COMMONWEALTH OF KENTUCKY
COURT OF APPEALS
Case No. 2024-CA-0781

KKR & CO., L.P., *ET AL.* — Petitioners

vs.

HON. THOMAS WINGATE
FRANKLIN CIRCUIT COURT — Respondent

- and -

TIA TAYLOR, *ET AL.* — Real Parties in Interest

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**RESPONSE OF REAL PARTIES IN INTEREST TO THE HEDGE FUND SELLERS' WRIT PETITION**

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## I. COUNTER STATEMENT OF THE CASE

1. The Court should deny this Writ Petition[1] because, with absolute certainty, the Tier 3 Trust Plaintiffs[2] have constitutional standing under *Overstreet v. Mayberry*, 603 S.W.3d 244 (Ky. 2020). While *Overstreet* held that the Tier 1 and Tier 2 members lacked standing to bring claims on KRS's behalf, the Supreme Court expressly exempted from that holding the Tier 3 members, whose "'***Hybrid Cash Balance Plan***' … has characteristics of both a defined-benefit plan and ***a defined-contribution plan***." *Id.* at 253 n.21; *see also* ¶¶ 13, 26, 105, 196.

Indeed, the Tier 3 Trust Plaintiffs' Complaint pleads in detail their "injury in fact" from the Hedge Fund Sellers' participation in the breach of trust. *E.g.*, ¶¶ 23–26, 105, 200–206. Specifically, the amounts in the Tier 3 members' individual pension accounts and ultimate pension payments are—by the design of the Hybrid Cash Balance Plan created by KRS § 61.597—dependent upon the annual investment returns of the KRS Trusts. ¶¶ 196, 203–204. Each Tier 3 member's individual account and ultimate pension entitlement have been and continue to be diminished

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[1] Petitioners are the "Hedge Fund Sellers"—Defendants KKR & Co., L.P., Henry R. Kravis, George R. Roberts, Prisma Capital Partners, L.P., Girish Reddy, Blackstone Group L.P., Blackstone Group Inc., Blackstone Alternative Asset Management L.P., J. Tomilson Hill, Stephen A. Schwarzman, Pacific Alternative Asset Management Company, LLC, and Jane Buchan.

[2] The Real Parties in Interest are the "Tier 3 Trust Plaintiffs"—Tia Taylor, Ashley Hall-Nagy, Bobby Estes, and Jacob Walson, members of the Tier 3 Hybrid Cash Balance Plan of the Kentucky Retirement Systems ("KRS"). The allegations in their August 19, 2021 complaint (the "Complaint") (Exhibit 1) are cited as "¶ ____." Pages in the Complaint are cited as "Compl. at ___." Additional exhibits, including the Investigation Report issued by Calcaterra Pollack LLP on May 12, 2021 (the "Report") (Ex. 4), are submitted as evidence pursuant to Kentucky Rule of Appellate Procedure 60(E). Unless otherwise noted, all emphases in quoted texts are added.

due to the $1.8 billion hedge fund escapade. ¶¶ 105, 195–206. Amounting to "***thousands of dollars***" for each Tier 3 Trust Plaintiffs (¶¶ 25, 105), this diminution in value of their individual accounts and benefits constitutes "injury in fact" because they have a "concrete stake" in this lawsuit. *Cf. Thole v. U.S. Bank N.A.*, 590 U.S. 538, 541 (2020) (no "concrete stake" exists if plaintiffs "were to lose [or win] …, they would … receive the … same … benefits …, not a penny less, … not a penny more").

The Tier 3 Trust Plaintiffs further allege that their injury was caused by the Hedge Fund Sellers' participation in the Trustee's breach of trust—the same "***significant misconduct***" that the Supreme Court found to have been alleged in the *Mayberry* complaint (*Overstreet*, 603 S.W.3d at 266). In light of these allegations, redressability is easily satisfied because, under the long-standing common law of trusts, beneficiaries have a right to pursue damage claims to recover trust assets against the culpable trustee and third parties who knowingly participated in the breach of trust. *See* RESTATEMENT (SECOND) OF TRUSTS § 326 (1959). Indeed, as alleged in the Complaint and provided in KRS §§ 61.515 and 61.650, redress is available to the Tier 3 Trust Plaintiffs because a recovery to the KRS Trusts can be allocated to plan beneficiaries under the Circuit Court's "broad equitable powers … to remedy breaches of trust." *Katsaros v. Cody*, 744 F.2d 270, 282 (2d Cir. 1984).

In sum, the Tier 3 Trust Plaintiffs have alleged a concrete injury, caused by the Hedge Fund Sellers, that is redressable by the Circuit Court's judgment, including equitable monetary relief for the benefit of the Trusts. The Tier 3 Trust Plaintiffs have standing to bring these breach-of-trust claims for the KRS Trusts.

2. This Court should reject the Hedge Fund Sellers' assertion that the Circuit Court misapplied the common law of trusts. This assertion challenges the merits of the Tier 3 Trust Plaintiffs' legal theory and has nothing to do with subject-matter jurisdiction. *Hoskins v. Maricle*, 150 S.W.3d 1, 18 (Ky. 2004) (distinguishing between the classes of writs of prohibition). In any event, the Circuit Court correctly found that the Tier 3 Trust Plaintiffs have a right, under the common law of trusts, as recognized by courts in Kentucky and beyond, to sue third parties for participating in the Trustee's breaches of trust. *See City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 68 Cal. App. 4th 445, 465 (1998); *see also* RESTATEMENT (SECOND) OF TRUSTS § 326 (1959).

