the Tier 3 Plaintiffs' proposed Complaint in Intervention of collusive efforts by KKR Prisma and KRS management (David Eager) and long-term key Trustee (J.T. Fulkerson) to permit KKR and Prisma to self-deal with trust assets through the secret Advisory Services Agreement (ASA) that expressly permitted KKR Prisma to "develop further business relationships with third parties through the provision of services under this Agreement." The claims arising from these allegations are potentially worth hundreds of millions of dollars or more of compensatory and punitive damages as well and it is in the interests of the Tier 3 members and beneficiaries that they be prosecuted aggressively; and

- The AIC also conspicuously omits the claims against the large, highly profitable and insured Ice Miller law firm that approved or permitted the vast fiduciary failures complained of in the Mayberry Five's First Amended Complaint ("FAC") and the Tier 3 Plaintiffs' proposed complaint, which claims have been upheld by this Court. *See generally* Nov. 30, 2018 Opinion & Order.[7]

B. KRS Is Frozen, Having Wasted $1.2 Million

The position of KRS in all of this is bewildering. KRS just spent $1.2 million (from KRS trust funds) on an "independent investigation" of "any improper or illegal activities" in connection with KRS's past investment activities. After waiting for months for this "investigation" to be completed and for the investigation report to be delivered to the AG, and telling the Court it needed the Report to decide what to do, the KPPA Board finally acted last week, on May 26, 2021, by unanimously resolving:

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

> That KPPA … not move to intervene as a plaintiff in the Attorney General's Amended Complaint and that KPPA … not file any litigation against any party in the Mayberry claims at this time.

At the same time, the CERS and KRS (KERS + SPRS) Boards decided to "take no action" in respect to this litigation.[8] In other words, the KRS (now KPPA) Board decided to ***do nothing***, standing pat and remaining ***on the sidelines***, as before. The Board did ***not*** vote to try to take over the claims or to join the action as a plaintiff or intervenor; did ***not*** vote to retain the AG to represent KRS; and did ***not*** (on May 26 or prior) vote to rescind or repudiate the prior Board's Joint Notice with regard to this case.[9] Neither did the Board take any formal action to terminate the Tier 3 Plaintiffs' claims. Whether KRS still opposes the Tier 3 Plaintiffs' intervention seems lost in the shuffle.

While someone at KRS has worked to lock down the Secret Report as if it contained nuclear secrets or the recipe to Coca Cola, a couple of things must be true. First, no new facts or wrongdoing were found beyond the facts discovered and pleaded by the Mayberry Five and Tier 3 Plaintiffs because nothing new is pleaded in the AIC. The AG cut-and-pasted 100% of the substantive allegations in its AIC from the Tier 3 Plaintiffs' complaint (and the Mayberry Five's complaint before that). Second, that the "investigation" ***confirmed the facts underlying the original claims*** made in the *Mayberry* FAC, and the value of those claims since the AG copies them again as he did with his original intervening complaint. Third, that the "independent investigation" found a way to justify elimination of previously approved claims against law firm Ice Miller. Fourth, even after

[8] *See* https://www.facebook.com/kyretirement/videos/447181379586607/.

[9] We are cognizant that KRS-retained lawyers have previously indicated that the Joint Notice was no longer "operable." But there is no such action reflected in any publicly-available Board Minutes, and rescission of Board action usually requires another Board action.

the "investigation," KRS and the AG remain mute as to ***the allegations of misconduct and breaches of duties by current KRS Executive Director Eager and current Trustee Fulkerson***, detailed in the Tier 3 Plaintiffs' proposed complaint, but absent from the AG's AIC or from any public discussion by KRS, its Board or the AG.[10] Sort of a secret summary judgment.

So where does that leave us?

With KRS still on the sidelines. With the Joint Notice apparently still in place. With the KRS Board taking no action in the face of the fire that threatens to devour the pension and insurance funds. With the AG attempting to ***insert himself*** into the case ***as a party*** in the place and stead of the KRS Board, with its "sole interest" duties as Trustee — ***and as counsel*** representing KRS's interests — in the complete absence of Board action either assigning trusteeship duties/obligations or requesting legal representation. And with conflicts and uncertainties aplenty. But, again, that's what happens when those in charge are conflicted — the net result of the $1.2 million exercise[11]

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[10] As discussed in more depth below, and especially in the Tier 3 Plaintiffs' proposed complaint in intervention, David Eager was initially appointed to the KRS Board in April 2016. He attended one Board meeting (where he made the motion to add $300 million to KKR/Prisma's Daniel Boone Fund). After that one meeting, Eager left the KRS Board to become its highly-paid Executive Director. In that role, he permitted the secret self-dealing contract with KKR/Prisma to remain in place and failed to disclose its illegal terms and existence. Neither Eager nor any other representative of KRS (or the AG) has ever tried to justify a contract that ***explicitly permitted a fiduciary (KKR/Prisma) to leverage its position as gatekeeper of close to $1 billion of KRS trust funds to its own business benefit***. Rather, they just try to ignore this legal elephant in the room and hope it will go away. That is what happens when conflicted parties remain in charge.

[11] It is apparent that ***the AG relied in one way or another on the $1.2 million Secret Report in crafting his AIC***. If not, what have we all been waiting for — what was the $1.2 million for? The AIC adds not one single new factual or substantive allegation, yet cuts out allegations of wrongdoing by KRS current insiders and Ice Miller — KRS's current fiduciary counsel and already a defendant in the case. The AIC fails to plead the 2015–2016 secret self-dealing ASA with KKR/Prisma. It does not plead the key involvement of KRS's current CEO/Executive Director Eager or

seemingly was an effort to insulate the Executive Director from any scrutiny or liability, and to permit him to continue in his lucrative position while keeping a firm (if largely unseen) hand on the litigation tiller.

It makes you wonder why we all waited all these months for a Secret Report.

C. The AIC Asserts Defective and Conflicting Claims

We offer the following in opposition to the AG's motion to file the AIC:[12]

- The AG cannot simultaneously serve as a party and represent (as an attorney) interests adverse to his role as a party;
- The entry of the Commonwealth into the case does not preempt the claims of the Tier 3 Plaintiffs under the combined statutory/common-law scheme of which KRS § 61.645(15)(e) and (f) [and now 61.505(12)(e) and (f)] are parts;
- To the extent the AG attempts, as a party, to step into the role of Trustee, he would be deemed "unsuitable" as that term is used in Restatement (Third) of Trusts § 107 (2012) (2)(b), and thus unable to block the Tier 3 Plaintiffs from asserting their right to pursue their claims herein as beneficiaries.
- The AG/KRS are attempting to assert causes of action that ***they lack standing to assert***, ***and usurp or block the assertion of those claims by persons with standing and legal right to assert them***, ***by opposing the Tier 3 Plaintiffs' intervention***. As this Court held in its November 30, 2018 order, "a person" can sue for "monetary damages" for the benefit of KRS under Section 61.645(15)(f) for breach of trusteeship duties, as

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current long-serving Trustee Fulkerson in that conflict-laden arrangement and the follow-on self-dealing by KKR/Prisma. It eliminates as a defendant KRS's current fiduciary counsel Ice Miller — who approved or permitted that and more self-dealing, even though this Court upheld the previously pleaded claims against them. By contrast the Tier 3 Plaintiffs' complaint (like the FAC before it) lays out, in great detail, this critical aspect of the overall scheme, course of conduct and common enterprise to target, exploit and abuse KRS, and members. *See* Tier 3 Pls.' Compl. ¶¶ 57–61; 111–113; 130–132; 210–218. Kentucky public interest groups are demanding the Secret Report be made public via "public records" requests. KRS and the AG have refused to do so. The consequences of the use and involvement of the Secret Report at this point and the changes in and omissions from the AIC are further addressed in our separate filing — "Submission re: Secret Report."

[12] We did not and do not object to the AG's intervention on behalf of the Commonwealth. The Intervening Complaint he filed at that time is on file. We object to the AG's attempt to expand his role by claiming to represent multiple competing and conflicting interests, seemingly with the objective of squeezing out independent representation of the Tier 3 members' interests, which he does not adequately represent.

can a trust beneficiary, *i.e.*, KRS member. *See* Nov. 30, 2018 Opinion & Order at 8. This includes the ability to sue any person who aids, abets, assists, conspires with or pursues a common enterprise with a KRS Trustee. *Id.* at 27–28.

- Neither KRS nor the AG is a person.[13] Neither is a beneficiary of KRS's Trusts. Neither the AG nor KRS is legally capable (*i.e.*, have standing) to assert these unique statutory and trust-beneficiary claims. Only the Tier 3 Plaintiffs have the legal capability — and standing — to assert those claims, which belong to the Tier 3 ***persons*** — members and beneficiaries of KRS's trust/pension plans. While those claims are asserted in a "derivative format," they are not technically derivative claims ***on behalf of KRS***, ***but rather statutory and trus***t-***beneficiary claims for the benefit of KRS***. The Court made clear in its November 30, 2018 ruling that the members of KRS asserting those claims for the benefit of KRS did not have to seek permission of either KRS or the AG to do so, and ***did not accept Defendants' argument that the AG had the exclusive authority to assert those claims***. *See id.* at 8–9.

- Due to actual and potential legal, factual and representational conflicts KRS and the AG/KRS (and their new outside counsel) cannot adequately represent the Tier 3 Plaintiffs' interests in seeking to remedy either the injury / harm suffered individually by them that creates their constitutional standing or as KRS Plan Members or in seeking plan wide relief, *i.e.*, recovering the ***plan-wide damages*** for KRS's trust funds that must be recovered to benefit the Tier 3 plan members/beneficiaries ***specifically***, by compensating the KRS trusts/plans ***overall*** for the damage caused by Defendants' misconduct, with some part of the recovery flowing through to the Tier 3 Plaintiffs' individual accounts to compensate them for their unique injuries.

- KRS (and the AG as its counsel, if he is) is barred by the equitable doctrine of judicial estoppel from taking positions inconsistent with KRS's earlier legal position reflected in the Joint Notice filed with the Court supporting the prosecution of the claims then being asserted for its benefit by plan members in the "derivative" format and later upheld by this Court.[14] The Tier 3 Plaintiffs are plan members as well and if the Court finds they have constitutional standing — ***they will continue to assert the same claims asserted***

[13] Under Section 61.510 ("Definitions for KRS 61.510 to 61.705"), "'[p]erson means a natural person[.]" KRS § 61.510(30). The Tier 3 Plaintiffs are "persons" within the meaning of the statute and are "beneficiaries" of the KRS Trusts. *See also* KRS § 61.510(26) ("'Beneficiary' means the person or persons or estate or trust or trustee designated by the member in accordance with KRS 61.542 or 61.705 to receive any available benefits in the event of the member's death.").

