COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
DIVISION I
CIVIL ACTION NO. 17-CI-1348

JEFFREY C. MAYBERRY, *et al.* **PLAINTIFFS**

v. **OPINION & ORDER**

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

This matter is before the Court on Defendants' Motions to Dismiss. The parties appeared before the Court on August 23, 2018 to argue the matter. At that time, the plaintiffs were represented by Ann Oldfather, Vanessa Cantley, Michelle Lerach, Johnathan Cuneo, and Abe Kucjaz. The following counsel appeared on behalf of the defendants listed: Philip Collier and Jefferey Moad for R.V. Kuhn & Assocs., Inc., James Voytko, and Rebecca Gratsinger ("RVK Defendants"); Robert Brazier and Charles English, Jr. for Cavanaugh MacDonald LLC, Thomas Cavanaugh, Todd Green, and Alisa Bennett ("CavMac Defendants"); Cory Skolnick, Margaret Keeley, and Ana C. Reyes for Ice Miller LLP ("Ice Miller"); Dustin E. Meek and Melissa M. Whitehead for the Government Finance Office Association ("GFOA"); Donald Kelly, Virginia Snell, Jordan White, Brad S. Karp, Lorin L. Reisner, Andrew J. Ehrlich, and Brette Tannenbaum for Blackstone Asset Management LP ("BAAM"), Blackstone Group LP ("Blackstone"), Stephen Schwarzman, and J. Tomilson Hill; Barbara Edelman, Grahmn Morgan, and Barry Barnett for KKR & Co. L.P., Henry Kravis, and George Roberts ("the KKR Defendants"); Barbara Edelman, Grahmn Morgan, and Paul C. Curnin for Prisma Capital Partners LP ("Prisma"), Pacific Alternative Asset Management Co., LLC ("PAAMCO"), Jane Buchan, and Girish Reddy; Glenn Cohen and Lynn Watson for William Cook; David Guarnieri and Kenton Knickmeyer for David Peden; Sean Ragland for Jennifer Elliott; Richard Guarnieri for Bobby Henson and Randy

Overstreet; Mark Guilfoyle for Thomas Elliott; John Dwyer for Tim Longmeyer; Mel Camenisch, Jr. for T. J. Carlson; Kevin Fox for William Thielen; Brent Caldwell and Noel Caldwell for Vince Lang; and Christopher Schaefer and Sarah Bishop for nominal defendant Kentucky Retirement Systems ("KRS"). Plaintiffs Jeffrey Mayberry, Brandy O. Brown, Martha M. Miller, and Ben Wyman were also present.

Also before the Court is the Motion to Defer Ruling on Plaintiffs' Lack of Standing Until Finality of Recent Supreme Court Opinion That Would Compel Dismissal, filed by Defendants Blackstone and BAAM. Defendants PAAMCO, Prisma, the KKR Defendants, the RVK Defendants, Ice Miller, and the GFOA have also joined in this Motion. By Order dated November 14, 2018, the Court permitted Plaintiffs to file a responsive memorandum. Upon receipt of the plaintiffs' memorandum, the matter was taken under submission and is addressed herein in the Court's analysis on standing.

Accordingly, having considered the arguments of counsel and being otherwise sufficiently advised, the Court hereby rules as follows:

BACKGROUND

Plaintiffs are several members of the Kentucky Employees Retirement Systems ("KRS"), suing both derivatively and as taxpayers on behalf of the Commonwealth. They allege that several trustees and officers of the Kentucky Employees Retirement Systems ("KRS") breached various duties owed to its members and ultimately depleted KRS's pension funds by investing in high-risk hedge funds. It is also alleged that certain entities including actuarial and investment advisors, hedge fund sellers, and their executives similarly breached duties owed to KRS and its public employee members and aided and abetted the breaches of the trustees and officers. In addition, all defendants are accused of participating in a joint enterprise or civil conspiracy to breach various

fiduciary duties and enrich certain defendants at the expense of KRS and its public employee members. More specifically, Plaintiffs assert the following causes of action in their First Amended Complaint: Breach of Trust and Fiduciary Duties (Count I); Breaches of Statutory, Fiduciary, and Other Duties (Count II); Joint Enterprise and/or Civil Conspiracy (Count III); Aiding and Abetting Breaches of Statutory, Fiduciary, and Other Duties (Count IV); and Punitive Damages (Count V). Plaintiffs seek monetary damages, as well as declaratory and injunctive relief.

In response, several defendants joined to file a Consolidated Motion to Dismiss, arguing that Plaintiffs lack standing to sue, either derivatively or as taxpayers. In addition, most defendants filed separate motions to dismiss, asserting a variety of defenses, including lack of personal jurisdiction, lack of subject matter jurisdiction, immunity, statutes of limitations, and failure to state a claim. Many, if not all, of these defenses are asserted and briefed by multiple defendants. Accordingly, the Court issued an agenda outlining the various topics for oral argument and will now address each issue in the same order that they were argued on August 23, 2018.

STANDARD OF REVIEW

When a court considers a motion to dismiss under Kentucky Rule of Civil Procedure ("CR") 12.02, "the pleadings should be liberally construed in a light most favorable to the plaintiff and all allegations taken in the complaint to be true." *Gall v. Scroggy*, 725 S.W.2d 867, 869 (Ky. App. 1987) (citation omitted). Thus, the Court should only grant a motion to dismiss when it "appears the pleading party would not be entitled to relief under any set of facts which could be proved in support of his claim." *Mims v. Western-Southern Agency, Inc.*, 226 S.W.3d 833, 835 (Ky. App. 2007) (quoting *James v. Wilson*, 95 S.W.3d 875, 883–84 (Ky. App. 2002)).

ANALYSIS

I. Standing

In their First Amended Complaint, Plaintiffs bring suit as members of KRS "pleading a member/beneficiary derivative action for [KRS] and its trust funds," and as taxpayers bringing a taxpayer action on behalf of the Commonwealth. *See* First Am. Compl. 1. In response, Defendants filed a Consolidated Motion to Dismiss, asserting lack of standing. After oral argument on the various Motions to Dismiss, Defendants BAAM and Blackstone filed a Motion to Defer this Court's ruling on the issue of standing. More specifically, the defendants asked this Court to stay the matter until a recent Kentucky Supreme Court decision, *Commonwealth of Kentucky, Cabinet for Health and Family Services v. Sexton*, 2016-SC-000529 (Ky. Sept. 27, 2018), becomes final. That decision, Defendants allege, makes clear that Plaintiffs lack constitutional standing.

For the reasons set forth below, the Court finds that Plaintiffs have standing to bring this suit, both derivatively and as taxpayers. The Motion to Defer and the Consolidated Motion to Dismiss, as well as the separately filed Motions to Dismiss, will therefore be denied to the extent they argue lack of standing.

a. Plaintiffs allege a concrete injury and satisfy the test for constitutional standing as stated in *Sexton*.