The breach-of-trust claims asserted here stand in stark contrast with the Commonwealth's taxpayer claims asserted by the Attorney General (the "AG") and his private contingency-fee counsel.[3] That related lawsuit, which was started with a carbon copy of the initial *Mayberry* complaint,[4] faces defenses of *in pari delicto* and causation due to the misconduct of the KRS Trustee and chronic underfunding by the Commonwealth. More importantly, the Tier 3 Trust Plaintiffs can recover all losses suffered by the KRS Trusts (plus punitive damages) and secure the return of the

[3] When the *Mayberry* case was commenced in 2017, the then-AG was presented with "an advance copy of [the] complaint" setting forth the taxpayer claims, but declined to bring them. *Overstreet*, 603 S.W.3d at 251. In 2020, to bring the taxpayer lawsuit, the AG retained private contingent-fee counsel, some of whom had represented the *Mayberry* plaintiffs. To avoid the statutory limitation on fees, the AG sought and obtained special legislation over Governor Beshear's veto. *See* Ex. 13.

[4] The AG's private counsel copied the *Mayberry* complaint—the work product of counsel for the Tier 3 Trust Plaintiffs, who drafted both the *Mayberry* complaint and the breach-of-trust Complaint in this case.

exorbitant fees and other diverted Trust assets to the KRS Trusts by way of restitution and disgorgement remedies.

On the other hand, the AG is required by statute (KRS § 48.005(3)) to deposit all proceeds from the Commonwealth's lawsuit to its general fund—not to the KRS Trusts. As the Circuit Court aptly recognized, this breach-of-trust case and the AG's case "are different and distinct in important respects," and "the different theories of the case may well result in different remedies." *Taylor v. KKR & Co., L.P.*, No. 21-CI-00645, slip op. at 4–5 (Ky. Cir. Ct. Franklin Cnty. May 1, 2024) (Exhibit 2). All told, this breach-of-trust case under Section 326 of the Restatement (Second) of Trusts is not subject to the defenses based on *in pari delicto*, causation, contractual exculpation, and comparative fault. The recovery in this case will directly benefit the Trusts and, in turn, the KRS beneficiaries. This case is therefore not just different, but better and stronger, than the AG's taxpayer case.

Respondent, the Honorable Thomas D. Wingate, properly upheld the sufficiency of the Complaint. He has acted well within his discretion in managing this KRS pension litigation by permitting both this case and the Commonwealth's case to proceed. The Hedge Fund Defendants' petition is nothing more than a disguised interlocutory appeal of Judge Wingate's management of two related cases involving KRS—what one financial expert described as "a contender … [for] the title of the most corrupt and the most incompetent public pension fund in the U.S."[5]

[5] Gary Rivlin, *The Whistle Blower, How a Gang of Hedge Funders Strip-Mined Kentucky's Public Pensions*, THE INTERCEPT, at 5 (Oct. 21, 2008).

3. Finally, as a matter of law, the multi-billion-dollar Wall-Street Hedge Fund Sellers cannot establish irreparable harm based on having to defend these two lawsuits in Kentucky. As stated in the Hedge Fund Sellers' filings with the Securities and Exchange Commission ("SEC"), lawsuits like these by dissatisfied investors are nothing more than an inconvenience and a cost of doing business. If they lose, they can appeal; and if they show the cases are frivolous, they can get their legal fees.

In sum, the Circuit Court has acted well within its jurisdiction in upholding the Complaint, whose allegations the Supreme Court in *Overstreet* recognized as having "alleg[ed] significant misconduct." 603 S.W.3d at 266. The Circuit Court has acted well within its discretionary authority in allowing this breach-of-trust case to go forward alongside the AG's taxpayer case. The Court should deny the Writ Petition and allow this case to proceed in the Circuit Court, as the Judiciary must do its part to protect the Commonwealth's 420,000 public employees and to hold the Hedge Fund Sellers accountable for their misconduct.

## II. BACKGROUND

### A. Judge Wingate Denied the Hedge Fund Sellers' Motions to Dismiss the Lawsuit by the Tier 3 Trust Plaintiffs for the KRS Trusts and the Lawsuit by the Commonwealth for Taxpayers

Two separate lawsuits are pending before Judge Wingate:

- this breach-of-trust lawsuit filed by the Tier 3 Trust Plaintiffs based on the "culpable trustee" theory under Section 326 of the Restatement (Second) of Trusts, *Taylor v. KKR & Co., L.P.*, No. 21-CI-00645; and
- the taxpayer lawsuit filed by the Commonwealth through the AG using the *Mayberry* complaint, *Commonwealth v. KKR & Co., Inc.*, No. 20-CI-00590.

In this breach-of-trust lawsuit, the Tier 3 Trust Plaintiffs are seeking to recover compensatory and punitive damages, recapture over $300 million in "exorbitant hedge fund fees," and obtain any other equitable relief necessary to make the KRS Trusts whole. Any recoveries and equitable relief the Tier 3 Trust Plaintiffs achieve are Trust assets to be used "***solely***" for trust beneficiary and benefit purposes (KRS § 61.515) and will (and must) be paid into the Trusts, to be allocated by the Trustee under KRS § 61.685. In contrast, any recovery in the AG's taxpayer suit, must by statute be paid into the Commonwealth's Treasury and placed in its general fund—not paid over to the KRS Trusts. KRS § 48.005(3).

On May 1, 2024, Judge Wingate issued separate orders denying the Hedge Fund Sellers' motions to dismiss in both cases. *Taylor*, slip op. at 18; *Commonwealth v. KKR & Co., Inc.*, No. 20-CI-00590, slip op. at 18 (Ky. Cir. Ct. Franklin Cnty. May 1, 2024) (Exhibit 3).

### B. This Breach-of-Trust Lawsuit Is Not a Repeat of the *Mayberry* Lawsuit in Terms of Constitutional Standing, Because the Facts Alleged in the Tier 3 Trust Plaintiffs' Complaint Satisfy *Overstreet*'s Requirements

The Hedge Fund Sellers pretend that this case, filed by Tier 3 members in 2021, is the same as the *Mayberry* derivative case, filed by Tier 1 and Tier 2 members in 2017. The *Mayberry* case was dismissed based on a technicality—that the Tier 1 and Tier 2 members could not plead injury in fact under *Sexton*.[6]

[6] When *Mayberry* was filed in 2017, the Supreme Court had not decided *Sexton*, which adopted the federal standing requirement. *See Cabinet for Health & Family Servs. v. Sexton*, 566 S.W.3d 185, 196 (Ky. 2018). Because plaintiffs' individual harm was irrelevant pre-*Sexton*, the *Mayberry* complaint—unlike this breach-of-trust Complaint—made no attempt to specifically plead constitutional standing.