[14] KRS is correctly a (nominal) defendant in this case, *i.e.*, the *Mayberry* action. In order to become a plaintiff, KRS must seek realignment as a "plaintiff." When the case was filed, KRS was given the opportunity to seek realignment, but it decided not to do so and made its decision clear to the Court and the parties by filing the "Joint Notice" and otherwise. Absent realignment, KRS remains a "defendant," not a "plaintiff."

earlier by the Mayberry Five — as endorsed by KRS in its court-filed Joint Notice and upheld by the Court.

- Due to their statutory obligations to act "***impartially***" toward, and make decisions "***solely in the interests of***," KRS's members and for the "***exclusive purpose***" of "***providing benefits***" to them — KRS's Trustees lack authority to block or terminate the continued prosecution of the claims asserted by the Tier 3 Plaintiffs' for KRS's sole benefit (by opposing intervention or otherwise) ***unique claims that have been upheld and are potentially worth billions of dollars***. If the AG is counsel for KRS, it has no greater power than KRS.

The AG and his newly retained private counsel seek to take "complete control of this action" and "occupy the field" — and, by doing so, intend to squeeze out of the case the individuals who originated the case, who imagined and created most, if not all, of its intellectual underpinnings, and who brought the AG's new private counsel to the table in the first place.[15] Putting aside the unseemliness of the attempted squeeze-out, the fact is that the AG and our former colleagues cannot advocate every position for every player, because attempting to do so would draw them into untenable conflicts of interest and result in twister-like contortions. The Tier 3 Plaintiffs and their counsel should — indeed must — continue to play a vital role in this litigation, a role that is not — and cannot — be filled by the AG or his lawyers. The reasons are:

- To avoid disabling conflicts of interest, both in representation of conflicting/competing claims and parties;

- To materially strengthen the case overall, as the Tier 3 KRS member/beneficiary plaintiffs will be able to avoid serious affirmative defenses (imputation of Trustee misconduct and *in pari delicto*) that will be interposed — and may be effective — against the entity plaintiffs, KRS and the Commonwealth; and

- To materially strengthen the case overall, by allowing the Tier 3 Plaintiffs to press the allegations of collusive efforts by KKR Prisma (and KKR/Prisma operatives William Cook and Michael Rudzik) and KRS management

[15] The two Kentucky firms were hired by the Lerach firm as local counsel. The Texas firm was added much later. The new Washington D.C.-based firm has had nothing to do with the case.

> (including CEO/Executive Director David Eager) around the secret ASA that expressly provided for self-dealing by KKR Prisma with hundreds of millions of KRS trust fund dollars — a claim that the KRS Board and the AG have not pursued, and apparently will not pursue."

The AG's AIC nowhere pleads the role of Eager, Fulkerson, or KKR/Prisma partner Rudzik in the 2015–2016 wrongdoing — specifically the ***secret*** KRS/KKR Prisma ASA that let Rudzik inside KRS (while on the KKR Prisma payroll) to takeover and run and self-deal in KRS assets in clear violation of KRS's Conflict of Interest policies that the Trustees were to police and enforce. The AIC eliminates Ice Miller — KRS's fiduciary counsel who approved, permitted this corrupt, illicit arrangement in clear violation of KRS's conflict-of-interest policies and the Trustees and other Defendants' fiduciary duties, even though the claims against Ice Miller were upheld in the November 30, 2018 Order. The absence of these allegations weakens the case as pleaded by the AG on the merits and eliminates substantial damages while cleansing current KRS insiders. It provides all Defendants an opportunity to defend by pointing fingers at KRS's fiduciary counsel, who approved or permitted this and the other fiduciary breaches alleged — yet is not even identified in the AIC, let alone named as a defendant, as it should be.

Ice Miller and Rudzik are named defendants in the Tier 3 Plaintiffs' complaint, while Eager and Fulkerson are identified as active wrongdoers whose breaches of duty were aided and abetted by the Defendants and who allegedly conspired and pursued an illegal common enterprise with Defendants. ***The Tier 3 Plaintiffs' complaint thus avoids imputation and the*** **in pari delicto** ***defense***, ***triggered by KRS/AG suing directly***, plus the risk of an interlocutory appeal. Although their alleged participation of these key KRS actors in key parts of the overall conspiracy and common enterprise were upheld by this Court or have been publicly alleged in verified complaints for years, ***none of their names even appear in the AG's AIC***.

The appearance of our former colleagues in the case in positions that seem and certainly feel adverse to the clients and claims we jointly represented (Mayberry Five) raises conflict issues.[16] These issues may be tractable — as long as they hew to a posture that avoids what would otherwise prove to be an intolerable and disabling conflict, *i.e.*, as long as they "stay in their lane." That lane has, for better or worse, been marked out by the Supreme Court, which held in effect that it makes no difference to Tier 1 and Tier 2 KRS members or beneficiaries whether dollars recovered in this case go to the KRS trust funds or to the Commonweal Treasury, because their benefits are protected in all events by the "Inviolable Contract." That this holding was made in the specific context of "constitutional standing" does not matter for present purposes; the holding is what the holding is. And as a result of that holding, one set of lawyers ***may*** (at least arguably) represent the interests of the Tier 1 and Tier 2 KRS members and the AG simultaneously.

But those lawyers ***cannot*** also represent or protect the interests of the Tier 3 Plaintiffs, none of whom has retained any of them. That is because of (1) the differences in retirement plan structure — the Tier 3 Plaintiffs' hybrid plan and its inclusion of the Upside Sharing Interest — and (2) the fact that the Tier 3 Plaintiffs' have no Inviolable Contract protection. It matters greatly to the Tier 3 Plaintiffs where the recovery goes — every dollar of damage that goes to the KRS trust funds benefits the Tier 3 members, while in contrast every dollar of damage directed by the Commonwealth to the State Treasury

[16] We have been told that when the AG hired four new law firms as private counsel without any RFP or public process, ***he agreed to exempt them from the statutory fee caps and other restrictions imposed on counsel retained by the AG under Kentucky law that were expressly relied upon by the Supreme Court in inviting the AG to come forward and prosecute the Commonwealth's taxpayer claims***. *Overstreet v. Mayberry*, 603 S.W.3d 244, 265–66 & n.99 (Ky. 2020) ("importantly, when the Attorney General turns to outside counsel to assert claims belonging to the Commonwealth, their relationship is governed by strict statutory procurement and oversight requirements").

hurts the Tier 3 members. In short, the Tier 3 members have unique interests, different from (but not in conflict with) Tier 1 and Tier 2 members, and divergent from (***and in conflict with***) those of the Commonwealth itself. Neither the AG nor his new private lawyers can represent these divergent interests.[17]

D. Structural Conflicts Require Separate Representation of the Tier 3 Plaintiffs' Claims

In a fundamental sense, the conflict among the claims here is structural. It is not waivable. The AG's charge is to "protect[] the interests of ***all the people***." *Commonwealth ex rel. Beshear v. Commonwealth Office of the Governor*, 498 S.W.3d 355, 363 (Ky. 2016). In contrast, Tier 3 members are entitled to "***sole interest***" protection. KRS § 61.650(1)(c). These standards are irreconcilable. While it may be in the best interests of the Commonwealth — of "all the people" — to direct some or all of the recovery to the State Treasury as the AG is bound to do, the legally protectable "***sole interest***" of the Tier 3 members demands something entirely different — *i.e.*, pursuit of the claims they assert for the ***sole benefit*** of KRS and its trust funds,[18] with that recovery going to the KRS pension and insurance trust funds alone (and with some portion then being allocated to retroactive increases to the Upside Sharing Interests of the Tier 3 members). The court dealt with a somewhat analogous conflict situation in *People ex rel. Sklodowski v. Illinois*, 642 N.E.2d 1180 (Ill. 1994). In that case, the conflict revolved around whether certain public pension funds would remain in the pension trusts or be

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[17] *See, e.g.*, KY. SUP. CT. R. 3.130(1.11, 1.07, 1.09).

[18] With constitutional standing, *i.e.*, $1 of harm — a "farthing" of injury — the Tier 3 members are legally entitled to seek "plan wide relief," "sweeping beyond their own injuries" and thus recover ***all damages suffered by KRS from Defendants unlawful conduct***, unincumbered by the Trustees' wrongdoing being imputed or *in pari delicto* being used to defeat the uniquely valuable claims they assert. *See* Tier 3 Pls.' Feb. 1, 2021 Br. at 15–26.

directed instead to the general state treasury. The attorney general sought — as attorney, not party — to represent both sides. The court recognized the "conflict between the interests of the State defendants (to divert the pension funds to other uses) and the responsibilities of the retirement systems (to regain financial stability in order to meet current and future pension obligations)." *Id*. at 1184. The court ultimately decided not to disqualify the attorney general, but only because (1) he was ***not*** appearing as a party;[19] and (2) was ***not*** attempting to "represent[] the interests of the *participants in and beneficiaries of* the five retirement systems" who were separately represented by private derivative counsel. *Id*. at 1184 (emphases in original). A separate opinion emphasized that the decision not to disqualify was largely driven by the presence in the case of derivative counsel.

> ***The derivative nature of the action … insures that the Attorney General's dual involvement will not compromise the interests of the participants and beneficiaries of the pension systems. Any remedy will come about because the issues are pressed by the representative plaintiffs, not the Attorney General.***

Id. at 1187.

Moreover, given the legal infirmities in the conflicts and claims the AG is trying to assert, he may perceive it to be in the best interest of the Commonwealth to settle earlier,

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[19] The important distinction between an attorney general's role as party and as attorney was likewise emphasized in *Granholm v. Mich. Pub. Serv. Comm'n*, 625 N.W.2d 16, 28–31 (Mich. Ct. App. 2000). ("[T]he Attorney General's unique status requires accommodation, not exemption, under the rules of professional conduct. … Thus, the precise and narrow question to be answered … is whether such accommodation should be extended to allow the Attorney General to appear in court on the one hand as a party litigant (and as counsel to herself), and on the other hand purport to function as legal representative of an independent executive agency that is an adverse party litigant. … [W]hen the Attorney General is an actual party to the litigation, independent counsel should be appointed to remedy the ethical impediment[.]").

and for some amount less than what might be achieved through maximal effort — but that would clearly not be a product of a "sole interest" analysis.[20] And, if the AG is the only party plaintiff left in the case, the Court itself could well be impaired in its oversight role unless the AG is required to bring any proposed settlement to the Court for an independent review and approval, including how any recovery is allocated.