In *Sexton*, the Supreme Court of Kentucky considered "whether the courts of Kentucky can undertake a statutorily created judicial review of an administrative agency's final order when the person appealing that final order does not have a concrete injury." *Sexton*, slip op. 2. It ultimately concluded that "the existence of a plaintiff's standing is a constitutional requirement to prosecute any action in the courts of this Commonwealth," and it formally adopted the *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992) test for standing. Under the *Lujan* test, the plaintiff must have

suffered an "injury in fact" which he or she can causally connect to the conduct at issue. *Lujan*, 504 U.S. at 560–61. The injury must be "concrete and particularized" and "either actual or imminent." *Sexton*, slip op. at 2 (quoting *Lujan*, 504 U.S. at 560). The *Sexton* Court further clarified that a case is considered nonjusticiable if the plaintiff lacks an injury in fact, or otherwise lacks constitutional standing.

Applying this test, our Supreme Court found that the plaintiff in *Sexton* lacked a concrete injury and, as a result, lacked constitutional standing. Sexton, a Medicaid beneficiary, sought medical treatment at a hospital, but the relevant managed-care organization would not preauthorize certain services. Due to the life-threatening nature of Sexton's condition, the hospital proceeded with the medical treatment, and the managed-care organization then denied reimbursement. The hospital acted as Sexton's representative to ultimately bring suit in circuit court. On appeal, the Supreme Court characterized Sexton as "the true plaintiff" in the suit and found that Sexton had not been "injured" for purposes of standing. The Court noted that Sexton received the medical treatment that she sought and needed. The hospital, not Sexton, sought reimbursement for those services, and Sexton therefore also lacked a financial interest in the dispute. Thus, the "true injuries" in the case involved losses suffered by the hospital, namely, unreimbursed medical expenses. *Id.* at 22. The remedy—reimbursement—would make the hospital whole but would have no effect on Sexton. In other words, regardless of the outcome of the case, "Sexton would be no better or worse off." *Id.* at 21. The Court therefore found that Sexton lacked the particularized injury necessary to establish standing.

The *Sexton* decision was rendered on September 27, 2018 but is not yet final. Defendants therefore ask this Court to defer ruling on the issue of standing until the decision is final, at which time the Court should apply the same analysis to find that Plaintiffs in the present matter also lack

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standing. More specifically, Defendants argue that (1) KRS's financial loss is not a concrete and particularized injury suffered by the individual plaintiffs; (2) even if they have suffered a sufficient injury, Plaintiffs cannot establish causation between that injury and the defendants' conduct; and (3) that injury is unlikely to be redressed by the recovery sought because any damages will be paid to the Commonwealth, rather than directly to KRS.

However, the Court finds the present suit distinguishable from *Sexton*. In the *Sexton* case, an entity (the hospital) sought to enforce the rights of an individual (Sexton). The Court then considered whether that individual—the "true plaintiff"—suffered an injury, and it ultimately concluded that the true injuries were suffered by the entity. Here, however, these individual plaintiffs (KRS members) seek to enforce the rights of an entity (KRS) by bringing a derivative action on behalf of the entity. They also bring this suit as taxpayers seeking to enforce the rights of the Commonwealth. Thus, under *Sexton*, the Court should consider whether *KRS* and the *Commonwealth*—the true plaintiffs—suffered concrete and particularized injuries.

The injury alleged is the depletion of KRS's pension funds, which allegedly resulted from the actions of KRS's trustees, officers, hedge-fund sellers, and advisors, primarily, their breaches of fiduciary duties. While Defendants may argue that this injury is not a concrete and particularized injury suffered by the individual named plaintiffs, it is no doubt a sufficient injury suffered by the true plaintiffs: the Commonwealth and KRS. Plaintiffs have therefore demonstrated a concrete injury that satisfies the *Lujan/Sexton* test. These allegations also satisfy the essential element of causation, which requires only that the injury be "fairly traceable" to the alleged misconduct. *See, e.g., Allen v. Wright*, 468 U.S. 737, 751 (1984) (citation omitted).

In addition, the Court finds that these individual plaintiffs have also suffered concrete and particularized injuries. These public employees paid into the defined benefit pension program, as

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mandated by statute. They therefore have a vested financial interest in ensuring that the state retirement fund, which secures their retirement, is administered in compliance with the safety net of fiduciary duties designed to protect their financial interests, and those of all similarly situated members. The alleged breaches of those fiduciary duties give rise to a case or controversy in which the plaintiffs have a very real and tangible stake in the outcome. Again, the alleged misconduct of the defendants—the willful and reckless breach of duties, among other things—is alleged to be causally connected to the depletion of the retirement funds in which the plaintiffs have a property interest.

Lastly, the Court disagrees with Defendants' assertion that no redress is available. Defendants claim that the monetary damages sought by Plaintiff cannot redress the alleged injury (depletion of pension funds) because the award must be paid directly to the Commonwealth, after which the General Assembly decides its allocation. In other words, a monetary award does not automatically restore KRS's funds. However, to say that there is no redress available simply because the funds might be paid to the Commonwealth, rather than directly to KRS, is to say that there is no way to ever redress a financial loss suffered by a state agency or public entity. The Court cannot accept that argument. Instead, the Court finds that the relief sought by Plaintiffs can disgorge the defendants of inappropriately-obtained funds and restore, at least in part, the losses suffered by KRS. Plaintiffs have therefore satisfied the third element of the *Lujan* test: redressability. Accordingly, Defendants' Motion to Defer will be denied.

In their Motion to Defer, Defendants Blackstone and BAAM assert that *Sexton* "announced a sea change in Kentucky courts' approach to the determination of standing." Defs. Blackstone and BAAM's Mot. to Defer 1. At most, however, the *Sexton* decision formally adopts the federal standard of *Lujan*—an analysis already informally applied in Kentucky courts—and clarifies that

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constitutional standing is a matter of justiciability. *Sexton* does not purport to alter the established derivative and taxpayer standing analyses of Kentucky's courts, and the Court therefore addresses each in turn.

b. Plaintiffs may sue derivatively as members and beneficiaries of KRS and its trust.

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)

(relying on similar provision in the Restatement (Second) of Trusts)). Neither KRS 61.645 nor the Restatement contains a demand requirement.

In addition, even if this Court presumed that a demand requirement existed for these plaintiffs, that requirement was essentially met when the KRS Board expressly declined to bring suit. In the Joint Notice attached to Plaintiffs' response to the Motions to Dismiss, KRS explains why it declined to pursue these claims and its belief that Plaintiffs are acting in the best interests of KRS. For this reason, and the reasons set forth above, the Court will deny the Motions to Dismiss to the extent they allege lack of standing to sue derivatively.

c. Plaintiffs may sue on behalf of the Commonwealth as taxpayers.

In addition to being members of KRS and beneficiaries of its trust, Plaintiffs are also taxpayers. *See* First Am. Comp. ¶ 58. In this suit, they allege that the wrongful conduct of the KRS trustees and officers ultimately resulted in damages to the Commonwealth and its taxpayers, as the trust is funded by public tax dollars. *See id.* ¶¶ 272–73, 275. Prior to bringing this suit, however, they made a written demand on the Attorney General to bring these claims, but the Attorney General also declined to do so. *See id.* ¶ 274.