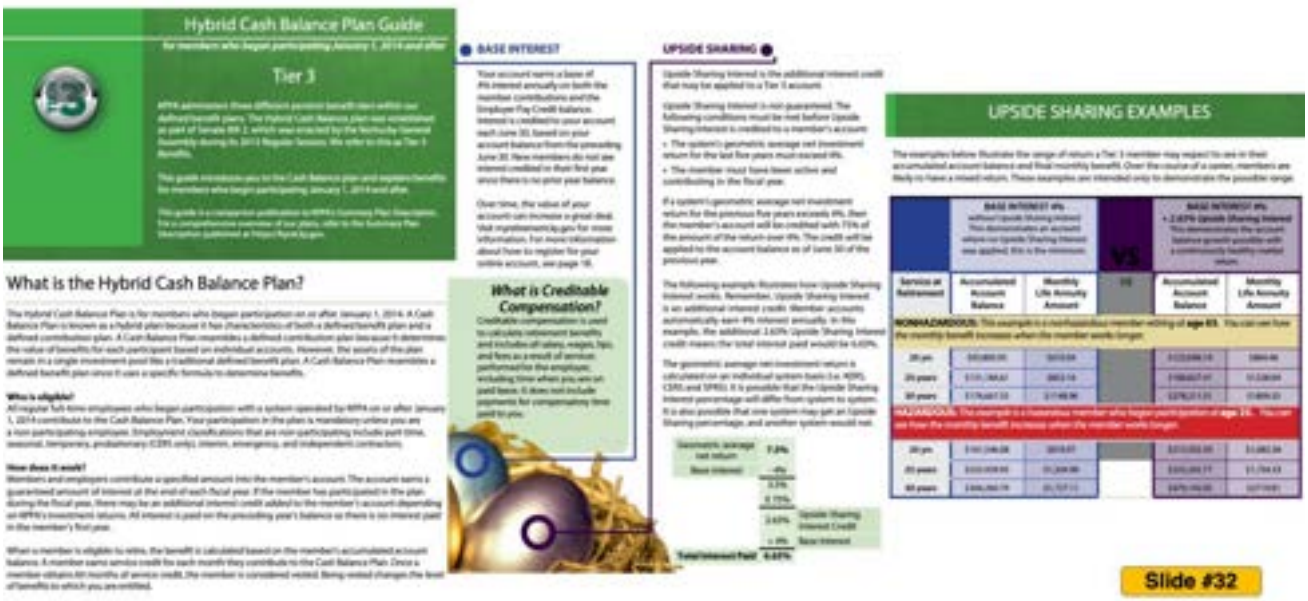
But the dismissal of *Mayberry* applies only to the Tier 1 and Tier 2 members, who are "beneficiaries of KRS defined-benefit plans." *Overstreet*, 603 S.W.3d at 263 ("this case concerns only the ability of beneficiaries of KRS defined benefit plans to sue"). Expressly exempted from *Overstreet*'s standing analysis are the Tier 3 members, who are obligated by law to contribute to the "Hybrid Cash Balance Plan":

> [N]one of the [*Mayberry*] Plaintiffs are members of the KRS "Hybrid Cash Balance Plan," which has characteristics of both a defined-benefit plan and a defined-contribution plan. The plan became available to members who began participation with KRS on or after January 1, 2014.

603 S.W.3d at 253 n.21.

By plan design, each Tier 3 member has an individual retirement account within the KRS Trusts. ¶ 26. Each Tier 3 member contributes thousands of dollars of his or her own earnings to KRS to fund their account. *Id*. Each Tier 3 member's ultimate pension benefit depends upon the Trustee's investment performance each year, cumulated over the years the Tier 3 member works for the state. *Id.* The accumulated value is then paid out to the retiree over time. ¶ 203. Any investment loss, under performance or bad investment today, as well as any "exorbitant" fees paid today, negatively impacts the ultimate pension. ¶¶ 105, 200–206.

The terms of the Tier 3 plan are clear as can be:




¶ 196 (Compl. at 96–98).

A Tier 3 member's individual account earns a guaranteed 4% of interest and there "maybe" an additional interest credit added to the member's account depending on KRS's investment returns. To get the additional credit, KRS's geometric average net investment return for the last five years must exceed 4%. If 4% is exceeded, then the member's account will be credited with 75% of the amount of the return over 4%. ¶ 196 (Compl. at 96–97). This upside credit is entirely dependent on investment returns. *See*, *e.g.*, ¶ 26. And it truly matters.

According to KRS, a non-hazardous member (a court clerk, for example) who works 30 years but gets no upside sharing due to inadequate investment returns would have an accumulated account balance of $176,667.55, yielding a monthly pension of $1,148.96. *See* Compl. at 97. But if KRS obtains the full upside sharing each year due to a continuous healthy market return, the accumulated account

balance would be $278,211.51, yielding a monthly pension of $1,809.35—over 57% higher than the pension without upside sharing.

Take a court clerk ("nonhazardous") who, after working for 30 years, retires at 50 and lives till 80. The clerk's pension benefits between an account without upside sharing, and an account with upside sharing, amount to a difference of $661 per month, $7,932 per year, and $237,760 for her lifetime. *See id.* For a cop or firefighter ("hazardous"), it would be $992 per month, $11,904 per year, and $357,120 for her lifetime. *See id.* Investment returns make a huge difference to the individual pension accounts of the Tier 3 members.

The Culpable Trustee sold off billions in trust assets—34% of the Trusts' good dividend paying stocks, 53% of the fixed income investments and 100% of the US Treasures—all to fund the Black Box speculation. ¶ 48. Had this not occurred—had the Trustee stood pat, done nothing, and turned the Wall-Street Hedge Fund Sellers aside, the Trusts would have billions more in assets today and each of the Tier 3 Trust Plaintiffs' current retirement accounts and ultimate pension payments would be worth "thousands of dollars" more. ¶¶ 276, 279–283.