E. There Is No Reason for Further Delay — the AG's Motion to File the AIC Should Be Denied

Circuit courts have broad discretion in deciding whether to grant or deny leave to amend pleadings. *Kenney v. Hanger Prosthetics & Orthotics, Inc.*, 268 S.W.3d 866, 869–70 (Ky. Ct. App. 2007) (affirming a denial of leave to amend the complaint because the circuit court did not abuse its discretion). In exercising this discretion, circuit courts "may consider such factors as the failure to cure deficiencies by amendment or the futility of the amendment itself." *Id.* at 869 (quoting *First Nat'l Bank of Cincinnati v. Hartman,* 747 S.W.2d 614 (Ky. Ct. App. 1988)). Furthermore, circuit courts should consider whether the proposed amendment "would prejudice the opposing party or would work an injustice." *Id. (*citing *Shah v. Am. Rubber Corp*., 655 S.W.2d 489, 493 (Ky. 1983)).

In the language of the intervention statute (CR 24.01), the interests of the Tier 3 Plaintiffs "relating to the property or transaction which is the subject of the action" are manifestly ***not*** "adequately represented by existing parties," *i.e.*, the Commonwealth/AG

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[20] This is a serious issue. As Professor Lemos has observed:

> Like class counsel, public attorneys have ample incentives to accept settlements that are quick and easy — and may be inadequate from the perspectives of both compensation and deterrence — rather than to fight tooth and nail to extract the largest sanctions possible. If anything, that tendency is exacerbated by the attorney general's duty to represent the public interest, an interest that will often conflict with that of the represented individuals.

Lemos, 126 HARVARD L. REV. at 491.

— precisely because the AG cannot elevate the Tier 3 Plaintiffs' "***sole interests***" above the competing interests of "***all the people***."

There is no reason for further delay. The Court should deny the AG's Motion to File the AIC and permit it to proceed on its complaint in intervention filed months ago on behalf of the Commonwealth, if it desires to do so. There is no reason to endure another cut and paste "do-over." The Tier 3 Plaintiffs' Motion to Intervene should be granted. They have standing. The AG cannot adequately represent their interests or prosecute their uniquely valuable statutory and trust-beneficiary claims. Their counsel are ready to prosecute these claims as laid out in the Motion for Pre-Trial Order No. 1 they filed some time ago. The Tier 3 Plaintiffs' uniquely valuable claims can be prosecuted alongside whatever direct claims the AG is asserting for the Commonwealth or KRS with coordinated/common discovery, under the Court's supervision. This will allow for ***separate***, ***adequate representation*** of the Tier 3 Plaintiffs' claims that are being asserted for the ***sole benefit*** of KRS.

While these separate claims carry significant legal differences and face different potential defenses, they all arise from a common factual matrix. Coordinated prosecution of competing even conflicting claims arising from common facts is far from unheard of in complex multi-party litigations involving billions of dollars, even where ultimately separate trials are necessary if the conflicts compel it. Any recovery on the Commonwealth's claims can go to the State treasury surplus fund. The recovery on the Tier 3 Plaintiffs' statutory/trust-beneficiary claims for KRS's sole benefit will go to KRS.

Separate claims are often coordinated for pre-trial proceedings, where clear conflicts that prevent consolidation and common representation. While the damages claimed in the competing claims may or may not overlap to some extent, in some respects

they are distinct. In any event, the Court can take appropriate steps to prevent any "double recovery" or vexation of the Defendants.

It is even possible to maximize the overall recovery for the competing plaintiffs asserting conflict claims in this manner. Defendants who have inflicted this carnage on a public pension fund covering some 400,000 beneficiaries have no right to be subject to one set of claims — only one lawsuit, for their convenience. And tools for the management of complex litigation are well documented. *See* MANUAL FOR COMPLEX LITIGATION (FOURTH) § 10.22, Coordination in Multi-Party Litigation (2012).

F. The Rules and Circumstances Permit the Tier 3 Plaintiffs to Intervene

KRS (and the AG) has strung this Court along for ***months***, delaying the case, spending $1.2 million for an "independent" internal investigation and Secret Report to determine what to do. KRS then voted ***to do nothing***. Its Board ***has not*** rescinded the Joint Notice. Its Board ***did not*** retain or authorize the AG to represent KRS or its funds to assert claims or its behalf. ***Its $1.2 million investigation of past wrongdoing in KRS investments apparently did not uncover a single additional wrongful act*** beyond those uncovered by the Mayberry Five's and their counsel's investigation as pleaded over the past three years in the FAC, proposed amended complaints and the Tier 3 Plaintiffs' current proposed complaint in intervention. After getting the Secret Report, the AG still copied 100% of the Tier 3 Plaintiffs' complaint's substantive allegations of wrongdoing while ***only eliminating allegations of wrongdoing by the current KRS CEO***, ***its most-important***, ***long-serving Trustee and previously sustained claims against its current fiduciary counsel in the 2015–2016 self-dealing***, ***conflict-laden transactions***.

What happened? Instead of relying upon and using this Secret Report, the AG should be investigating into the procurement irregularities surrounding the award of the investigation contract and the conduct of the "independent" investigation, as well as the writing of the Secret Report — all in a conflicted setting as detailed in the Tier 3 Plaintiffs' separate submission regarding Secret Report. $1.2 million has been wasted — used by current insiders to procure a Secret Report apparently clearing current insiders — to protect themselves and their allies. Something has gone terribly wrong.

There may be no perfect solution to the situation created by the Supreme Court's reliance on legal precedents decided ***after the FAC*** was filed to dismiss the otherwise perfectly valid claims asserted by KRS members for KRS's benefit in a "derivative" format, on a legal technicality, followed now by this waste of $1.2 million on a whitewash internal investigation and Secret Report under suspicious circumstances. The best solution is to deny the AG's motion to file its AG, let the AG prosecute whatever claims it is wishing to prosecute for the Commonwealth based on its original complaint in intervention, and let the Tier 3 Plaintiffs intervene to prosecute the uniquely valuable and already upheld claims that they assert now and the Mayberry Five (who support this endeavor) asserted earlier. In effect, we simply have to start over with plaintiffs with the "technical" standing and lawyers with the ability and experience to prosecute these claims in the vigorous, independent manner they deserve ***solely*** for the benefit of KRS. Justice has certainly been delayed by these events. Granting intervention of the Tier 3 Plaintiffs will assure that justice is not denied to KRS, its trust funds and its members and beneficiaries.

II. ARGUMENT

A. The Proposed Amended Intervening Complaint Shows the AG Cannot Adequately Represent the Interests of the Tier 3 Plaintiffs Individually, or in Obtaining Plan-Wide Relief for KRS and Its Members/Beneficiaries

The AG is seeking leave of court to file an AIC apparently attempting to assert claims for ***everybody*** — the Commonwealth (taxpayers) ***and*** KRS's pensions/trusts ***and*** its members/beneficiaries, including the Tier 3 Plaintiffs, ***who are already separately represented by private counsel***, pursuing a unique statutory cause of action (KRS § 61.645(15)(f)), as persons and KRS pension plan members, and claims as trust beneficiaries. Every single human being in, and public agency of, Kentucky.

When first entering the case the AG ***appeared for*** (***and only for***) ***the Commonwealth and sought only a recovery for the Commonwealth***, not for KRS. The AG sought to recover only the Commonwealth's — not KRS's — damages. Compare paragraph 1 of the AG's intervening complaint and paragraph 1 of the AIC and the respective prayers for relief, wherein the ***AG deliberately cut out the language about damages incurred by KRS***.[21] Now he wants to take over the whole case and assert all claims for everybody. But, the factual and legal conflicts between the Commonwealth's and KRS's competing claims and the Tier 3 Plaintiffs' uniquely valuable statutory and trust-beneficiary claims are disabling to any attempt by the AG to

[21] *Compare* AG's July 20, 2020 Intervening Compl. ¶ 1 (seeking "damages for the losses incurred by the Commonwealth") *with* AIC ¶ 1 ("The Commonwealth of Kentucky ("Commonwealth") brings this action … on its behalf and for the benefit of all its departments, commissions, agencies, political subdivisions, citizens, taxpayers, and pension plan beneficiaries of any and all tiers and classifications who may seek to assert the Commonwealth's claims derivatively, to recover damages for the Defendants' breach of certain fiduciary duties and aiding and abetting in the breach of fiduciary duties, which have combined to cause financial injury to the Commonwealth, its departments, commissions, agencies, political subdivisions, citizens, taxpayers, and all pension plan beneficiaries[.]").

simultaneously prosecute both the Commonwealth's broad claims for everybody with any recovery to go to the State Treasury surplus fund ***and*** the Tier 3 Plaintiffs' claims seeking recovery for the ***sole benefit*** of KRS and its trust funds.

To further complicate matters, the AG hired three law firms that formerly represented the Mayberry Five about whom they are ***irrefutably presumed*** to know and/or possess sensitive, confidential and private information. They have been retained to represent clients (*e.g.*, AG/KRS and apparently the Tier 3 Plaintiffs as well while taking on or will soon take on positions adverse to their prior clients and positions they previously advanced and were advocated for by them. This raises questions as to duties of loyalty and misuse of confidential information obtained, not merely in a prior matter substantially related to a new matter, ***but in the same case***. Potential representational conflicts abound.[22]

But setting aside these representational issues for now, there are other problems with the AG usurping the claims asserted by the Tier 3 Plaintiffs and representing them. The AG's complaint has ***not yet faced a legal challenge*** on any of the many grounds that can be urged to seek dismissal of his complaint. ***None*** of the damage, causation and

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[22] The Mayberry Five do not concede they lack Constitutional standing. They do not desire to re-litigate the point ***the Mayberry Five remaining parties to the case with their right to appeal the denial of their motion to file an amended complaint still extant***. This Court never said they did not have constitutional standing, rather that their standing facts had not been timely pleaded. *See* Nov. 30, 2018 Opinion & Order at 10–11. Then exercising its discretion, the Court declined to permit them to amend to assert their "standing" facts. *See id.* They continue to maintain they have constitutional standing and their request for leave to amend should have been granted. ***They still have legal interests at stake in this proceeding***.

