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Kentucky Appellate Court Vacates Decision Allowing Pension Plan Beneficiaries to Sue Managers of Funds in Which Plan Invested

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On April 23, 2019, a Kentucky appellate court overruled an earlier decision that had allowed a novel suit filed by eight individual beneficiaries of the Kentucky Employees Retirement System ("KRS"). The earlier decision allowed a suit against two investment managers for allegedly poor performance of hedge funds managed by the investment managers (although the performance of the funds met or exceeded the stated target in KRS' investment guidelines), to proceed as a “derivative” action purportedly on behalf of KRS, as well as on a primary basis on the argument that the plaintiffs had standing due to their status as Kentucky taxpayers.

The lower court ruling was significant for private fund managers that have accepted or are considering accepting investments from Kentucky plans, as it had the potential to expose managers to liability to Kentucky pension plan beneficiaries.

The Kentucky appellate court determined that the lower court was incorrect, and that plaintiffs lacked standing to sue. Specifically, the appellate court found that:

1. The financial injury was too speculative. The plaintiffs did not allege that their benefits would decrease as a result of any purported investment underperformance. Instead, they asserted only that KRS is currently in a budgetary shortfall. Therefore, the plaintiffs’ claims were based on “fears of a hypothetical future harm” rather than “actual or imminent” injury.
2. The statute setting forth standards of conduct and duties for KRS trustees did not create standing without an actual injury.
3. Plaintiffs could not have standing based on an argument that the beneficiary of a trust can sue when a trustee cannot or will not do so, because KRS is not a trust under Kentucky law.

4. The plaintiffs did not have "taxpayer standing," based on the idea that a citizen may have standing to sue because the financial state of KRS could result in increased contributions by the State of Kentucky and, by extension, its taxpayers. Plaintiffs had merely speculated that their taxes could be raised, rather than alleging that any specific bill, law, levy or expenditure had caused them injury. Even if the plaintiffs had pointed to a specific injury, they would also need to argue that it was caused by the investment managers' actions, and that it was possible for the court to redress.

While the order remains subject to the possibility that the plaintiffs may seek further action either in the appellate court or the Kentucky Supreme Court, this Kentucky appellate court ruling is a positive development for investment managers.

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