Because the Tier 3 members are not in a defined-benefit plan, they each have actually been harmed by the $1.8 billion in Black Box Hedge Fund allocations. The $300 million in exorbitant fees, subpar returns and losses on the Black Boxes in several years, harmed these Tier 3 Trust Plaintiffs' individual pension accounts, reducing the current value of these individual accounts and the ultimate pension payout amounts by "thousands of dollars." ¶¶ 23–26, 105, 195–197, 200–206.

In addition to the variability of their current pension accounts and ultimate pension payout based on annual investment returns, all the Tier 3 Trust Plaintiffs' pension accounts and benefits are at risk of future reduction—even complete loss. If the Trusts were to become insolvent or require a restructuring (as almost happened in 2020) the benefits are not guaranteed, or if the legislature decides that the "welfare" of the Commonwealth "demands" it, to "suspend or reduce" the benefits, the Tier 3s will suffer that loss without remedy. *See* ¶¶ 23–28, 197.

### C. This Breach-of-Trust Lawsuit Is Neither Duplicative of, Nor Displaced by, the AG's Lawsuit—the Tier 3 Trust Plaintiffs Can Recover *All* the Trusts' Losses, Including Recapturing the "Exorbitant Hedge Fund Fees," While the AG's Lawsuit Cannot

Ignoring the factual and legal differences between this breach-of-trust lawsuit and the taxpayer suit being prosecuted by the AG's private counsel, the Hedge Fund Sellers assert that that separate suit makes this breach-of-trust action duplicative and bars it from recovering damages or obtaining other relief for the KRS Trusts. To do so, the Hedge Fund Sellers ignore the pleading rules governing motions to dismiss and distort the Complaint's allegations that Judge Wingate found to have stated a claim for the Culpable Trustee's breaches of its fiduciary duties, the Hedge Fund Sellers' participation in those breaches, and the resulting injury to the Tier 3 beneficiaries. *See* Taylor, slip op. at 3–6. These allegations establish the Tier 3 Trust Plaintiffs' standing to sue as trust beneficiaries under Section 326:

> A third person who … has notice that the trustee is committing a breach of trust and participates therein is liable to the beneficiary for any loss caused by the breach of trust.
>
> ***
>
> [I]f the trustee purchases through a stockbroker securities which it is a breach for him to purchase and the broker knows that the purchase is

in breach of trust, the broker is liable for participation in the breach[.]

RESTATEMENT (SECOND) OF TRUSTS § 326 & Cmt. (a) (1959).[7]

That is this case. *See* 76 Am. Jur 2d Trusts § 603 ("a trust beneficiary may sue third persons who, for their own financial gain or advantage, induced the trustee to commit a breach of trust, participated with, aided or abetted the trustee in such a breach of trust, or while knowing of the breach of trust, received and retained trust property from the trustee"). Joint and several liability exists. *Steelvest, Inc. v. Scansteel Serv. Ctr.*, 807 S.W.2d 476, 485 (Ky. 1991) ("a person who knowingly … aids and abets a fiduciary in … a breach of the fiduciary relationship becomes jointly and severally liable"); *see also* RESTATEMENT (SECOND) OF TORTS §§ 875–876 (1979) (rules governing "contributing tortfeasors" and "persons acting in concert").

This is not a derivative case for KRS. The Hedge Fund Sellers assert that the Tier 3 Trust Plaintiffs are suing "on behalf of KRS." Pet. at 10. But the Complaint belies this assertion. The Complaint does not say the Tier 3 Trust Plaintiffs are suing "on behalf of KRS." To the contrary, the Complaint expressly states that "[t]his action is not a derivative action on behalf of KRS or its trusts." ¶ 16. Instead, "this is a

[7] Although reorganized and renumbered, RESTATEMENT (THIRD) OF TRUSTS carries forward Section 326. Sections 100 and 107 of the Third Restatement recognize the beneficiaries' ability to sue when the "trustee is unable, unavailable, unsuitable or failing to protect the beneficiaries interest." RESTATEMENT (THIRD) OF TRUSTS §§ 100, 107(2)(b) & Reporter's Notes, Cmt. f (2012). The cause of action is a trust asset—the Trust gets the recovery, which the Trustee allocates according to the terms of the Trusts. *See* KRS § 61.685; *see also* Austin W. Scott, William F. Fratcher & Mark L. Ascher, SCOTT AND ASCHER ON TRUSTS §§ 28.1–28.2 (5th ed. 2008); and George C. Bogert & George T. Bogert, THE LAW OF TRUSTS AND TRUSTEES §§ 869, 955 (Rev. 2d ed 1995).

direct action by trust beneficiaries against culpable third parties to recover damages for the trusts." *Id*. And the law is that "the right of the beneficiaries against the [third party] is a direct right and not one that is derivative through the trustee." *City of Atascadero*, 68 Cal. App. 4th at 465.

The breach-of-trust lawsuit is unique. It is essentially a "strict liability" breach of fiduciary duty case based on the common law. ¶¶ 8, 16, 373–400. The burden is on Defendants to prove their alleged conduct in the billions of challenged Black Box transactions and their $300 million in fees, met stringent fiduciary standards. They bear the burden on damages as well, proving any losses, poor returns and associated funding declines were not due to the Trustee's breach of fiduciary duties—including "alternative investments"—and these Black Boxes, the largest and worst investment ever made with Trust funds.

The lawsuit by the AG's private counsel in no way justifies dismissal of this case. Any recovery in the AG's lawsuit must by statute be paid to the Treasury general fund, not to the KRS Trusts. KRS § 48.005(3).[8] But in this breach-of-trust case, all recovery are Trust assets—which must by statute (KRS § 61.515) be used "solely" and "exclusively" for Trust beneficiaries, and thus must be paid into the Trusts, to be allocated by the Trustee. KRS § 61.685.

[8] Under KRS 48.005, 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). Those monies end up in the "general fund surplus account." KRS § 48.005(4).