Because the Tier 3 Plaintiffs and Mayberry Five just learned the AG hired these law firms that previously represented the plan members' unique statutory and trust-beneficiary claims that they now seek to block or terminate, they both reserve their right to seek relief from or a remedy for this possible breach of duty of loyalty to former clients. *See* KY. SUP. CT. R. 3.130(1.9) ("Duties to former clients").

legal theories asserted by the AG for the Commonwealth have been tested. No one knows which of those legal claims are viable as to which defendant or ***which***, ***if any***, ***of the claimed damages for the Commonwealth are*** "***ripe***," *i.e.*, "***justiciable***." Caution should be exercised in relying on the AG AIC's legal viability for the claims he asserts for the Commonwealth.

KRS is positioned differently than the Commonwealth. KRS (and its members/beneficiaries) had fiduciary and trust relationships with Defendants. All Defendants owed them substantial legal duties. Whether Defendants owed those same duties to the Commonwealth is disputed and has yet to be determined.[23] ***There is no reported case where the state***, ***on behalf of taxpayers***, ***has successfully pursued third parties using the fiduciary duty***, ***aiding/abetting***, ***common enterprise***, ***and conspiracy theories available to the Tier 3 Plaintiffs suing for the benefit of KRS***. In fact, when the Commonwealth tried to do so in a similar fact pattern in *Sandoz Inc. v. Commonwealth*, the Commonwealth's claims were barred as a matter of law by an *in pari delicto* defense, because there, as here, the Commonwealth was actively involved in, part of and clearly aware of the illicit conduct and actually benefited, at least in the short-term, from the core wrongdoing. *See* 405 S.W.3d 506, 511–12 (Ky. Ct. App. 2012) (finding that "the Commonwealth was fully aware of the practices [at issue in the action]" and "was entirely complicit in [the allegedly fraudulent] system of pricing").

The Tier 3 Plaintiffs are situated differently from the AG/Commonwealth with separate interests and legal rights as well. Because the Court denied Defendants' motion

[23] The Hedge Fund Sellers and others argued they owed the Commonwealth no fiduciary duty during the 2018 motion-to-dismiss proceeding. The Court did not address the issue.

to dismiss the legal claims asserted earlier by the Mayberry Five that the Tier 3 Plaintiffs seek to continue to prosecute, we know those unique statutory and trust-beneficiary claims ***asserted by KRS plan members who are*** "***persons***" (*i.e.*, the Mayberry Plaintiffs first and now the Tier 3 Plaintiffs) are powerful claims for breach of fiduciary duty, breach of trust, aiding and abetting, common enterprise and conspiracy, including ***direct*** breach-of-fiduciary duty claims against the advisors and hedge fund sellers, that can yield punitive damages. *See* Nov. 30, 2018 Opinion & Order at 32–33.

The goal of the Tier 3 Plaintiffs is to maximize the recovery for the KRS pension/trust funds, not the Commonwealth's general surplus fund. Importantly, because the Tier 3 Plaintiffs' claims are asserted by plan members in a "derivative" format under § 61.645(15)(f) and as trust beneficiaries ***for the benefit of KRS and not asserted directly by the entity*** — they are not subject to being defeated or even defended — by "***imputing***" the wrongful conduct of the KRS Trustees and Officers or being barred by *in pari delicto* — defenses which the AG's AIC seems to invite, if not admit, by actually ***naming former KRS officials as defendants in a direct action by KRS*** who the AG claims to represent.

1. The AG's Legal Conflicts

To the extent the AG's claims for the Commonwealth survive motion practice and are actually prosecuted, ***unique defenses*** to these claims will occupy the AG. Dealing with them will prejudice any vigorous concurrent prosecution of claims for KRS or the claims asserted by the Tier 3 Plaintiffs for the benefit of KRS. Countering these defenses will require them to ***focus on defending the Commonwealth's past conduct to avoid the* in pari delicto *defense***. *Sandoz*, 405 S.W.3d at 512 (holding that "the Commonwealth's actions were *in pari delicto* with [defendants]").

Attorney generals also face their own "standing" barriers when suing for their states. "A claim is not ripe for adjudication if it rests upon contingent events that may not occur as anticipated or indeed may not occur at all … [it is] too speculative whether the problem Texas presents will ever need solving." *Texas v. United States*, 523 U.S. 296, 300, 302 (1998). The Attorney General will also have to establish that any damages claimed by him for the Commonwealth are "***ripe***," *i.e.*, actual damages presenting a "***justiciable***" claimed, as opposed to ***future*** damages, contingent on unknown events that may never occur. *See* Tier 3 Pls.' Feb. 1, 2021 Br. at 40–45.

While the Commonwealth has made financial contributions into KRS in the past (the Annual Required Contribution "ARC") — those contributions ***were required by law***, ***not caused by***, ***Defendants' alleged misconduct***. ***The Commonwealth knew that the payments made were inadequate***, ***less than the law required***, ***and were actually contributing to KRS's financial decline***. Nevertheless the Commonwealth continued to deny the legally required funding. How those legally deficient payments (which impaired KRS's trust funds' finances and induced the risky, super-expensive and destructive Black Box investments that pushed KRS over the edge) damaged the Commonwealth has not been pleaded remains to be determined.

What ***actual*** damage — what current "***justiciable***" damage claim "***ripe***" for adjudication — has the Commonwealth suffered? ***Nothing specific is alleged in the AIC***. It seeks to disgorge and recover excessive hedge fund fees, ***but those fees were paid by KRS out of its trust funds by or on behalf of its members***, ***including the Tier 3 Plaintiffs***, ***not the Commonwealth***. Whatever payments the Commonwealth made into KRS were what was then required by law. The Commonwealth has not yet been called upon to pay anything — not one penny — to KRS or any KRS

member or anyone else based on its inviolable contract obligations and the ***AG's AIC does not allege otherwise***.

Concurrent pursuit of past "hard" damages (like those suffered by KRS and sought to be recovered for its benefit via the Tier 3 Plaintiffs' unique statutory and trust beneficiary claims) and future "soft" or "contingent" damages (like the ones the AG alleges for the Commonwealth) by common representation ***creates a disabling conflict***. The United States Supreme Court in *Amchem Products, Inc. v. Windsor*, 521 U.S. 591 (1997), noted "***these factual differences***" translate into "***significant legal differences***" and mandated that claims of current damage and future damage claimants, which ***are fundamentally different***, ***require separate representation to insure adequate representation***. *See id.* at 609. This reasoning compels that the Tier 3 Plaintiffs be permitted to intervene to assure ***separate***, ***adequate*** representation of their own interests and their unique statutory and trust-beneficiary claims, where 100% of any recovery will go ***exclusively*** to KRS for the ***sole*** benefit of its funds and its member/beneficiaries. *See, e.g.*, *Trbovich v. United Mine Workers of Am.*, 404 U.S. 528, 538 n.10 (1972) ("[t]he requirement of [Rule 24] is satisfied if the applicant shows that representation of his interest '***may be***' inadequate; and ***the burden of making that showing should be treated as minimal***").

The issue of damages yields a further conflict as to what the AG does with any recovery he obtains. Whenever the AG "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 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. Those monies must go into the "general fund surplus account" (KRS § 48.005(4)) and thus become

available to elected officials to pay general obligations of the Commonwealth. Those funds are not protected and segregated trust funds recovered on behalf of KRS. Any recovery on damage claims being asserted on behalf of and for the benefit of KRS will be an asset of KRS — "trust funds to be held and applied solely" for the benefit of KRS and its members. *See* Tier 3 Pls.' Compl. ¶¶ 222–223; KRS § 61.515. Those litigating the claims for the benefit of KRS and their lawyers have fiduciary duties to KRS to maximize the value, *i.e.*, recovery for the KRS funds and its beneficiaries, not the Commonwealth's "surplus account." ***The AG has never addressed this conflict or explained how it or the Court has discretion to circumvent KRS §§ 48.005(3) or 61.515. This is not addressed in the AIC, or in any filing in support of the filing of the AIC because the AG made none***.

2. The AG's Factual Conflicts

Regardless of whether or not the AG can properly represent KRS, or can usurp and assert the Tier 3 Plaintiffs' unique statutory or trust-beneficiary claims for the sole benefit of KRS, or the Commonwealth has suffered any "ripe" damages, or how the AG will deal with the statutory directive to put any recovery obtained in the Commonwealth's general "surplus fund" — the AG still faces the serious unavoidable factual dispute — conflict — ***of just whose fault it is that KRS has been so badly damaged***.

Who "caused" — contributed to causing — the damages to KRS? Defendants will continue to argue that the primary reason KRS failed was not their selfish misdeeds in exploiting and assisting the Trustees' breaches of their duties, but rather because the Commonwealth for many years deliberately underfunded KRS, ***despite formal requests and public pleas for more funds*** — for the Commonwealth to comply with its legal and funding obligations. The Commonwealth's actions clearly contributed to damaging the financial condition and impaired the financial future of the KRS funds and

resulted in the Trustees falling into the hands of Wall Street predators who enticed them to take excessive risks — desperately to try to make up for the funding shortfall the state caused, including agreeing to invest in the Black Boxes leading to the "death spiral" fiasco KRS is trapped in today.[24] These facts are not going away. They yield utterly inconsistent narratives. The AG cannot ride all these horses — a troika — pulling in different directions at the same time.