Though the Attorney General is authorized to bring such claims, his failure to do so does not preclude Plaintiffs from now filing this taxpayer suit. In fact, Kentucky favors taxpayer suits. *See generally Price v. Commonwealth*, 945 S.W.2d 429 (Ky. App. 1996); *Rosenbalm v. Commercial Bank of Middlesboro*, 838 S.W.2d 423 (Ky. App. 1992); *Russman v. Luckett*, 391 S.W.2d 694, 699 (Ky. 1965). Thus, Kentucky courts typically do not impose difficult restrictions upon taxpayers seeking to bring such suits. Instead, a claimant must show only "(1) a wrongful act on the part of a public body or its officers, (2) injury to the complaining taxpayer or to the public body, and (3) a right to seek the relief prayed for." *Price*, 945 S.W.2d at 432–33 (quoting

Rosenbalm, 838 S.W.2d at 427) (internal quotation marks omitted). There is no requirement that the claimant first present their claims to the Attorney General, nor is any statutory authority necessary to bring suit.

With this standard in mind, the Court finds that these Plaintiffs allege sufficient facts to demonstrate taxpayer standing. They allege that the wrongful acts of KRS, a public body, and its trustees and officers ultimately resulted in depleted pension funds and, as a result, damage to the Commonwealth and its taxpayer citizens. *See, e.g.*, ¶¶ 239–43 (charging excessive fees); ¶¶ 251, 255 (making false and misleading statements with the intent to create a false sense of security); ¶¶ 279, 285 (claiming damages, including lost funds and increasing costs). They also allege that they have a right to seek the relief prayed for in the First Amended Complaint. *See, e.g., id.* ¶¶ 272–274. These factual allegations are sufficient to defeat Defendants' Motions to Dismiss to the extent that they allege lack of taxpayer standing.

Moreover, under controlling case law, the plaintiffs have a property interest in the funds administered by KRS. For example, the Kentucky Supreme Court has held that public employees have a protected property interest in the retirement funds administered by KRS by virtue of their personal contributions to those retirement funds through payroll deductions. *See Commonwealth ex rel. Armstrong v. Collins*, 709 S.W.2d 437, 446–47 (Ky. 1986). As noted above, Plaintiffs are public employees who have paid into the pension program to secure their retirement, and they therefore have a vested financial interest in ensuring that the program is administered in compliance with the very fiduciary duties that are designed to protect the interests of KRS's members. Thus, the alleged breach of those duties gives rise to a case or controversy, and Plaintiffs have a very real and tangible stake in the outcome. Their personal financial contributions to the KRS retirement funds, matched by public appropriations that are subject to the fiduciary duties set

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forth in statute and case law, give the plaintiffs standing to sue over alleged breaches of fiduciary duties in the administration of those funds. Accordingly, the Court will deny the Motions to Dismiss to the extent they allege lack of standing to sue as taxpayers.

II. Statutes of Limitations and Tolling Doctrines

Defendants argue that Plaintiffs claims are time-barred, at least in part, because a five-year limitation period applies to breach of fiduciary duty and breach of trust claims, while a one-year statute of limitations period applies to conspiracy claims. *See* KRS 413.120(2) (providing that an action upon a liability created by statute must be brought within five years of the accrual of that cause of action, if no other time is fixed by statute); KRS 413.120(6) (allowing five years to bring a personal injury suit); KRS 413.140 (providing a one year statute of limitations for civil conspiracy claims); *Middleton v. Sampey*, 522 S.W.3d 875, 878–79 (Ky. App. 2017) (applying five-year statute of limitations to breach of fiduciary duty and breach of trust claims). Plaintiffs initiated this suit on December 27, 2017. Thus, Defendants argue, the Court must dismiss any breach claims and related aiding and abetting claims arising prior to December 27, 2012 and any conspiracy claim arising prior to December 27, 2016. Plaintiffs, on the other hand, argue that (1) KRS 413.160 applies and allows for ten years to file "an action for relief not provided for by statute" (i.e., breach of trust) and (2) regardless, each violation constitutes a new cause of action under *Tibble v. Edison International*, 135 S.Ct. 1823 (2015); and (3) tolling doctrines, such as the adverse domination theory and equitable tolling, apply.

The Court finds that there are sufficient allegations to overcome the statute of limitations defenses for purposes of these Motions to Dismiss. For example, the plaintiffs allege that the compensation of the hedge fund sellers was grossly excessive and breached fiduciary duties to the members, and Plaintiffs further allege that the full compensation of some of the defendants has

remained secret and sealed from public disclosure. *See* First Am. Compl. ¶¶ 239–43 (discussing excessive fees). To the extent that the defendants may have received excessive compensation in breach of fiduciary duties, and that compensation has not yet been fully disclosed, the statute of limitations may not have even started to run, since a limitations period cannot run before the plaintiffs were reasonably on notice of the nature and extent of the breach of duty.

Accordingly, Defendants' Motions to Dismiss will be denied to the extent they rely on a statute of limitations defense. However, discovery is necessary to provide the full factual context as to when specific causes of action accrued, and whether any tolling occurred to extend the relevant limitations periods. Accordingly, if necessary and appropriate, the statute of limitations defense may be raised by a motion for summary judgment after completion of factual discovery.

III. Qualified Official Immunity

In their Motions to Dismiss, the individual trustee and officer defendants assert claims of official immunity, both absolute (if sued in their official capacities) and qualified (if sued in their individual capacities). At the time these Motions were filed, it remained unclear whether Plaintiffs intended to sue these defendants in their individual or official capacities. However, in their reply memorandum, Plaintiffs expressly state, "Plaintiffs are bringing claims against Trustees and Officers *in their individual* capacity, with no intent, in fact *disclaiming any intent*, to hold KRS liable for their actions." Pls. Opp. 108. Thus, as explained below, the Court need only consider whether qualified official immunity bars Plaintiffs' claims. By Order entered September 5, 2018, the Court allowed the parties to submit supplemental briefs on this issue.

a. Qualified immunity does not apply to actions taken in bad faith.

The doctrine of official immunity shields public officers and employees from tort liability for acts performed in the exercise of their discretionary functions. *Yanero v. Davis*, 65 S.W.3d

510, 521 (Ky. 2001). It is absolute when asserted by a public officer or employee being sued in his or her official or representative capacity. *Id.* However, when public officers and employees are sued in their individual capacity, they "enjoy only qualified official immunity, which affords protection from damages liability for good faith judgment calls made in a legally uncertain environment." *Id.* at 522. More specifically, "[q]ualified official immunity applies to the negligent performance by a public officer or employee of (1) discretionary acts or functions, *i.e.*, those involving the exercise of discretion and judgment, or personal deliberation, decision, and judgment; (2) in good faith; and (3) within the scope of the employee's authority." *Id.* (citations omitted).

In the present suit, however, the actions at issue—as alleged in the First Amended Complaint—do not entitle the KRS trustees and officers to qualified official immunity. For example, Plaintiffs allege that these defendants acted in bad faith. *See*, *.e.g.* First Am. Compl. ¶ 7 (describing use of 7.75% return rate as "willfully reckless"), ¶ 169 (describing concealment of KRS's financial condition as "deliberate, willfull manipulation"), ¶ 171 (explaining that KRS trustees and Ice Miller failed to pursue training in good faith), ¶ 174 (listing scenarios in which KRS trustees and officers acted "willfully or recklessly" in violation of duties and "did not act in good faith"), ¶ 195 (explaining that conflicts of interest among trustees and entities made it impossible to use good faith judgment), ¶ 239 (explaining that each defendant "knowingly" participated in a civil conspiracy or scheme). The Court must accept these allegations as true when considering the CR 12.02 Motions to Dismiss. Thus, at this time, the allegations are sufficient to overcome the trustees' and officers' Motions to Dismiss to the extent said Motions are based on qualified official immunity.

b. KRS 61.645 serves as a limited waiver of immunity for KRS trustees.