### D. Defending This Lawsuit in Kentucky Is Not "Irreparable Harm" to the Wall-Street Hedge Fund Behemoths

These multibillion-dollar Wall-Street enterprises, as well as their billionaire founders, claim they would suffer "great and irreparable harm" if they are forced to defend this lawsuit. But the cost and inconvenience of defending a lawsuit is not "irreparable harm." *Romines v. Coleman*, 671 S.W.3d 269, 276 (Ky. 2023) ("[a] great and irreparable injury is not merely the high cost of time and money attendant with litigation"); *Ison v. Bradley*, 333 S.W.2d 784, 786 (Ky. Ct. App. 1960) (same).

Here, there can be no claims of financial distress. These are multi-billion-dollar Wall-Street enterprises. Blackstone has $40 billion in assets, makes $2 billion a year, and boasts a net worth of $7 billion. *See* ¶ 126. KKR has $317 billion in assets, makes $5 billion a year, and boasts a net worth of $23 billion. *See* ¶ 108. Their principals Schwarzman, Hill, Kravis, and Roberts pocket hundreds of millions every year and are worth billions. ¶¶ 126–136, 152–160.

In contrast to their claim of "irreparable harm" (Pet. at 26), the Hedge Fund Sellers stated in their SEC filings, signed by Schwarzman, Hill, Kravis, and Roberts, that the outcome of this case "will not have any adverse impact" on their businesses.

In any event, Judge Wingate will oversee the separate prosecutions of the two cases in a manner to prevent duplicative litigation or double recoveries. If the Hedge Fund Sellers are found liable, they can appeal. If the case is frivolous, they can recover their fees. Thus, there can be no credible claim of great injustice or irreparable harm.

### E. The Hedge Fund Sellers Have Delayed These Meritorious Claims for Years—Exploiting the Kentucky Legal System to the Detriment of KRS Trust Beneficiaries

The Hedge Fund Sellers are responsible for the long delay in finally reaching the merits of the factual allegations in the Complaint by asserting pleading technicalities and attacking Kentucky judges and counsel. They first derailed the *Mayberry* case by seeking to enforce *Sexton's* requirement of pleading constitutional standing, which had not existed when *Mayberry* was commenced.

After the *Overstreet* remand, this breach-of-trust case was commenced by the Tier 3 members and assigned to Judge Shepherd, who had earlier found that the *Mayberry* claims were "serious and demanded remedy." ¶ 14. Despite Judge Shepherd's years of labor in presiding over the related cases, the Hedge Fund Sellers attacked him and forced him to recuse from all the KRS cases. The cases were dumped on Judge Wingate, who was forced to completely redo the litigations. After a great deal of work—thousands of pages of submissions and several hearings—he denied the motions to dismiss both lawsuits.

The Hedge Fund Sellers attack anyone who tries to hold them accountable. Their attack on Judge Shepherd is echoed in this Writ Petition, with its diatribe against "out of state contingency fee lawyers," *i.e.*, the lawyers who have devoted years of effort to try to remedy the harm done by these Wall-Street predators to the KRS Trusts holding the pension savings of 420,000 Kentucky public employees.

Contrary to their insinuation of vexatious litigation by "out of state" lawyers, this lawsuit is all about Kentucky—prosecuted by Kentuckians to benefit Kentucky public employees and, ultimately, all citizens of the Commonwealth. The lead lawyer

for the Tier 3 Trust Plaintiffs is Michelle Ciccarelli Lerach, a 1993 graduate of the University of Kentucky School of Law who, after completing a judicial clerkship in the Kentucky Court of Appeals, practiced for years in Kentucky before joining a renowned national law firm.[9] *See* Ex. 5 at 5.

In early 2017, because Ms. Lerach had years of experience representing pension funds in securities litigation, her law-school classmate, then-sitting judge Hon. Brandy O. Brown, and Kentucky State Police Captain Jeffrey M. Mayberry[10] requested that she investigate the KRS fiasco. *Id*. at 5–6. Within months, Ms. Lerach assembled a team of investigators, forensic accountants, pension fund experts, and consultants. *See id*. That team investigated, marshalled the facts, drafted, and then filed the 200-page *Mayberry* complaint by December 2017,[11] which eventually led to this breach-of-trust lawsuit. *See id*. at 4–8

Working alongside Ms. Lerach as local counsel is retired judge Hon. Jeffrey M. Walson, who is based in Clark County. In contrast, Defendants' 1,000-page Writ Petition was created in a Wall-Street skyscraper—not in Frankfort.

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[9] Now known as Robbins Geller Rudman & Dowd LLP, where she was a partner and later of counsel, Ms. Lerach's firm specialized in representing investors, most often pension funds, in lawsuits involving investment misconduct. Her firm recovered over $60 billion for investors, including $7 billion in the *Enron* litigation, where she played a major role, and where pension funds received billions as a result of her firm's efforts. She later helped litigate "mass actions" by small groups of public pension funds against Wall-Street banks for their participation in the WorldCom and AOL-Time Warner frauds that resulted in recoveries of over $2 billion in those cases.

[10] Captain Mayberry was Ms. Lerach's landlord, while she served as a judicial law clerk on the Kentucky Court of Appeals. He was also Judge Brown's cousin.

[11] The *Mayberry* complaint was later copied by the AG's private counsel to pursue the taxpayer case.

Sadly, Brandy Brown died on the morning of May 1, 2024, just hours before Judge Wingate issued his order upholding the claims she and Captain Mayberry courageously pioneered years ago.

### F. The Hedge Fund Sellers' Factual Distortions Cannot Prevent Moving onto the Prosecution of Their "Significant Misconduct" Pleaded by the Tier 3 Trust Plaintiffs

The facts pleaded, which repeat and expand the allegations in *Mayberry* and are presumed to be true in this context, amply support the breach-of-trust claims. Before the Hedge Fund Sellers drove Judge Shepherd out of these cases, he characterized these allegations as "extremely serious" violations of fiduciary duties, including "severe misconduct" involving "self-dealing, exorbitant fees, conflicts of interest." *See Mayberry v. KKR & Co., L.P.*, No. 17-CI-01348, slip op. at 15 (Ky. Cir. Ct. Franklin Cnty. Dec. 28, 2020) (Exhibit 6).