Based on this factual reality, Defendants will likely assert that the Commonwealth is subject to **in pari delicto *defenses not applicable to the claim asserted by the Tier 3 Plaintiffs***. In *Sandoz*, 405 S.W.3d 506, the court overruled two jury verdicts and ***took away*** a multi-hundred-million-dollar recovery for the Commonwealth (which included punitive damages) in a suit brought by the AG against drug companies who ***conspired*** to cheat and lie about drug prices ("AWP") to obtain and profit from higher reimbursements from state programs. However, the miscreant drug companies proved state officials' "***knowledge that*** [***the drug prices***] ***were inflated***" and the Court of Appeals said this was "***the real crux of this case***," concluding (*id*. at 511–12):

> States across the nation were aware that pharmaceutical companies were reporting bloated AWPs. Further, ***the Commonwealth itself commissioned a private study of AWP and discovered that AWP was significantly inflated .... Despite this information***, ***the Commonwealth chose not to implement the suggested reimbursement reductions .... Clearly***, ***the Commonwealth was aware that AWPs were not the actual prices paid for generic drugs***. ***In light of this fact***, ***it is wholly untenable for the Commonwealth to now claim millions of dollars in compensatory***

[24] Defendants have been asserting an "it's the State's fault" defense from the outset. *See* RVK Motion to Dismiss ("For 12 out of the last 17 years, the state has appropriated less money than requested by the Board of Trustees to adequately fund the annual required contribution."). KKR's counsel argued "It[']s been under-funded for twelve [of] the last 17 years quoting state officials" — "We should own up to the fact that we've underfunded KRS for 12 years."

> ***damages for harm caused by the false or fraudulent reporting of AWPs to price publishers***.
>
> ***Because the Commonwealth was fully aware of the practices in the industry with respect to AWP***, ***there can be no causation of damages***. ***Frankly***, ***it is appalling that the Commonwealth had actual knowledge of this*** "***shell game***" ***method of pricing employed by the drug companies***, ***the wholesalers, and the pharmacists***. ***However***, ***even more appalling is the fact that***, ***in spite of that knowledge***, ***it acquiesced***, ***billed accordingly***, ***and now seeks reimbursement by way of compensatory and punitive damages***.
>
> ***The Commonwealth was entirely complicit*** in this system of pricing … basic equitable principles also prohibit the Commonwealth from recovering. In situations such as the present one, where a party's actions are *in pari delicto* with the tortfeasor, recovery is barred by the principles of equity. … Here, the Commonwealth's actions were *in pari delicto* with the drug companies and other players in the Medicaid reimbursement scheme — a scheme in which the Commonwealth systematically participated by submitting those same figures to the federal government as true and accurate.

The Commonwealth was also entirely complicit in the collapse of KRS. So were the KRS officials, whom the AG ***has actually named as defendants***, ***in direct claims it asserts***. The Defendants will have a wealth of evidence to support this uncomfortable factual narrative. Given this *Sandoz* opinion, Defendants will pursue the causation and *in pari delicto* defenses *Sandoz* recognizes because of the State's knowledge and deliberate underfunding of KRS and diverting funds due KRS to the other priorities they favored or had to fund. Given that the AIC actually names former KRS officials as ***defendants*** in claims by KRS, this defense could well metastasize to poison KRS's claims which the AG claims to represent and whose claims it purports to assert. ***These defenses are especially dangerous since the Commonwealth's claims are being asserted directly by the AG and not in a*** "***derivative***" ***format by***

innocent plan members for the benefit of KRS as permitted by KRS § 61.645(15)(f) and trust-beneficiary law. These defenses unique to the Commonwealth's claims and KRS's direct claims will pollute the prosecution by the AG of the KRS claims directly by the AG.

Restatement (Third) of Trusts § 107 allows the beneficiaries to sue not only when the trustee is unable or unwilling to sue, but also when the trustee is "unsuitable" as the plaintiff: "A beneficiary may maintain a proceeding related to the trust or its property against a third party … if … the trustee is ***unable***, ***unavailable***, ***unsuitable***, ***or improperly failing to protect the beneficiary's interests***."

The Tier 3 Plaintiffs' ***uniquely valuable*** claims are different ***in quality*** — *i.e.*, their ability to actually recover ***in a trial setting*** the damages (and punitive damages) caused to KRS by Defendants' misconduct. To appreciate the unique quality of the Tier 3 Plaintiffs' claims on behalf of KRS, one must factor in the issue of "***imputation***." Litigation in derivative format, *i.e.*, claims asserted by one person for the benefit of another person or entity, exists because of the need to protect the rights of legal entities and their innocent members/shareholders damaged by fiduciary misconduct by insiders, *i.e.*, Trustees, Officers and third parties who assist or conspire with them in stealing from or damaging the entity. The entity cannot sue directly as the conduct and knowledge of the entity's governing officials — Trustees/Officers — ***are imputed to the entity under agency principles***. The fact they were "in on it" claims against third parties who were aiding and abetting the insiders' misconduct, conspiring with and/or pursuing a common enterprise with them.

By permitting innocent stockholders/members to assert the claims like those provided by § 61.645 and analogous common law, as well as trust-beneficiary law — in a "derivative format" — independently from the wrongdoers who control or influence the

derivative entity and were participants in the wrongdoing — the "derivative plaintiffs" avoid ***imputation*** and any *in pari delicto* defense. ***Kentucky follows the non-imputation doctrine***. *See Wilson v. Paine*, 288 S.W.3d 284 (Ky. 2009). In *Wilson*, the Supreme Court denied imputation of the knowledge of corporate insiders to time-bar a corporate claim asserted "derivatively" on behalf of the insolvent entity, the bankruptcy trustee (*see id*. at 287–88):

> The doctrine of adverse domination has not heretofore been considered by this Court, but has been widely applied by federal courts in cases involving corporate causes of action against directors and officers.
>
> The doctrine is rooted in the long-established principles of agency law. Adverse domination is premised on the notion that knowledge is not imputed if the agent is acting in a manner adverse to the interests of the principal. This rule is consistent with Kentucky agency law. ... Thus, "[t]he knowledge of the agent is the knowledge of the corporation he serves when the knowledge relates to some matter over which the agent has control and with which his duties are connected and when they relate to matters over which he has authority ...." ... In the corporate context, the corporation is the principal and the board of directors as a whole is the agent. ***When the board of directors is accused of breaching its duty to the corporation***, ***it necessarily is accused of acting adversely to the principal's interests***.

The non-imputation doctrine bars wrongdoing corporate Directors/Trustees and those who aid and abet or conspire with or pursue a common enterprise with them from using the complicit acts and knowledge of the Trustees or Directors to defeat claims asserted in a ***representative manner***, ***i.e.***, ***derivatively***, via an *in pari delicto* defenses or otherwise. While an *in pari delicto* defense for third-party service providers is recognized in a minority of jurisdictions when they are only accused of negligence, *i.e.*, malpractice, ***nowhere is the defense available to fiduciaries or to third-party wrongdoers who aided and abetted***, ***conspired with or pursued a common enterprise with the Trustees***, and the claim is being pursued in a derivative format.

See Stewart v. Wilmington Trust, 112 A.3d 271, 319 (Del. Ch. 2015) ("Delaware law sets aside *in pari delicto* when a receivership trustee or derivative plaintiff seeks to sue the corporation's fiduciaries for breach of their fiduciary duties"; Therefore, "claims against [banks and auditors] for aiding and abetting breaches of fiduciary duty" not barred by *in pari delicto*."), *aff'd* 126 A.3d 1115 (Del. 2015); *Am. Int'l Grp., Inc. v. Greenberg*, 965 A.2d 763, 828 n.246 (Del. Ch. 2009), *aff'd* 11 A.3d 228 (Del. 2011) ("[A]lthough the behavior of faithless fiduciaries is imputed to the corporation when the corporation faces liability to innocent third-parties … [,] [***t***]***his of course, has never prevented the corporation*** [***itself***] ***from recovering against those faithless fiduciaries in a derivative suit***"); *Official Comm. of Unsecured Creditors v. Pricewaterhousecoopers, LLP*, 989 A.2d 313 (Pa. 2010) (misconduct of insiders not imputed to corporation; *in pari delicto* defense not available if third party acts in bad faith); *NCP Litig. Trust v. KPMG, LLP*, 187 N.J. 353 (2006) (same, even if third party is only negligent); *FDIC v. O'Melveny & Myers*, 61 F.3d 17 (9th Cir. 1996) (same); *Merrimack Coll. v. KPMG LLP*, 480 Mass. 614 (2019) (same, with widespread and informative discussion of imputation). ***Imputation or*** **in pari delicto** ***will not apply to the claims asserted by the Tier 3 Plaintiffs for the benefit of KRS because they are asserted*** "***derivatively***" (*i.e.*, for the benefit of KRS) and authorized by statute and common law. ***To the extent the AG asserts claims for KRS directly***, ***the bad conduct of KRS officials it actually named as Defendants will be attributed to KRS and bar those claims***.

In order to ***adequately and effectively*** advocate for any claims for the sole benefit of KRS it will likely be necessary for counsel asserting those claims to argue that the Commonwealth's elected officials ***diverted funds due to KRS and failed to make the legally required annual contributions to fund other priorities they***

favored. ***The actions of the Commonwealth denied KRS the funds it needed***, ***and which had they been paid in a timely manner would arguably have avoided KRS's current*** "***death spiral***."

Arguing to a fact finder the Commonwealth is a ***victim*** of Defendants' alleged wrongdoing entitled to recover damages for a disaster ***it helped cause*** seems uncomfortably inconsistent with arguing KRS was denied the state funding required by law which contributed to its increasingly underfunded status and led to its exploitation by the Hedge Fund Sellers. Only the Tier 3 Plaintiffs with unique claims immune from imputation and *in pari delicto* defenses — with separate counsel — are positioned to credibly make that argument to the fact finder.

It is unfortunate that the AG has opted for a power grab rather than attempt to construct a cooperative public/private prosecution that could maximize the Commonwealth's and the Tier 3 Plaintiffs' unique claims' strengths, while recognizing their conflicts and competing interests. If the Tier 3 Plaintiffs are permitted to intervene to continue to prosecute the previously sustained § 61.645(15)(f) and trust-beneficiary claims to recover damages solely for the benefit of KRS, alongside the prosecution of the direct KRS/Commonwealth claims by the Attorney General and his outside counsel, nature may take its course, necessity may become the mother of intervention and concurrent pursuit of competing claims yet lead to the largest overall recovery for the good of Kentucky.