Plaintiffs' allegations also trigger the limited statutory waiver of immunity for KRS trustees, as expressed in KRS 61.645. That statute directs a KRS trustee to discharge his or her duties in good faith, on an informed basis, and "[i]n a manner he [or she] honestly believes to be in the best interest of the Kentucky Retirement Systems." KRS 61.645(15)(a). It further provides that a trustee's action or inaction cannot form the basis for a suit for injunctive relief *unless* "[t]he trustee has breached or failed to perform the duties of the trustee's office in compliance with this section." KRS 61.645(15)(e)(1). Monetary damages, on the other hand, may be sought if "the breach or failure to perform constitutes willful misconduct or wanton or reckless disregard for human rights, safety, or property." KRS 61.645(15)(e)(2). In other words, the General Assembly provided a specific waiver of KRS trustees' immunity (absolute or qualified) in certain circumstances, namely, when a trustee breaches his or her statutorily-defined duties.

In the present suit, Plaintiffs allege that the trustee defendants breached or failed to perform those duties listed in KRS 61.645 and that the breaches constituted willful misconduct or gross negligence. For example, as noted above, Plaintiffs allege that these defendants acted in bad faith, in derogation of their statutory duty to act in good faith, as outlined in KRS 61.645(15)(a). Plaintiffs also allege that these defendants "consistently used, or allowed the use of, outdated, misleading or false estimates and assumptions of the actuarial value of the Trust Funds' actuarial assets and liabilities." First Am. Compl. ¶ 169. According to Plaintiffs' Complaint, this constituted "deliberate, willful manipulation to conceal the true financial and actuarial condition and underfunded status of the KRS Plans." *Id.* Summarizing its claim against the trustee and officer defendants, Plaintiffs explain,

> Trustees and Officers willfully or recklessly violated their duties to KRS and its Funds and the taxpayers of Kentucky and did not act in good faith or in what they

> honestly believed was in the best interests of KRS, and its Funds when they failed to: (i) adequately safeguard the trust funds under their control; (ii) procure adequate fiduciary insurance: (iii) invest the trust assets prudently, (iv) avoid excessive and/or unreasonable fees and expenses; (v) use realistic estimates and assumptions regarding the actuarial condition and future investment returns of the funds; (vi) adequately match the assets and liability of the funds; (vii) failed to protect and assure KRS' full legal rights, including the right to sue in Kentucky state court, in open proceedings, with a jury trial, if KRS's legal rights were violated by others – especially by sophisticated out-of-state sellers of investment products who might try to limit or eliminate KRS' legal remedies or (viii) make truthful, complete, accurate disclosure of, or a fair presentation of, the true financial and actuarial condition the KRS Funds and Plans as is detailed in this Complaint.

Id. ¶ 174. These allegations of bad faith and willful and/or reckless misconduct—when accepted as true for purposes of considering a CR 12.02 motion—allow Plaintiffs to sue the KRS trustees for monetary relief under KRS 61.645(15)(e).

In sum, Plaintiffs sue the trustee and officer defendants in their individual capacity and allege that these defendants acted willfully or in bad faith or were otherwise grossly negligent. Allegations of actions taken in bad faith defeat the trustees' or officers' claims for qualified official immunity in the context of these Motions to Dismiss. In addition, these actions constitute a breach of the trustees' statutory duties listed in KRS 61.645, thereby triggering the limited waiver of immunity contained within that provision and allowing Plaintiffs to seek injunctive relief. Willful misconduct and gross negligence similarly trigger the statute's limited waiver of immunity and allow Plaintiffs to sue for monetary damages.

Likewise, the statute's express authorization for the "purchase of fiduciary liability insurance" under KRS 61.645(2)(e), in combination with the statute's express reference to suits for monetary damages in KRS 61.645(15)(e), may also constitute a limited waiver of any qualified, official, or governmental immunity for the alleged breaches of fiduciary duty, at least to the extent of the insurance coverage. *See Reyes v. Hardin Cnty.*, 55 S.W.3d 337 (Ky. 2001). Accordingly,

to the extent that any KRS trustee or officer defendants asserts a claim of official immunity, the Motions to Dismiss will be denied without prejudice.

IV. Subject Matter Jurisdiction

Several defendants argue that the Kentucky Claims Commission retains exclusive jurisdiction over these claims under KRS 49.070, thereby depriving this Court of the subject matter jurisdiction necessary to resolve this suit. That statute provides that the Commission "shall have primary and exclusive jurisdiction over all negligence claims for the negligent performance of ministerial acts against the Commonwealth, any of its cabinets, departments, bureaus, or agencies, or any officers, agents, or employees thereof while acting within the scope of their employment." KRS 49.070(2). Such claims cannot be brought in this Court, or any other forum, until the Commission determines that it does not have primary and exclusive jurisdiction. KRS 49.070(5).

In this suit, Plaintiffs' First Amended Complaint does not list a cause of action for negligence against any defendant. Regardless, Defendants assert that Plaintiffs' claims against the KRS trustees and officers are based in negligence and must therefore be presented to the Kentucky Claims Commission. For example, Count II alleges that "[e]ach of the Defendants by their actions and inactions, as alleged herein, acted in a negligent manner and failed to exercise due care and failed to fulfill their statutory and other duties, including their fiduciary duties, to KRS and its Funds and to Kentucky and its taxpayers." First Am. Compl. ¶ 288.

The Court notes, however, that the General Assembly intended to provide a limited waiver of sovereign immunity through KRS 49.070. *See* KRS 49.060; *Yanero*, 65 S.W.3d at 524 (explaining that the Board of Claims Act "represents not a creation of immunity, but rather a limited waiver of immunity to the extent that immunity exists"). Thus, if one is injured by the negligent acts of a state officer, agent, or employee acting within the scope of his or her

employment, that injured party can seek damages against the Commonwealth, something otherwise barred by the doctrine of sovereign immunity. In other words, the statute provides a limited waiver of sovereign immunity to allow for negligence suits against the state itself. However, because it serves as a *waiver* of immunity, it applies only to state agencies that would otherwise be shielded by immunity; it does not shield government agencies, officers, and employees who are not immune from suit. *See Yanero*, 65 S.W.3d at 525.

The Board of Claims (now the Kentucky Claims Commission) was established to allow limited recovery to parties injured by state action by creating a limited waiver of sovereign immunity. Here, however, Plaintiffs have now made clear that they seek damages against the KRS trustees and officers in their *individual* capacity; they do not seek damages from the Commonwealth for the negligent acts of those individuals. *See* Pls.' Opp. 108. Thus, there is no threat to the state treasury and no need to rely on the limited waiver of sovereign immunity contained within KRS 49.070. Stated another way, Plaintiffs' claims for breaches of fiduciary duty against third parties and state employees and officers in their individual capacities do not fall within the jurisdiction of the Kentucky Claims Commission.