While refraining from joining this litigation as a party, KRS has likewise found that the factual allegations asserted based on the investigation of counsel for the *Mayberry* plaintiffs "have merit" and should be pursued to "provid[e] substantial potential recovery that would directly benefit KRS":

> KRS is persuaded that the potential rewards of the 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, risk and costs associated with such litigation.

Ex. 7 at 3–4.

Taking special note of this Joint Notice by KRS, the Supreme Court recognized that KRS "endorsed the [p]laintiffs' pursuit of these claims" in *Mayberry*. *Overstreet*,

603 S.W.3d at 250. The Supreme Court also "recognize[d] that [the *Mayberry* plaintiffs] allege significant misconduct." *Overstreet*, 603 S.W.3d at 266. As Judge Shepherd found, "principles of equity and public interest require that the factual allegations in the case … should be adjudicated on the merits." *See Mayberry*, slip op. at 16–17; *see also Mayberry v. KKR & Co., L.P.*, No. 17-CI-01348, slip op. at 19–21 (Ky. Cir. Ct. Franklin Cnty. Nov. 30, 2018) (Exhibit 8).

* * *

This litigation has been proceeding in the Kentucky courts for seven years. Yet, the Hedge Fund Sellers continue to insist that no one can sue them. No KRS member. Not Tier 1, not Tier 2, and not Tier 3. No trust beneficiary. None of KRS's 420,000 members. But for centuries in Kentucky, "[r]eason and justice unite in declaring that for every wrong, there should be a remedy; for every injury, there should be a compensation." *Williams v. Hedricks*, 2 Ky. 175, 175 (Ky. Ct. App. 1802); *see also Giuliani v. Guiler*, 951 S.W.2d 318, 320 (Ky. 1997) ("[i]t is the purpose of all tort law to compensate one for the harm caused by another and to deter future wrongdoing"). Yet these Wall-Street operators walked away with $300 million in "exorbitant hedge fund fees," leaving the KRS Trusts grossly underfunded and permanently impaired—all to the harm and injury of the KRS Trusts and the Tier 3 Trust Plaintiffs. This Court should promptly deny this Writ Petition and permit the Tier 3 Trust Plaintiffs to pursue their meritorious claims against these Wall-Street malefactors, holding them to account and protecting Kentucky's 420,000 public employees.

## III. ARGUMENT

### A. This Court Should Deny the Writ Petition Because the Circuit Court Correctly Concluded That the Tier 3 Trust Plaintiffs Have Constitutional Standing

Constitutional standing is not a medieval trap for the unwary, designed to shield wrongdoers from liability. *See Thole*, 590 U.S. at 547 ("[c]ourts sometimes make standing law more complicated than it needs to be"). In fact, the requirement simply aims to assure "concrete adverseness" in judicial proceedings—that wrongdoers when sued face a real fight, *i.e.*, a meaningful prosecution on the merits "'in an adversary context.'" *Massachusetts v. EPA*, 549 U.S. 497, 517 (2007) (quoting *Flast v. Cohen*, 392 U.S. 83, 95 (1968), and *Baker v. Carr*, 369 U.S. 186, 204 (1962)). The Tier 3 Trust Plaintiffs' vigorous prosecution of their breach-of-trust claims leaves no room for doubt of their "personal stake" and the resulting "concrete adverseness" in this controversy. *See id*.

Because the petition challenges the Circuit Court's denial of CR 12.02 motions, the question of constitutional standing here is a matter of pleading and must thus be decided by "accepting as true all of the complaint's material allegations and construing the complaint in [plaintiffs'] favor." *Baur v. Veneman*, 352 F.3d 625, 631 (2d Cir. 2003). "At the pleading stage, general factual allegations of injury resulting from the defendant's conduct may suffice, for on a motion to dismiss [courts] presum[e] that general allegations embrace those specific facts that are necessary to support the claim." *Lujan v. Defenders of Wildlife,* 504 U.S. 555, 561 (1992).

Moreover, the amount of alleged injury to the individual plaintiff can be minimal, *i.e.*, as small as a dollar or "farthings," so long as it is concrete and

particularized. *See Uzuegbunam v. Preczewski*, 592 U.S. 279, 293 (2021) ("for the purpose of Article III standing, nominal damages provide the necessary redress for a completed violation of a legal right"); *see also id.* at 305 (Roberts, C.J., dissenting). All the Tier 3 Trust Plaintiffs are required to do is to allege "(1) an injury in fact that is concrete, particularized, and actual or imminent, (2) that the injury was caused by the defendant, and (3) that the injury is redressable by a ruling favorable to [them]." *Overstreet*, 603 S.W.3d at 249 & n.1 (citing *Sexton*, 566 S.W.3d at 196).

Tested under these well-settled rules, adopted into Kentucky law through *Sexton* and *Overstreet*,[12] the Tier 3 Trust Plaintiffs' allegations conclusively establish standing under Section 112(5) of the Kentucky Constitution.

### 1. The Complaint Alleges Injury in Fact—Harm to the Value of the Tier 3 Trust Plaintiffs' Individual Pension Accounts and Their Ultimate Pension Payments, Both of Which Vary Based on Annual Investment Returns

In rejecting the Tier 1 and Tier 2 members' claim of constitutional standing, the Supreme Court in *Overstreet* expressly exempted the Tier 3 members from that holding. *See* 603 S.W.3d at 253 n.21. It did so because, unlike the Tier 1 and Tier 2 members whose retirement benefits from their defined-benefit plans are guaranteed under KRS's "'inviolable contract'" with the Commonwealth (*id.* at 233 & n.22), the Tier 3 members' retirement benefits—from the Hybrid Cash Balance Plan—are not guaranteed. *See* ¶¶ 2, 195, 197; *see also* KRS § 61.702(4)(e)(7). Nor is the Tier 3

[12] "[W]e have interpreted the Kentucky Constitution to have the same justiciability requirements as the federal constitution." *Overstreet*, 603 S.W.3d at 257 n.46 (citing *Sexton*, 566 S.W.3d at 196–97).

members' benefit "defined" or fixed:

> The Tier 3 members are not in a defined benefit plan with a fixed and guaranteed future pension benefit like Tier 1 and Tier 2 members. The Tier 3 Plan is a Hybrid Cash Balance Plan where a member's actual pension benefit depends on the value of the member's ***individual account*** when he/she retires. Tier 3 members have ***individual accounts and their retirement benefits are based on the value of their individual accounts*** at the time they retire. That value depends significantly on the investment performance and expense levels of KRS.