The Tier 3 Plaintiffs and their counsel reiterate their willingness to try to work with the AG to effectively coordinate the prosecution of competing claims ***if*** the AG will respect the separateness of the claims (Commonwealth ***versus*** Tier 3 ***versus*** KRS) ***and the private plaintiffs' separate role in the case using their privately retained counsel***. That is the counsel they (and their predecessors, the Mayberry 5) retained to

investigate the case, draft the FAC (which the AG largely copied in intervening) and now again in crafting its AIC which ***contains zero new facts or work product despite a $1.2 million investigation*** — in other words, counsel whose work product has been unilaterally appropriated by the AG in both its original and AIC.[25] As KRS itself has acknowledged in the Joint Notice, the work of the Tier 3 Plaintiffs' counsel has been outstanding. Their efforts to date have already conferred a ***substantial benefit*** on KRS and the Commonwealth and created the launchpad for the AG's new outside counsel to try to move forward as best they can, given the obvious infirmities in the claims they will prosecute. The continued involvement of the lawyers who conceived and started the case — and created the launch pad — will benefit all concerned, except the Defendants.

3. The AG's Representation Conflicts

As noted above representational conflicts are evident. They could also be disabling. The ***only way*** those issues may be avoided at least for now is for the representation of those law firms to be ***restricted*** to the claims properly assertable by the AG and for them to take no action adverse to their former clients and not use any confidential information obtained in the prior representation — assuming the latter restriction can somehow be enforced. *See Bowers v. Ophthalmology Grp.*, 733 F.3d 647 (6th Cir. 2013) (disqualifying counsel for Ophthalmology Group from representing group against former partner of the group because of "substantial risk that confidential factual information as would normally have been obtained in the prior representation") (quoting

[25] It is said that "imitation is the highest form of flattery." Given the shameless appropriation and copying of the Tier 3 Plaintiffs' counsels work product in the AIC — including their graphics, charts and theories, economic and historical presentations we are very flattered, but the Tier 3 Plaintiffs are unwilling to turn over the prosecution of their uniquely valuable claims to copycat imitators who specialize in cut-and-paste productions.

KY. SUP. CT. R. 3.130 (1.9 Cmt. 3); *see also Gen. Elec. Co. v. Valeron Corp.*, 608 F.2d 265, 267 (6th Cir. 1979) (disqualification of lawyer who "had access to the files on [the clients]").

> ***A lawyer's duty of absolute loyalty to his client's interests does not end with his retainer. He is enjoined for all time, except as he may be released by law, from disclosing matters revealed to him by reason of the confidential relationship. Related to this principle is the rule that where any substantial relationship can be shown between the subject matter of a former representation and that of a subsequent adverse representation, the latter will be prohibited.***
>
> This salutory principle is summed up in Canon 6 of the Canons of Professional Ethics adopted by the American Bar Association, which, in part, provides:
>
> "The obligation to represent the client with undivided fidelity and not to divulge his secrets or confidences forbids also the subsequent acceptance of retainers or employment from others in matters adversely affecting any interest of the client with respect to which confidence has been reposed."
>
> * * *
>
> To compel the client to show, in addition to establishing that the subject of the present adverse representation is related to the former, the actual confidential matters previously entrusted to the attorney and their possible value to the present client would tear aside the protective cloak drawn about the lawyer-client relationship. For the Court to probe further and sift the confidences in fact revealed would require the disclosure of the very matters intended to be protected by the rule. It would defeat an important purpose of the rule of secrecy — to encourage clients fully and freely to make known to their attorneys all facts pertinent to their cause. Considerations of public policy, no less than the client's private interest, require rigid enforcement of the rule against disclosure. No client should ever be concerned with the possible use against him in future litigation of what he may have revealed to his attorney. Matters disclosed by clients under the protective seal of the attorney-client relationship and intended in their defense should not be used as weapons of offense. The rule prevents a lawyer from placing himself in an anomalous position. Were he permitted to represent a client whose cause is related and adverse to that of his former

> client he would be called upon to decide what is confidential and what is not, and, perhaps, unintentionally to make use of confidential information received from the former client while espousing his cause. Lawyers should not put themselves in the position "where, even unconsciously, they might take, in the interests of a new client, an advantage derived or traceable to, confidences reposed under the cloak of a prior, privileged relationship." In cases of this sort the Court must ask whether it can reasonably be said that in the course of the former representation the attorney might have acquired information related to the subject of his subsequent representation. If so, then the relationship between the two matters is sufficiently close to bring the later representation within the prohibition of Canon 6.

T. C. Theatre Corp. v. Warner Bros. Pictures, Inc., 113 F. Supp. 265, 268 (S.D.N.Y. 1953). These time-honored principles remain true today. *See Webb v. E. I. Du Pont de Nemours & Co.*, 811 F. Supp. 158, 161 (D. Del. 1992) (former client "not required to show that during the earlier representation it disclosed matters to the attorney related to the instant case"); *Battaglia v. Nat'l Life Ins. Co.*, 2005 WL 101353 (S.D.N.Y. 2005) (not allowed to "switch sides"); *DeFazio v. Wallis*, 459 F. Supp. 2d 159, 165 (E.D.N.Y. 2006) ("irrebuttable presumption that confidences were shared"); *Kaplan v. Emerson Radio Corp.*, 1991 U.S. Dist. LEXIS 3520 (E.D.N.Y Mar. 14, 1991) (attorney who had prior attorney-client relationship with corporate defendant disqualified from bringing shareholder derivative case on behalf of corporation; "[a]lthough a shareholder derivative action can be conceived as not being adverse to the interests of the corporation, plaintiff seeks to force Emerson to take steps that it would not otherwise take").

The AG and his new outside counsel deal with these apparent conflicts ignoring them, hoping the Court and others will as well. It may be that because of the Commonwealth's obligation to guarantee all the pension benefits of the KRS Tier 1 and Tier 2 members, it does not matter to KRS whose pocket any recovery goes into, as the Commonwealth is supposedly on the hook for those benefits no matter what happens. So

despite different legal rights, factual situations and damages, and defenses, they treat KRS and the Commonwealth as one entity, which either agreed or not agreed to divide whatever recovery comes the AG's way on some yet-to-be-disclosed but one presumes ***before the respective legal and factual claims of both*** "***clients***," ***i.e.***, ***KRS and the Commonwealth***, ***have been tested by motion practice***, ***discovery***, ***defense attacks or trial***. The AIC does not state how whatever is obtained will be split – indeed if any of the recovery will go to KRS. Since the AG did not file a supporting memorandum, much remains unclear. Has KRS hired the AG retained it — empowered it — consented to it — representing KRS or is this a unilateral usurpation of KRS's legal claims.

It is entirely possible that as the AIC is pleaded KRS will not ***get a single penny from any recovery in the AG's action*** with 100% of the money going to the Commonwealth's general surplus fund — which the law appears to require — ***leaving KRS in its current distressed financial condition*** — the "***death spiral***". If and when KRS's funds fail, the Commonwealth supposedly will pick up the tab. One can only try to imagine how much dislocation, political angst and huge agency costs that would entail. ***Certainly a huge recovery now directly to and solely for KRS would be a better outcome an outcome***, ***achievable only through the Tier 3 claims on behalf of and for the sole benefit of KRS and its pension funds and members***.

The Tier 3 Plaintiffs, as well as the uniquely valuable claims they are asserting ***solely*** for the benefit of KRS and its members and beneficiaries, must not be swept into a conglomeration of conflicting and competing claims, which will compromise their effective prosecution — especially where those claims are to be prosecuted by lawyers who formally represented KRS plan members who asserted claims under § 61.645(15)(f) and as trust beneficiaries and advocated in favor of these claims — both procedurally and

substantively. ***The only way the AG and its new outside counsel can avoid disabling conflicts is to refrain from representing the unique legal claims asserted by the Tier 3 Plaintiffs***. The unique claims asserted by the Tier 3 Plaintiffs for the exclusive benefit of KRS simply cannot be ***adequately represented*** by KRS/AG or their outside counsel under these circumstances.

Who gets what from whatever can be extracted from the wrongdoers matters to the Tier 3 Plaintiffs because none of their benefits, ***vested or are otherwise*** are guaranteed by the Commonwealth. They ***have already suffered losses*** in their current account balances and to their final pension benefits due to the Defendants alleged misconduct including excessive fees. *See* Tier 3 Pls.' Compl. ¶¶ 10–15, 18, 77–79, 82–85, 86–95; Tier 3 Pls.' Feb. 1, 2021 Br. at 9–15. They seek to recover every possible dollar of damage for the benefit of KRS and KRS ***solely***. They do not care about the taxpayers or the Commonwealth's general surplus fund — at least not near as much as they care about their impaired, diminished, threatened and unguaranteed pension accruals. They seek and are entitled to "plan-wide relief" "sweeping beyond their own injury harm," so that KRS's common trust funds, in which they are, ***will get 100% of the benefit of any recovery*** on the claims they assert and the recovery will "trickle down" (so to speak) to their unique hybrid cash balance individual retirement accounts. That can only happen if they obtain plan-wide relief/damages. They want to prosecute their unique claims — ***not subject to imputation of Trustee misconduct or an*** **in pari delicto** ***defense*** — and obtain a recovery pursuant to § 61.645(15)(f) and/or as trust beneficiaries ***undiluted by any obligations to share the recovery on these claims with anyone else*** — claims that ***only they can assert*** for the exclusive/sole benefit of KRS.

B. Any Attempt by the AG/KRS to Act Inconsistently with KRS's Judicially Filed Endorsement of the Assertion of the Claims Asserted by the Tier 3 Plaintiffs for KRS's Benefit Is Barred by the Equitable Doctrine of Judicial Estoppel

Shortly after this litigation was originally filed in late 2017, the Court asked KRS to carefully consider and then state its position on the newly filed case asserting claims on its behalf. In response KRS's Board of Trustees reviewed the FAC's ***detailed allegations of wrongdoing by KRS's Trustees and their assistors in the FAC***. This involved an extensive presentation to a KRS Board "Special Litigation Committee" by Plaintiffs' counsel, conducted by the Board with the assistance of its counsel Stoll Keenan. ***There was an internal KRS investigation***, then ultimate consideration by the full Board and its outside general counsel. This process resulted in the filing of the Joint Notice between KRS and Plaintiffs with the Court in early 2018. This filing was ***authorized by the KRS Board of Trustees represented by separate counsel***. ***That filing endorsed the prosecution of the claims by KRS plan members through private counsel***, ***who had investigated the claims***, ***drafted 95% the FAC***, ***and agreed to fund the presentation of the claims and work on a contingent fee basis***.