Accordingly, the Kentucky Claims Commission is not an available remedy for the breaches of duty asserted by the plaintiffs; therefore, to the extent that Defendants' Motions to Dismiss assert a lack of subject matter jurisdiction (or failure to exhaust administrative remedies), these Motions must be denied.

V. Personal Jurisdiction

Several executives of Prisma, PAAMCO, and BAAM—namely, Kravis, Roberts, Schwarzman, and Hill—contest personal jurisdiction. These individual defendants argue that the First Amended Complaint lacks any specific allegations that trigger Kentucky's long-arm statute.

In addition, they argue that the plaintiffs' allegations do not warrant piercing the corporate veil and holding the individuals liable for the actions of their companies.

Blackstone and KKR also contest personal jurisdiction. For example, Blackstone argues that the First Amended Complaint groups Blackstone and BAAM together, but BAAM was Blackstone's subsidiary and was responsible for marketing and managing the "Henry Clay Fund." As the parent company, Blackstone argues, it cannot be held liable for the actions of BAAM unless Blackstone itself had direct contact with or activity in Kentucky. Because the Complaint lacks any allegations that Blackstone independently engaged in any conduct in Kentucky, it cannot be subject to suit in this Court. Similarly, KKR argues that the Complaint fails to allege with reasonable particularity that KKR had sufficient contacts with Kentucky. Though KKR combined with Prisma in 2017, it argues that that indirect ownership, without more, is insufficient.

The Court finds, however, that the First Amended Complaint contains sufficient allegations to survive the Motions to Dismiss on this issue. For example, Plaintiff states that each of the out-of-state defendants "participated in a years-long conspiracy, scheme, and common course of concerted conduct and enterprise with in-state Kentucky residents and actors, involving repeated travel into Kentucky by themselves or their agents for business purposes, thus subjecting themselves to the personal jurisdiction of Kentucky courts." First Am. Compl. ¶ 294. Stated another way, the plaintiffs allege that these defendants entered into business arrangements with a Kentucky entity and, through those arrangements, engaged in a pattern of intentional or reckless misrepresentation, which foreseeably caused significant financial losses to KRS, a Kentucky entity, and harm to its members, citizens of Kentucky, to the benefit of these out-of-state defendants. *See* KRS 454.210(2)(a)(4) (providing personal jurisdiction over non-residents that cause tortious injury in the Commonwealth by virtue of their business relationships, persistent

courses of conduct, or substantial revenue derived from their Kentucky relationships). Accordingly, the Motions to Dismiss will be denied to the extent they argue lack of personal jurisdiction.

However, facts uncovered in discovery may warrant revisiting of the issue of personal jurisdiction. Accordingly, the above-named defendants—Blackstone, KKR, Kravis, Roberts, Schwarzman, and Hill—will not be deemed to have waived their right to reassert this defense if warranted by facts established in pretrial discovery.

VI. Attorney Client Privilege and Scope of Legal Representation of Ice Miller

Plaintiffs describe Ice Miller as KRS's "fiduciary advisor." *See* First Am. Compl. ¶ 146. By virtue of this relationship and the circumstances surrounding it, Plaintiffs argue, Ice Miller was a fiduciary to KRS. Ice Miller now seeks dismissal of Plaintiffs' First Amended Complaint based primarily on two arguments. First, Ice Miller argues that this suit violates the "anti-assignment rule," which holds that assignment of a legal malpractice claim "is void against public policy." *Coffey By and Through Collins v. Jefferson Cnty. Bd. of Educ.*, 756 S.W.2d 155, 157 (Ky. App. 1988). Because the claims against Ice Miller stem from its attorney-client relationship with KRS, it argues that those claims constitute an assignment of KRS's right to sue Ice Miller for malpractice. Next, Ice Miller argues that Plaintiffs lack the privity necessary to sue Ice Miller directly, as Plaintiffs were not parties to or third-party beneficiaries of the contract between KRS and Ice Miller.

Both arguments can be resolved by this Court's finding that the plaintiffs were, in fact, third-party beneficiaries to the contract. One qualifies as a third-party beneficiary to a contract so long as the contract in question has been "made and entered into directly or primarily for the benefit of such third person." *King v. Nat'l Indus., Inc.*, 512 F.2d 29, 32 (Ky. App. 1975) (quoting *Long*

v. Reiss, 160 S.W.2d 558, 674 (Ky. 1942)). Though Ice Miller contracted with KRS to provide legal services, the firm was ultimately retained for the benefit of KRS's *members* and the citizens and taxpayers of the Commonwealth of Kentucky. True, the agency itself was the vehicle through which Ice Miller was retained, but there can be no doubt that the legal advisor was retained to protect the best interests of KRS's members and the Commonwealth's citizens and taxpayers. Simply put, the whole purpose of the engagement of legal counsel was to protect the interests of public employees and retirees. In other words, Ice Miller's work with KRS served the public—namely, the members and beneficiaries of KRS. As a result, the present suit is not an assignment of KRS's malpractice claim, but rather, a lawsuit directly brought by members of KRS, who at a minimum are third-party beneficiaries of Ice Miller's representation.

Furthermore, the Court notes that, regardless of the contractual nature of Ice Miller's relationship with KRS, the Complaint alleges facts sufficient to imply a common law fiduciary relationship. Such a relationship "may exist under a variety of circumstances," but "it exists in all cases where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence." *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 485 (Ky. 1992) (quoting *Security Trust Co. v. Wilson*, 210 S.W.2d 336, 338 (Ky. 1948)). It is not typically born solely out of a "generalized business obligation of good faith and fair dealing." *Ballard v. 1400 Willow Council of Co-Owners, Inc.*, 430 S.W.3d 229, 242 (Ky. 2013). However, when that relationship involves a special trust or reliance on the professional party to use its expertise in serving the client, which is knowingly accepted by the professional, a fiduciary relationship is created.

Here, Plaintiffs allege that Ice Miller, as KRS's professional fiduciary advisor, had unrestricted access to and intimate knowledge of KRS's financial records and data. First Am.

Compl. ¶ 146. According to the Complaint, Ice Miller also "has extensive expertise and experience in fiduciary matters for pension plan trustees including advising on the purchase of fiduciary insurance, conflicts of interest and investments in fund of hedge fund investments." *Id.* ¶ 147. Furthermore, the Complaint implies that Ice Miller knowingly accepted this role as fiduciary advisor. *Id.* ¶ 148 (discussing importance of the professional-client relationship between Ice Miller and KRS). Thus, while the full contours of the attorney-client relationship between KRS (and its members) and Ice Miller have not yet been developed in discovery, the plaintiffs have sufficiently alleged that Ice Miller owed fiduciary duties to them which were breached and resulted in injury. Accordingly, for this reason and those cited above, Ice Miller's Motion to Dismiss will be denied.