¶ 203 (emphases in original).

Unlike the defined-benefit plans for the Tier 1 and Tier 2 members, the "Cash Balance Plan" for the Tier 3 members "is known as a hybrid plan because it has characteristics of both a defined benefit plan and a defined contribution plan." ¶ 195. The Tier 3 Cash Balance Plan "resembles a defined contribution plan because it determines the value of benefits for each participant ***based on individual accounts***." *Id.*; *see also* ¶ 203. This is so by statutory design. Senate Bill 2, which created Tier 3 benefits for KRS members who joined on or after January 1, 2014 (¶ 195), requires that an "upside interest" be credited to each Tier 3 member's pension account each year at a rate equal to "[s]eventy-five percent (75%) of the system's geometric average investment return in excess of the four percent (4%) rate of return." KRS § 61.597(4)(b)(2); *see also* ¶¶ 26, 204–206.

As a result of the breaches of trust alleged in the Complaint, the annual rate of investment return for years was lowered due to both the poor Black Box returns (losses exceeding hundreds of millions in several years, with a negative return for the five years ended June 30, 2020) and "exorbitant fees" (over $300 million). *See* ¶¶ 30, 312. These losses and exorbitant fees lowered the rate of investment return and

caused the reduction of the upside interest credited to each individual account of the Tier 3 members every year. ¶¶ 105, 200–205. Specifically, the minimum "drag," *i.e.*, the amount the poor hedge fund returns and "exorbitant fees" reduced the investment returns of the Trusts for each of the five-year periods ending June 30, 2019 was at least:

| Fye 6/30/15 | Fye 6/30/16 | Fye 6/30/17 | Fye 6/30/18 | Fye 6/30/19 |
|---|---|---|---|---|
| -3.56% | -3.89% | -3.54% | -2.97% | -1.05% |

¶ 206.

And the reduction of the credited upside interest caused further reduction of each Tier 3 member's account value by reducing the amount of the automatic 4% increase calculated on June 30 of each year. ¶¶ 105, 200–205; *see also* KRS § 61.597(4)(b)(1) (requiring an annual interest credit "determined by multiplying the member's accumulated account balance on June 30 of the preceding fiscal year by … [f]our percent (4%)"). In the individual account of each Tier 3 member, ***this cumulative effect of even a small loss of upside sharing in every year translated into thousands of dollars of loss*** (*see* Point II.B., *supra*, at 6–10) ***and would continue to do so***. *See also* ¶¶ 25, 105, 196.

All Tier 3 members suffer such injury because contribution to the Tier 3 Cash Balance Plan is mandated by KRS § 61.597. ¶¶ 25, 201. Actual and real, concrete and particularized, this injury establishes the Tier 3 Trust Plaintiffs' constitutional standing to bring this breach-of-trust action. *See Overstreet*, 603 S.W.3d at 249.

Despite these allegations, the Hedge Fund Sellers assert that the Tier 3 Trust Plaintiffs' benefits are fixed and guaranteed, when they are alleged to be neither. *See*

Pet. at 16. The Court should reject this assertion outright because, as held in *Lujan* and adopted in *Sexton*, the Tier 3 Trust Plaintiffs' allegations of standing must be presumed as true at the pleadings stage. *Lujan,* 504 U.S. at 561. In fact, "[s]tanding allegations need not be crafted with precise detail nor must the plaintiff prove his allegations of injury." *Boley v. Universal Health Servs., Inc.*, 498 F. Supp. 3d 715, 720 (E.D. Pa. 2020). In *Boley*, plan beneficiaries sued third parties for breach of fiduciary duties, alleging that bad investments and excessive fees were negatively impacting their retirement accounts. 498 F. Supp. 3d at 719–25. Relying on the *Thole* framework, the court in *Boley* found standing based on allegations of "[***d*]*iminished returns relative to available alternative investments and high fees***." *Id.* at 720. Just like *Boley*, the Complaint here details the reduction of the "Upside Sharing Interest" credited to each Tier 3 Trust Plaintiff's individual pension accounts, amounting to "thousands of dollars." *See* ¶¶ 25, 105. These allegations are more than sufficient to establish standing. *See Overstreet*, 603 S.W.3d at 249.

Moreover, the Tier 3 Trust Plaintiffs allege that none of their benefits are guaranteed by the Commonwealth. *See* ¶ 195. In fact, by statute, the Legislature may "suspend or reduce the benefits … if … the welfare of the Commonwealth so demands." KRS § 61.692(2)(a); *see also* KRS § 61.702(4)(e)(7). In the event that the monies in the Trusts are lost or are insufficient to cover all payment obligations, a reduction of Tier 3 benefits—vested or otherwise—can occur. *See* ¶¶ 195–196; *see also* ¶¶ 23–25, 28–29, 33, 105.