> The Joint Notice stated ***to the Court***:
>
> Since this action was filed, Kentucky Retirement Systems ("KRS") has established ***an independent special litigation committee of the Board of Trustees to investigate*** and consider the claims asserted in Named Plaintiffs' Amended Complaint, and determine what role KRS should take in this litigation, including whether KRS should directly assert the claims advanced in the Amended Complaint. Based upon the work of the special litigation committee, and for the reasons set forth below, KRS has determined that, at this time, KRS: (1) will not pursue the claims asserted by Named Plaintiffs; (2) would not have been in a position to pursue those claimshad they been brought to KRS prior to the filing of the Complaint or the Amended Complaint; and (3) believes that it is in the best interests of

KRS for Named Plaintiffs to continue their pursuit of these claims on a derivative basis on KRS's behalf.

... KRS Trustees have expended diligent and significant efforts to ... investigate prior conduct at the Funds including, ***investigating the merits of the claims made by Named Plaintiffs in this litigation***, including specifically whether KRS can undertake the claims made herein and whether the best interests of KRS would instead be served by Named Plaintiffs' pursuit of the claims with their counsel of record.

Based on the investigation by the independent special litigation committee and the information currently available to it, the derivative claims made by Named Plaintiffs appear to have merit and should proceed to discovery under the civil rules. The amount in controversy in the Amended Complaint is substantial and, if recovered, could have a significant impact on the financial well-being of KRS and its member employees and retirees. The nature of the claims, however, is not typical of litigation a corporate board or state agency could easily authorize at this stage or pursue. Litigation of the nature and scope brought by Named Plaintiffs and their counsel is likely to be very expensive and time consuming. ... [I]t would be extremely onerous for KRS to maintain these claims by itself. KRS believes that there would be significant risk to KRS shouldit undertake to pursue these, or similar, claims on its own, especially in the form of costs of litigation and devotion of limited KRS time and resources without the certainty of recovery.

***

KRS believes that counsel for Named Plaintiffs are highly skilled, having specialized experience in cases of similar scope and magnitude, are highly motivated, and, as a result, are capable of handling litigation of this nature. In the derivative format, Named Plaintiffs and their counsel will bear the primary risk of litigation costs and time necessary to pursue these claims without undue expense to KRS, while providing a substantial potential recovery that would directly benefit KRS.

***

Named Plaintiffs are members and beneficiaries of one or more KRS pension plans and have been during the time period of alleged wrongdoing as set forth in the First Amended Complaint ("FAC") filed January 12, 2018. Based on KRS's observations and the investigation of the independent special litigation committee, KRS believes that Plaintiffs are

appropriate and adequate representatives for KRS and they are qualified to prosecute the derivative claims herein on behalf of KRS through their counsel of record.

KRS recognizes that there may be risks to it in the pursuit of these claims, even on a derivative basis, including, but not limited to, the unavoidable costs of litigation, even as a nominal defendant, the costs of counsel for former board members, officers, and employees (which KRS is statutorily obligated to pay). Despite these risks, KRS is persuaded based upon the information available to it, that the potential rewards of this litigation, in which billions of dollars are sought on behalf of KRS and its member retirees and state employees, justify pursuit by Named Plaintiffs of their claims.

This is especially true when viewed in light of the fact that Named Plaintiffs have capable and experienced counsel who have themselves undertaken much of the time, risks, and costs associated with such litigation.

KRS notes that several Defendants have raised the issue of Named Plaintiffs' standing to pursue their derivative claims to the ultimate benefit of the seriously underfunded KRS pension and insurance obligations, and KRS's members. Based on Named Plaintiffs' vigorous prosecution of this case to date, their retention of highly qualified counsel, and their status as respected members of KRS, ***as well as KRS's own inability to pursue these claims directly***, KRS acknowledges that Named Plaintiffs have standing to maintain this action and are currently acting in the best interests of KRS. KRS has considered the possibility that Named Plaintiffs' action could be dismissed on standing grounds. Although KRS disagrees with that possibility, KRS reserves all rights which might then be available to it, including to step into the shoes of theNamed Plaintiffs and directly pursue such claims should the Named Plaintiffs' claims be dismissed on standing grounds and should KRS then determine that it is in its best interests to do so. Should KRS take such action, under established law, KRS and Plaintiffs believe KRS's claims should relate-back to the filing of the Complaint by Named Plaintiffs in this action.

***

Recognizing that Named Plaintiffs have standing to pursue these claims, that KRS is not in a position to directly pursue these claims, and that Named Plaintiffs are represented by capable and experienced counsel who are willing to assume the

> ***expenses and risks associated with pursuing the claims in this action on behalf of KRS and its members, KRS declines, at this time, to seek realignment as a plaintiff in this action and agrees that it would have declined to pursue these claims had it been asked to do so before Plaintiffs filed the Complaint on December 27, 2017 and the Amended Complaint on January 12, 2018 for the reasons stated above***. KRS reserves the right to seek realignment as plaintiff if KRS subsequently determines that doing so is in the best interests of KRS, in the event a court determines that Named Plaintiffs lack standing to pursue these claims or dismisses the claims on a ground that is unique to the Named Plaintiffs' status that would not bar KRS from continuing to maintain some or all of the claims made in this action.

Joint Notice at 3–5.

When filing the Joint Notice, on April 20, 2018, KRS's Board of Trustees affirmed its commitment to support the prosecution of these claims in the "derivative format" on its behalf by plan members, issuing a press release to KRS's members and the public:

> The Kentucky Retirement System (KRS) and plaintiffs in the *Mayberry v. KKR, et al.* lawsuit filed a joint notice with the Court advising that KRS "does not intend to challenge its status as a "nominal defendant" … [and] is agreeable to plaintiffs moving forward with their claims. In conjunction with the notice, the Board of Trustees issued the following statement: The current Board commends Plaintiffs and their counsel for their diligent and significant legal and investigatory work that enabled them to present proper and potentially valuable claims on behalf of KRS – and without any compensation or assistance from KRS to date, this undertaking significant risks to themselves for the benefit of the members of KRS. These actions demonstrate Plaintiffs' commitment and that of their counsel to represent the best interests of KRS ….
>
> ***
>
> The current board has also ably undertaken to investigate prior conduct at the funds in which KRS invested, including, investigating the merits of the claims made by the Plaintiffs in this litigation. Plaintiffs and the current board have agreed that it is in the best interests of KRS for the Plaintiffs, through their experienced and capable counsel, to pursue the claims for the benefit of KRS and its member retirees and future

> retirees. A recovery in this litigation could go a long way in supporting underfunded retirement system.

KRS/KPPA recently voted to not get involved as a party, and did not rescind these prior Board actions and statement.

If KRS or the AG is actually going to try to assert claims directly ***in this lawsuit*** via the AG or have the AG assert claims for it — where it is currently named a defendant, it must seek permission from the Court to "realign" as a "plaintiff." It has not done so. To the extent the AG now "represents" KRS, it is bound and barred by its clients prior conduct and faces both factual and legal barriers to do so — including judicial estoppel, especially since the AG ***declined the request of the Mayberry Five that it join the case and assert the taxpayer claims at the outset***.

The Mayberry 5 Plaintiffs and later the Tier 3 Plaintiffs and their counsel relied on the 2017–2018 KRS process, investigation, Court filings and other statements supporting the merits and value of the claims while extolling their counsel's capabilities, work to date, ability to ***continue to prosecute the claims for the benefit of KRS***. Thus, over the next three years expending thousands of hours and some million dollars in out-of-pocket costs for the benefit of KRS and its members/beneficiaries, counsel for the Tier 3 Plaintiffs have persevered, conferring a substantial benefit on KRS and the Commonwealth.

The Court also relied on the Joint Notice, as part of its decision upholding the original plan members' prudential standing to sue and the lack any necessity to make a pre-suit demand while upholding the merits of the allegations. That lengthy / detailed opinion – consuming substantial judicial resources — made rulings that were later left ***undisturbed*** by the Kentucky Supreme Court and which stand today. And the Supreme Court was quite clear in saying that despite a "***technical***" pleading defect which forced the Court to dismiss on constitutional standing grounds — "***significant misconduct***"

had been alleged, pointedly ***exempting the Tier 3 members from its ruling as they were not then parties*** to the case and belong to a unique hybrid Tier 3 Plan — with their benefits variable, dependent on investment returns and expense levels and fiduciary stewardship and — ***without any state guarantees***. *Overstreet*, 603 S.W.3d at 266.

The merits of the unique statutory and trust-beneficiary claims being pursued by plan members for the benefit of KRS were completely upheld over three years ago, based on detailed factual allegations and legal theories created by counsel for the Tier 3 Plaintiffs. Factual allegations that this Court has said laid out "***extremely serious violations of fiduciary and other common-law duties on the part of certain KRS Board members and advisors and the defendant hedge fund managers***," "***severe misconduct and breaches of fiduciary duties***" involving "***self-dealing***, ***exorbitant fees***, ***conflicts of interest***" ***causing*** "***staggering losses of public funds***." This Court also upheld the legal viability of the claims asserted by plan members and stated that "***any party that breached its fiduciary duties and engaged in reckless conduct***, ***conflicts of interest***, ***or self-dealing should be held accountable***" ***and*** "***principles of equity and public interest require that the factual allegations should be adjudicated on the merits***." December 28, 2020 Order at 15–17. None of this was or is dependent upon the ***personal identities*** of the plan member plaintiffs asserting these claims. The only question was their "technical" standing to assert claims for the benefit of KRS and its pension plans. The Tier 3 Plaintiffs, asserting unique statutory and trust-beneficiary claims for the benefit of KRS — are entitled to be treated "***impartially***" by KRS Trustees, not singled out for hostile treatment because of personal animosity toward them or their lawyers.

KRS's lawyers (***but not KRS since it has never rescinded the Joint Notice***) disavowed the Joint Notice as "inoperative," offering up a transparently pretextual "***different plaintiffs***" — "***different claims***" claim. However dubious this claim is in human terms — and ignoring for present the fact that the KRS Board has not acted to reverse course — ***the law does not permit it either***. This kind of opportunistic inconsistent conduct — even where possible bias, self-interest and other doubts are not present, as they are here — is barred by the Judicial Estoppel Doctrine. In *New Hampshire v. Maine*, 532 U.S. 742 (2001), the Court held New Hampshire was "***equitably barred***" from asserting a different position than it had asserted in a prior litigation ***over 35 years earlier — holding the doctrine applies to states and their agencies***.