VII. Failure to State Claims for Breaches of Fiduciary, Statutory, and Other Duties

a. Trustees and Officers

Several of the trustee and officer defendants argue that Plaintiffs fail to allege specific duties and how those duties were breached. However, as noted above, KRS trustees have a clear duty under KRS 61.645 to act in good faith, on an informed basis, and in the best interests of KRS's beneficiaries. In paragraph 26 of the First Amended Complaint, Plaintiffs reference those duties and that portion of KRS 61.645 that allows one to sue for failure to perform said duties. That paragraph states, in part, "Trustees' and Officers [sic] actions and failures to act were violations of their mandatory duties under Kentucky law," clearly referring to KRS 61.645. The specific breaches—namely, the failure to act in good faith and on an informed basis—and the resulting damages are referenced throughout the Complaint, including but not limited to the following: ¶ 7 (describing use of 7.75% return rate as "willfully reckless"), ¶ 169 (describing concealment of KRS's financial condition as "deliberate, willfully manipulation"), ¶ 171

(explaining that KRS trustees and Ice Miller failed to pursue training in good faith), ¶ 195 (explaining that conflicts of interest among trustees and entities made it impossible to use good faith judgment), ¶ 239 (explaining that each defendant "knowingly" participated in a civil conspiracy or scheme); ¶¶ 279, 285 (claiming damages, including lost funds and increasing costs). In addition, paragraph 74 lists instances in which the trustee and officers "willfully or recklessly violated their duties," including the failure to adequately safeguard trust funds, obtain adequate insurance, invest prudently, avoid unreasonable fees, use realistic estimates, match the assets and liabilities of the funds, and make truthful disclosures of KRS's financial status. These allegations are sufficient to survive the CR 12.02 Motions to Dismiss on this issue.

The trustees, as well as the officers, are also subject to fiduciary duties under the common law. As noted above, a common law fiduciary relationship "exists in all cases where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence." *Steelvest*, 807 S.W.2d at 485 (quoting *Security Trust*, 210 S.W.2d at 338). However, the circumstances giving rise to such a relationship "are so varied, it is extremely difficult, if not impossible, to formulate a comprehensive definition of it that would fully and adequately embrace all cases." *Id.* at 489.

In this case, the First Amended Complaint expressly alleges that the trustees had an obligation to protect the trust funds, prudently invest those funds, and to pay benefits to the trust's beneficiaries. *See* First Am. Compl. ¶ 165. The Complaint implies that KRS officers had similar obligations. *See, e.g.*, *id.* ¶ 174 (noting that both trustee and officer defendants breached fiduciary duties by failing to perform the listed actions). The Court finds these allegations sufficient to imply a relationship of trust between the Board, the officers, and KRS members, and a duty to act in the best interest of those members. The Complaint also alleges a failure to act in accordance

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with that duty and resulting damages. *See, e.g., id.* ¶ 174 (breaches), ¶¶ 279, 285 (damages). In other words, the Complaint sufficiently alleges a fiduciary relationship and breaches of those duties. For these reasons, the Motions to Dismiss of the trustee and officer defendants will be denied to the extent they allege a failure to state a claim for breach of fiduciary, statutory, or other duties.

b. CavMac Defendants

The First Amended Complaint also alleges facts sufficient to imply a common law fiduciary relationship between the CavMac Defendants and KRS's members. For example, Plaintiffs allege that CavMac "represented that it had superior skill, experience and expertise in public pension fund actuarial matters." First Am. Compl. ¶ 139. With this experience and expertise, the CavMac Defendants "provided expert actuarial services to KRS for many years," supplying certification for each year's actuarial estimates and assumptions. *Id.* ¶ 140. The individual CavMac Defendants—Cavanaugh, Green, and Bennett—signed off on these certifications, as well as other related opinions and reports. *Id.* ¶ 141.

These allegations are sufficient to overcome the CavMac Defendants' Motion to Dismiss on this issue. Clearly, the CavMac Defendants had contractual duties concerning the administration of funds held in trust for the plaintiffs, but the Court cannot determine the full scope of such duties, or whether they were fiduciary in nature, until after full discovery on the nature of the relationship between the CavMac Defendants and KRS. Thus, factual discovery may support the CavMac Defendants' assertion that they had no fiduciary relationship; however, at this stage in the proceedings, the Court finds that the First Amended Complaint contains allegations that a duty exists and was breached, and that the breach of duty resulted in damages to the plaintiffs. Accordingly, the plaintiffs' claims against these defendants survive a CR 12.02 Motion to Dismiss.

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c. Government Finance Officers Association

GFOA is a nonprofit professional association of state and local finance officers that encourages its members, like KRS, to create financial reports, including Comprehensive Annual Financial Reports. *See* First Am. Compl. ¶ 154. Because KRS created such reports, it repeatedly received GFOA's "Certificate of Achievement" in financial reporting. *See id.* ¶ 157. Plaintiffs now allege that GFOA reviewed these Annual Reports and knew or should have known that the reports contained false or misleading information. *See id.* ¶ 158. Essentially, Plaintiffs argue that the Certificates of Achievement contributed to a false and misleading public perception of KRS's financial status. As a result, Plaintiffs sue GFOA for breaching statutory, fiduciary, or other duties (Count II); participating in a joint enterprise or civil conspiracy (Count III); and aiding and abetting the other defendants' breaches of statutory, fiduciary, and other duties (Count IV). Plaintiffs also attempt to assert a claim of negligent misrepresentation in their reply memorandum; however, the Court finds it inappropriate to amend the pleadings through memoranda and without leave of Court *See generally* CR 15. Regardless, the Court finds that the the First Amended Complaint fails to maintain a cause of action against GFOA for that additional tort, or any other named cause of action, because GFOA owed no duty to Plaintiffs, nor is there any basis but sheer speculation that GFOA's conduct, as alleged by Plaintiffs, had any causal connection to any injury or damages alleged by Plaintiffs.

First, the Court finds that Plaintiffs have failed to allege the breach of any duty owed by GFOA to the plaintiffs. The uncontested facts demonstrate that GFOA is a nonprofit entity that promotes public finance agencies by encouraging financial reporting among these agencies. However, there is no factual assertion that the public or any plaintiff—or *anyone*, for that matter—

has relied on the representations of GFOA (i.e., the Certificates of Achievement) in any material way relevant to the plaintiffs' claims.

In fact, the record is abundantly clear that it would be wholly unreasonable for anyone to assume that GFOA's Certificates are related to KRS's financial solvency, management competency, board competency, investment strategies, or any other material fact relevant to this litigation. GFOA merely promotes financial *reporting* among these agencies; it does not review the financial solvency of the agency. Simply put, GFOA has no regulatory authority or legal oversight responsibilities regarding KRS. Absent some statutory, regulatory, contractual, or other duty to Plaintiffs or the public, GFOA plays merely an advisory role in reviewing financial reports of government agencies.

For example, Plaintiffs' counsel has questioned what might have happened if GFOA had withdrawn its designation for KRS. To answer this question, the Court need look no farther than the description of the GFOA Certificate of Achievement cited in paragraph 157 of the First Amended Complaint:

> The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports and is valid for a period of one year. . . . In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized document. The report must satisfy both generally accepted accounting principles and applicable legal requirements.

From this description, the Court concludes that the only thing a reasonable person would assume from GFOA's hypothetical withdrawal of its Certificate would be that the KRS reports were not "easily readable and efficiently organized." A reasonable person might conclude that KRS needed better editors and graphic designers to put their reports in more readable formats or to make them more understandable to the average reader. If GFOA has withdrawn its certification, no reasonable person would have concluded that KRS was recklessly investing in hedge funds or breaching

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fiduciary duties to its members. It would be sheer speculation that the withdrawal of the GFOA seal of approval might have tipped off members or public officials with oversight responsibilities as to the dire financial condition of KRS. It is simply untenable to posit that any reasonable person would rely on GFOA designations to evaluate the financial status of a multi-billion-dollar public agency. The record is undisputed that the GFOA designation is based on the *form* of the reports, not their substance. In these circumstances, there is no breach of any duty to the plaintiffs.

For these same reasons, the Court finds that the First Amended Complaint lacks any facts to supports its claims that GFOA engaged in a civil conspiracy or aided and abetted the other defendants in their alleged breaches. As stated above, GFOA's Certificate of Achievement merely acknowledged the "easily readable and efficiently organized" nature of KRS's Annual Reports, and no reasonable person would rely on that Certificate to validate KRS's financial condition. Furthermore, there is no negligent misrepresentation where GFOA's description of the Certificate of Achievement clearly states that it is awarded based on the format of the agency's financial reporting—not the strength of the agency's financial status.

Accordingly, for the reasons set forth above, the Court will grant GFOA's Motion to Dismiss, thereby dismissing all claims against GFOA.

d. Hedge Fund Sellers

The "Hedge Fund Seller Defendants" include the entities responsible for the sale and management of the relevant hedge funds, as well as several top executives of those companies. These defendants now argue that Plaintiffs fail to identify a fiduciary duty, relying primarily on the contractual nature of the relationship between these defendants and KRS. In other words, they argue that no fiduciary relationship arose from the contracts; instead, these parties were bound

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only to the terms of their contracts and there are no allegations that they breached the specific terms of those agreements.

At this time, the Court finds that the First Amended Complaint contains allegations sufficient to imply a common law fiduciary relationship between the Hedge Fund Seller Defendants and KRS and its members. *See, e.g.*, First Am. Compl. ¶ 183 (referencing "superior knowledge and expertise" of the Hedge Fund Seller Defendants, KRS's dependence on said expertise, and Defendants' knowledge of that dependence). The Complaint also contains sufficient allegations of a breach of those fiduciary duties. For example, Plaintiffs reference the massive fees collected by these defendants in breach of the common law fiduciary duty to not charge excessive fees. *See id.* ¶¶ 239–243. After factual discovery is completed, those allegations may be disputed or disproven. At this time, however, without full disclosure of all fees, costs, and other expenses related to the management of these hedge funds, the Court cannot dismiss these defendants.

VIII. Failure to State Claim for Joint Enterprise/Civil Conspiracy

To successfully plead a claim of civil conspiracy, one must allege "an unlawful/corrupt combination or agreement between the alleged conspirators to do by some concerted action an unlawful act." *James v. Wilson*, 95 S.W.3d 875, 897 (Ky. App. 2002). Similarly, a claim of joint enterprise requires

> (1) an agreement, express or implied, among the members of the group; (2) a common purpose to be carried out by the group; (3) a community of pecuniary interest in that purpose, among the members; and (4) an equal right to a voice in the direction of the enterprise, which gives an equal right of control.

Huff v. Rosenberg, 496 S.W.2d 352, 255 (Ky. 1973) (citation omitted). Ultimately, "[a] conspiracy may be shown by circumstantial evidence, by the acts or declarations of the conspirators, or by the

cumulative effect of concerted action of the several parties concerned." *See Addison v. Wilson*, 37 S.W.2d 7, 11 (Ky. 1931) (citation omitted).

In the present suit, Defendants argue that Plaintiffs fail to allege an agreement among the defendants to do the unlawful or tortious act. However, accepting all allegations in the First Amended Complaint as true for purposes of this decision, the Court finds that Plaintiffs sufficiently plead circumstances that could lead a jury to conclude that such an agreement existed. For example, throughout the Complaint, Plaintiffs repeat their allegation that various defendants "knowingly aided and abetted the breach of duties by Trustees, while participating by committing overt acts, in an ongoing scheme, civil conspiracy, common course of conduct and joint enterprise" in concert with the KRS trustees, by "acting and failing to act as alleged herein." First Am. Compl. ¶¶ 93, 106, 138, 145, 153, 159. The actions and inactions included in the Complaint include providing false or misleading information, and otherwise acting in bad faith. *See, e.g.*, *id.* ¶¶ 7, 169. The Complaint also details alleged conflicts of interest among the KRS trustees and the other defendants, which could lead a factfinder to conclude that an agreement, express or implied, existed among these parties. *See, e.g., id.* ¶¶ 62, 69–70. Accordingly, at this time, the Court will deny the Motions to Dismiss to the extent they argue that Plaintiffs failed to sufficiently allege a claim for civil conspiracy and/or joint enterprise.

IX. Failure to State Claim for Aiding & Abetting

A claim of aiding and abetting a breach of fiduciary duty requires the following elements: "(1) the existence and breach of a fiduciary relationship; (2) the defendant gave the breaching party 'substantial assistance or encouragement' in effectuating the breach; and (3) the defendant knew that the party's conduct breached that fiduciary duty." *Insight Ky. Ptnrs II, L.P. v. Preferred Automotive Servs., Inc.*, 514 S.W.3d 537, 546 (Ky. App. 2016) (citing *Miles Farm Supply, LLC v.*

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Helena Chem. Co., 595 F.3d 663, 666 (6th Cir. 2010)). In this suit, several Defendants argue that Plaintiffs fail to sufficiently allege that they provided the "substantial assistance" necessary to support these claims.

However, accepting all allegations in the First Amended Complaint as true for purposes of this decision, the Court finds that Plaintiffs sufficiently plead their aiding and abetting claim. First, as explained in more detail above, Plaintiffs allege the existence and breaches of a fiduciary duty. Plaintiffs also allege that the defendants knowingly provided assistance to the breaching parties by promoting or allowing the use of false or misleading information in an effort to conceal KRS's financial status. *See, e.g.*, ¶¶ 105, 134, 136–37, 144, 152, 169. At this time, these allegations are sufficient to overcome the defendants' Motions to Dismiss on this issue.

In addition, at least one defendant argues that aiding and abetting a breach of fiduciary duty is not a separate cause of action in Kentucky, citing *Peoples Bank v. Crowe Chizek and Co., LLC*, 277 S.W.3d 255, 260–61 (Ky. App. 2008). However, this Court finds that *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476 (Ky. 1992) remains controlling law on this issue. *See Gundaker/Jordan American Holdings, Inc. v. Clark*, 2008 WL 4550540, *4 (E.D.Ky. Oct. 9, 2008) (declining to follow *Peoples Bank* and instead following *Steelvest*).[1] In *Steelvest*, our Supreme Court made clear that "a person who knowingly joins with or aids and abets a fiduciary in an enterprise constituting a breach of the fiduciary relationship becomes jointly and severally liable with the fiduciary for any profits that may accrue." 807 S.W.2d at 485. Thus, aiding and abetting is appropriately pleaded as a separate cause of action, and, for the reasons set forth above, this cause of action survives Defendants' Motions to Dismiss.