> Kentucky recognizes the equitable judicial estoppel doctrine:
>
> > The doctrine of judicial estoppel, which is a subset of the quasi-estoppel principle, also can be applied to prohibit a party from taking inconsistent positions in judicial proceedings. ... Although there is no absolute general formula for this principle, several factors have been recognized such as: (1) whether the party's later position is clearly inconsistent with its earlier position; (2) whether the party succeeded in persuading a court to accept the earlier position; and (3) whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped. ... Judicial estoppel is an equitable principle intended to protect the integrity of the judicial process.

Hisle v. Lexington-Fayette Urban Cnty. Gov't, 258 S.W.3d 422, 434–35 (Ky. Ct. App. 2008).

It is true that KRS reserved the ability to ***seek to realign as a plaintiff*** if the plaintiffs/plan members then suing lacked constitutional standing. ***But the KRS Board has not sought realignment and in fact has declined to come into the case as an active party***.

***Thus**, **the Court should decide the Tier 3 Plaintiffs'** **constitutional** "**standing**" to continue the prosecution of the already upheld claims and other factors relevant to intervention, without reference to or consideration the Secret Report or arguments or filings based on it. If the Tier 3 plan members have standing, **the Tier 3 Plaintiffs' statutory and trust-beneficiary claims can go forward prosecuted by plan members with standing**, **represented by separate**, **unconflicted counsel**.* The status quo *ante* will prevail.

C. No Legal Authority Exists Permitting the AG (or KRS's Trustees) to Block, Restrict or Take over Litigation Claims Filed by Members/Beneficiaries Seeking Recovery for the Sole Benefit of KRS Pension Funds/Trusts

By opposing intervention of the Tier 3 Plaintiffs to continue the prosecution of claims already upheld by this Court on the merits, KRS's Trustees (the AG) are in effect seeking to ***terminate the ongoing prosecution of those meritorious claims originally asserted by the Mayberry Five**, **sought to be continued by the Tier 3 Plaintiffs***. Now represented by lawyers who formerly represented the Mayberry Five and advocated those claims, KRS's opposition to intervention should be viewed and evaluated for what it really is — an attempt to terminate the continued prosecution of those meritorious claims by the Tier 3 Plaintiffs for the benefit of KRS.

Where, ***as in Kentucky**, **trustees are required by statute to act** "**impartially**" **towards and in the** "**sole interest**" **of members/beneficiaries***, there has never been a suit brought by plan members of either a public pension plan or an ERISA corporate plan for the benefit of the pension fund, where a court permitted in the suit to be blocked or stopped by the use of an internal investigation and report. While boards of ***for-profit corporations*** can under limit circumstances try to utilize Board Committees in the context of ***statutory derivative actions*** that procedure is ***only***

permitted because of the corporate directors' power to exercise their "***business judgment***" to act in the "***best interests***" of ***corporation and others in the corporate constellation of interests*** to halt litigation brought on behalf of the corporation by shareholders. ***However***, ***no such legal authority — no such*** "***business judgment rule***" ***authority — exists for the KRS Trustees who operate in the trust/pension fund universe***, ***with specific statutory duties***.

This Court considered and articulated this key distinction when it earlier dispensed with the Defendants pre-suit demand argument on multiple grounds:

> Typically, derivative suits arise in the context of dissenting shareholders who must first comply with various statutory requirements prior to bringing suit to enforce the rights of the corporation. *See* KRS 271B.7-400. Defendants now argue that Plaintiffs failed to comply with these statutory requirements. Specifically, Defendants point to the requirement that the shareholders first make a demand upon the board of directors under KRS 271B.7-400(2). Under that statute, the complaining shareholders must allege that the demand was refused or explain why they failed to make such a demand.
>
> However, the Court finds that Defendants' argument fails for two reasons. ***First***, ***this case is not a typical shareholder derivative suit against a private corporation***. Plaintiffs are not shareholders of a private for-profit corporation; instead they are members of KRS and beneficiaries of KRS's trust by operation of the statutes establishing Kentucky's public pension system. Accordingly, ***they are not bound by the precise statutorily mandated procedures set forth for private shareholder derivative suits***. Instead, ***their right to sue stems primarily from KRS 61.645(15)***, which lists the duties of the trustees and explains under what circumstances a person may sue for failure to perform these duties. *See* KRS 61.645(15)(e), (f). In addition, the Restatement (Third) of Trusts provides that a beneficiary of a trust can sue a third party when the trustee cannot or will not do so, to the detriment of the beneficiary's interest. *See* Restatement (Third) of Trusts § 107(2)(b) (2012); *Osborn v. Griffin*, 865 F.3d 417, 447 (6th Cir 2017).
>
> * * *

> ***There is no requirement that the claimant first present their claims to the Attorney General, nor is any statutory authority necessary to bring suit.***

Nov. 30, 2018 Opinion & Order at 8–10.

This Court made clear the claims asserted by KRS plan members for the benefit of KRS pension plans/trusts are not traditional corporate derivative claims like those authorized by statutes setting forth the rules for stockholder derivative lawsuits. Derivative suits on behalf of for-profit corporations take place within a statutory framework with explicit legislatively-imposed "gatekeeper rules": pre-suit demand, security for costs, contemporaneous and/or minimum share ownership requirements, *etc*. Corporate shareholders are investors. They share in the profits and also losses of the enterprise. Their investment is portable. They can sell, take their money and move on if they are hurt or dissatisfied. Not so with a pension fund member. Their pensions are immobile. They are "trapped." Their financial/property interest in the funds are completely dependent on the Trustees obeying their stringent fiduciary and statutory duties — including to act "***impartially***" and "***solely***" ***in their interests — not in anybody else's*** "***best interests***."

KRS is a not-for-profit trust existing in corporate form. Its assets are "trust funds."[26] The KRS Board is the "trustee" of those trust funds.[27] The legal claim first asserted by the Mayberry Plaintiffs and now to be carried on by the Tier 3 Plaintiffs ***for the benefit of*** KRS is a trust asset. Trustees must act impartially toward the Tier 3 members and must protect and maximize the value of trust assets. Restatement (Third) of Trusts § 107 (2012). It is the ***same asset*** KRS told the Court could "***go a long way***

[26] KRS § 61.515(2).

[27] KRS § 61.650(1)(a).

in supporting the underfunded retirement system," ***when it endorsed the merit***, ***value and importance of the claims and the prosecution by private counsel who agreed to fund the prosecution and work on a contingent basis***.

KRS's Trustees' may claim that they are acting in the "***best interests***" of KRS, its Trustees and other persons, entities and interests which empower them to block the prosecution of these judicially upheld claims. But "***best interests***" is not the legal standard by which their decisions are tested. Every decision of the Trustees must meet Kentucky's statutory command they "***impartially***" toward members and act "***solely in the interest of members and beneficiaries***" for the "***exclusive purpose of providing benefits***" to them. KRS §§ 61.645(15)(a), 61.650(c)(1)(2).

The "sole interest" standard is unique to the trust/pension world. According to leading legal scholars:

> **"Sole" Versus "Best" Interest**
>
> Roughly speaking, the fiduciary duty of loyalty comes in two flavors. One is a "sole" interest rule under which a trustee must "administer the trust solely in the interest of the beneficiaries." The sole interest rule is sometimes also called the "sole benefit" or "exclusive benefit" rule. ***Under this rule***, "***the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust***. "***The trustee***," ***in other words,*** "***is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person***." ***Acting with mixed motivates triggers*** "***an irrebuttable presumption of wrongdoing***," ***full stop***.
>
> Because the sole interest rule is prohibitory rather than regulatory, to prove a breach a beneficiary need only prove the fact of a trustee's mixed motives. Under the sole interest rule, a trustee violates the duty of loyalty — even in the absence of self-dealing — if the trustee has any motive or rationale for undertaking an action other than the "sole interest" or "exclusive benefit" of the beneficiary. A trustee who is influenced by his own or a third party's interests is disloyal, because the trustee is no longer acting solely in the interest of

> the beneficiaries. As we shall see, the sole interest rule is mandatory under ERISA and is the default in trust law.
>
> ***
>
> ERISA codifies the trust law sole interest rule by mandating that a pension trustee act "solely in the interest of the participants and beneficiaries" and for the "exclusive purpose" of "providing benefits" to them. At common law, these terms that have long been understood to mean that "the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust."
>
> Furthermore, in "providing benefits" under ERISA, the Supreme Court has held that the relevant purpose to which ERISA's sole interest rule applies is "financial benefits" for the plan beneficiaries.
>
> ***
>
> Under Supreme Court precedent, therefore, a pension trustee breaches the duty of loyalty whenever the trustee acts other than to benefit the beneficiaries financially. ***Acting under any other motive, even without direct self-dealing, is a breach of the duty of loyalty***.

Max M. Schanzenbach & Robert H. Sitkof, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STANFORD L. REV. 381, 400–04 (2020).

Analogous ERISA law covering corporate pension plans has assumed importance in this state court / state law case. In ERISA, the same "***sole interest***" standard for decision making applies to plan Trustees. ***In the hundreds of "derivative" suits by ERISA plan members for the benefit of their Plans***,[28] ***not one decision exists***

[28] In *Clifford v. Ghadrdan*, 2014 WL 11829337 (N.D. Ga. Mar. 5, 2014), a shareholder who was also a member of the corporate ERISA plan sued corporate directors derivatively for the benefit of the corporation and plan trustees for the benefit of the ERISA plan — alleging a common set of facts of misbehavior. Under express provisions of Georgia corporate law the court permitted a special litigation committee based on an internal investigation to seek to terminate the shareholders derivative claim and did so. However, it permitted the ERISA claim to go forward. The Trustees lacked any authority to even try to terminate these claims on behalf of the pension plan.

allowing the use an "internal investigation" device by Trustees to halt, takeover, block or terminate a litigation on behalf of the plan by ERISA members. Nor does any such case exist in the public pension plan arena in the US where the "***sole interest***" standard for Trustees predominates. Trustees of pension trusts lack the legal authority to terminate litigation filed independently on behalf of the trust – especially here where the suit is by a statutory scheme and trust law that nowhere mentions such a drastic unusual procedure.

III. CONCLUSION

For all the foregoing reasons, the Court should deny the AG's motion to file the AIC and allow the Tier 3 Plaintiffs to intervene in this action.

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Respectfully submitted,

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