[1] At the time of the *Gundaker/Jordan* decision, the *Peoples Bank* decision was not yet final. The Court noted this, explaining that the case "cannot be cited as authority in Kentucky courts." 2008 WL 4550540 at *4. However, this was only one factor in the Court's decision not to follow *Peoples Bank*; the primary reason was the precedential value of the Kentucky Supreme Court's holding in *Steelvest*, which was not addressed by *Peoples Bank*.

X. Economic Loss Rule

In support of their Motion to Dismiss, the CavMac Defendants explain that "all of the CavMac Defendants' actions complained of in this case were conducted pursuant to the terms of its contracts with KRS to perform actuarial services." CavMac Defs.' Mem. 18. Thus, they argue, each of Plaintiffs' claims is barred by the economic loss rule. In response, Plaintiffs insist that that the economic loss rule applies only to claims brought by the purchaser of a defective product for economic losses arising from the malfunction of that product. This Court agrees.

The Kentucky Supreme Court officially adopted the economic loss rule in 2011 in *Giddings & Lewis, Inc. v. Industrial Risk Insurers*, 348 S.W.3d 729 (Ky. 2011). Limiting its ruling to the commercial context, the Court explained that the rule "prevents the commercial purchaser of a product from suing in tort to recover for economic losses arising from the malfunction of the product itself, recognizing that such damages must be recovered, if at all, pursuant to contract law." *Id.* at 733. Other states have expanded this doctrine and applied the economic loss rule to other areas of the law, including construction contracts and real estate transactions. *See generally West Ridge Group LLC v. First Trust Company of Anaga*, 414 Fed. Appx. 112, (10th Cir. 2011) (violations of Real Estate Settlement Procedures Act); *Marion County Public Library v. Charlier Clark & Linard, P.C.*, 929 N.E. 2d 722 (Ind. 2010) (defective design and construction of parking garage); *Flagstaff Affordable Housing Limited Partnership v. Design Alliance, Inc*., 223 P.3d 664, 673 (Ariz. 2010) (construction defect).

The Kentucky Court of Appeals also expanded the rule in an unpublished decision involving a services contract, specifically, one for construction work. *See Cincinnati Ins. Cos. V. Staggs & Fisher Consulting Engineers, Inc.*, 2013 WL 1003543 (Ky. App. Mar. 15, 2013). However, that case has little precedential value, and Kentucky remains skeptical of the economic

loss doctrine. *See State Farm Mutual Auto. Ins. Co. v. Norcold, Inc.*, 849 F.3d 328, 335 (6th Cir. 2017) (explaining Kentucky's "skepticism" of the rule); *D.W. Wilburn, Inc. v. K. Norman Berry Associates, Architects, PLLC*, 2016 WL 7405774, *6 (Dec. 22, 2016) (explaining that *Staggs & Fisher* has "has no precedential value" and implying that, at most, its ruling is limited to the facts of that case). In fact,

> federal courts applying Kentucky law, both before and after the *Giddings & Lewis* decision, that have addressed the issue of whether the economic loss rule should apply to the provision of services consistently have held that the Kentucky Supreme Court would not apply the economic loss rule to service contracts.

NS Transp. Brokerage Corp. v. Louisville Sealcoat Ventures, LLC, 2015 WL 1020598, *4 (W.D.Ky. Mar. 9, 2015) (citations omitted). This Court declines to now extend the doctrine to such contracts.

This decision is not altered by Defendants' reliance on *Presnell Construction Managers, Inc. v. EH Construction, LLC*, 134 S.W.3d 575 (Ky. 2004). The *Presnell* decision—decided prior to *Giddings & Lewis*—does not mention the economic loss rule; rather, the rule is discussed in Justice Keller's concurring opinion. In fact, federal courts have since "found the absence of any such discussion by the majority indicative of our Supreme Court's unwillingness to expand the economic loss rule beyond products liability cases." *D.W. Wilburn, Inc.*, 2016 WL 7405774, *7 (referencing *Louisville Gas and Elec. Co. v. Continental Field Systems, Inc.*, 420 F.Supp.2d 764 (W.D.Ky. 2005)). As noted above, this Court also declines to extend the economic loss rule to the present suit involving a service contract between a state agency and an actuarial services provider. The CavMac Defendants' Motion to Dismiss will therefore be denied to the extent it relies on this doctrine.

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XI. Punitive Damages

As their fifth cause of action, Plaintiffs assert a claim for punitive damages. Some defendants argue that this claim fails as a matter of law because punitive damages are a remedy, rather than a separate cause of action. *See, e.g.*, CavMac Defs.' Mot. to Dismiss 19. The Court agrees that, generally speaking, "a claim for punitive damages is not a separate cause of action, but a remedy potentially available for another cause of action." *Dalton v. Animas Corp.*, 913 F.Supp.2d 370, 378 (W.D. Ky. 2012) (citation omitted); *see also Archey v. AT&T Mobility, LLC*, 2017 WL 6614106, *4 (E.D. Ky. Dec. 26, 2017) (citations omitted). However, as recently as 2017, our Court of Appeals explained, "Unlike the view of the federal courts and the state courts that follow them, Kentucky *does* consider punitive damages a separate claim and not merely an additional remedy along with compensatory damages." *Chesley v. Abbott*, 524 S.W.3d 471, 480 (Ky. App. 2017) (citation omitted). In that case, *Chesley v. Abbott*, the Court examined Kentucky case law, as well as Kentucky's punitive damages statute, KRS 411.186. That statute provides, in pertinent part, "In any civil action where *claims* for punitive damages are included, the jury or judge if jury trial has been waived, shall determine concurrently with all other issues presented, whether punitive damages may be assessed." KRS 411.186(1) (emphasis added). Accordingly, "[i]n Kentucky, a claim for punitive damages, although interrelated, is a separate claim that is extricable from a breach of fiduciary duty judgment and vice versa." *Chesley*, 524 S.W.3d at 480–81. As such, Plaintiffs' punitive damages claim (Count V) survives Defendants' Motions to Dismiss.

Defendants also argue that a claim for punitive damages must fail when the underlying tort is dismissed. However, for the reasons set forth above, Plaintiffs' claims have survived the

Motions to Dismiss (with the exception of GFOA's Motion). Accordingly, the Defendants' motions to dismiss the plaintiffs' claim for punitive damages must be denied.

CONCLUSION

For the reasons set forth above, the Court hereby **GRANTS** the Motion to Dismiss filed by Defendant GFOA, and all claims against GFOA are hereby **DISMISSED**. All remaining Motions to Dismiss are hereby **DENIED**. The Motion to Defer is also **DENIED**.

Furthermore, the parties are **ORDERED** to meet and confer and submit an Agreed Case Management Order within thirty (30) days of the entry of this Order. That Order shall address deadlines for completion of discovery, disclosure of lay and expert witnesses, and filing of dispositive motions, and any other necessary pre-trial deadlines. If the parties cannot agree on the terms of the Order, they shall contact Judicial Assistant Kathryn Marshall at 502-564-8383 to schedule a Case Management Conference with this Court.

SO ORDERED this 30th day of November, 2018.

/s/ HON. PHILLIP J. SHEPHERD
electronically signed
11/30/2018 1:51:29 PM

PHILLIP J. SHEPHERD, JUDGE
Franklin Circuit Court, Division I

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