Latching onto the plan feature that the Tier 3 members' accounts are

automatically credited with a 4% interest rate, the Hedge Fund Sellers assert that the Tier 3 members' benefits are "fixed." Pet. at 15. But this assertion conflates benefits based on a fixed formula with "fixed" or "defined benefits." This automatic 4% interest credit has nothing to do with the Upside Sharing component, which is entirely dependent upon KRS's geometric average net investment return. *See* ¶¶ 196, 203; *see also* KRS § 61.597(4). Nor does the automatic 4% interest credit relieve the Tier 3 members from the risks of any loss or diminution of KRS Trust assets. *See* ¶¶ 15, 23, 33, 105, 195–197; *see also* KRS §§ 61.692(2)(a), 61.702(4)(e)(7). A pension impacted by poor investment returns and exorbitant expenses under a fixed formula is not a "fixed" or "defined" benefit. All told, by the design of the Hybrid Cash Balance Plan, the Tier 3 members bear the risks of investment underperformance and loss of the KRS Trusts. *See id.*; *see also* KRS § 61.597(4). And, as demonstrated above (in Point II.B., *supra*, at 7–9), the diminution of KRS Trust assets can mean reduction of pension benefits by hundreds of thousands of dollars to a Tier 3 member.

Still undeterred, the Hedge Fund Sellers resort to labels. They say that all "cash balance plans" are essentially "defined-benefit plans," citing three inapposite cases, *Drutis*, *Hurlic*, and *French*.[13] ***But it is the features of the plans at issue***, rather than the titles or labels of the plans, ***that are determinative of the standing inquiry***. *See Lee v. Verizon Commc'ns, Inc.*, 837 F.3d 523, 530 (5th Cir. 2016) (deciding the standing issue of members of defined-benefit plans based on whether

[13] *Drutis v. Rand McNally & Co.*, 499 F.3d 608 (6th Cir. 2007); *Hurlic v. S. Cal. Gas Opinion Co.*, 539 F.3d 1024 (9th Cir. 2008); *French v. BP Corp. N. Am., Inc.*, 2010 U.S. Dist. LEXIS 53133 (E.D. Ky. May 28, 2010).

they alleged "any defined benefits are … potentially at risk"). Indeed, whether or not the underlying plan is "***a defined benefit plan is not the critical point***." *Slack v. Int'l Union of Operating Eng'rs*, 83 F. Supp. 3d 890, 906 (N.D. Cal. 2015). After all, whether or not a plan is labelled as "defined-benefit" or "defined-contribution," plan members have standing to sue ***so long as they allege that they "have been and will continue to be deprived of benefits that the [p]lan itself promises them***." *E.g.*, *Diaz v. Westco Chems., Inc.*, 2020 U.S. Dist. LEXIS 250099, at *18 (C.D. Cal. Sept. 1, 2020) (finding that members of a defined-benefit plan have standing).

In any event, *Drutis*, *Hurlic*, and *French* do not—and cannot—convert the "Hybrid Cash Balance Plan" created by KRS § 61.597 into "defined-benefit plans" because none of these cases involved a plan with an "Upside Sharing Interest" feature. In fact, neither *Hurlic* nor *French* has anything to do with constitutional standing. And even though plaintiffs in *Drutis* were found to lack standing, they were not members of the "cash balance plan" at issue in that case. *See* 499 F.3d at 611. So *Drutis*'s standing analysis has nothing to do with any features of the "cash balance plan" there. The Hedge Fund Sellers' reliance on these cases is misplaced.

Nor does *Hirt* provide the Hedge Fund Sellers any aid.[14] At the outset, *Hirt* does not address standing. More importantly, unlike the Tier 3 hybrid plan, the "cash balance plan" at issue in *Hirt* did not include an "Upside Sharing Interest" feature. *See* 533 F.3d at 104–05. The court in *Hirt* found the "cash balance plan" there to

[14] *Hirt v. Equitable Ret. Plan for Emps., Managers & Agents*, 533 F.3d 102 (2d Cir. 2008).

constitute a defined-benefit plan because "employers, not employees, bear the market risks." *Id*. at 105. In other words, the plan members in *Hirt* would receive the same benefits regardless of the rate of investment returns in their plan. *Id*. But that is not the case here. As alleged in the Complaint, and as required by KRS § 61.597, the Tier 3 Trust Plaintiffs' benefits are dependent upon KRS's investment returns. ¶¶ 25, 105. And, under Sections 61.597(4), 61.692(2)(a), and 61.702(4)(e)(7) of Kentucky's pension statutes, the Tier 3 Trust Plaintiffs and other Tier 3 members bear the risks of KRS's investment. *See* ¶¶ 2, 195–197, 200–206. *Hirt* is therefore inapposite.

Finally, the Hedge Fund Sellers mischaracterize the injury alleged by the Tier 3 Trust Plaintiffs as "speculative." Pet. at 17–18. Their mischaracterization cannot square with the allegations of the reduction of the "Upside Sharing Interest" credited to each Tier 3 Trust Plaintiff's individual accounts each year, which amounts to "thousands of dollars." *See* ¶¶ 25, 105, 196. As reflected in the example of the 50-year-old retired court clerk whose benefits would take a $237,760 hit for her lifetime (*see* Point II.B., *supra*, at 8–9), the injury alleged in the Complaint is actual and real. ¶¶ 25, 105, 196, 200–206. On this point, the three cases cited by the Hedge Fund Sellers, *Loren*, *David*, and *Lee*, are inapposite because plaintiffs in those cases alleged only "risks" or "probability" of harm and failed to articulate any reduction of benefits caused by defendants. *See Loren v. Blue Cross & Blue Shield*, 505 F.3d 598, 608 (6th Cir. 2007); *David v. Alphin*, 704 F.3d 327, 338 (4th Cir. 2013); *Lee*, 837 F.3d at 546.

Devoid of legal support and contrary to the well-pleaded allegations, the Hedge Fund Sellers' standing arguments are meritless and must be rejected.

### 2. The Complaint Alleges Redressability of the Injury to the KRS Trusts, as Well as the Tier 3 Trust Plaintiffs' Individual Accounts and Ultimate Pension Benefits

In addition to alleging an actual, concrete injury, the Complaint articulates in the "Prayer for Relief" section how a recovery of damages to the KRS Trusts would remedy the harm done to the Tier 3 Trust Plaintiffs' individual accounts:

> 5. Ordering a full and complete accounting of all … (d) ***how the Tier 3 members upside sharing was computed each year*** …

Compl. at 203. Here, the KRS Trustee has broad authority to allocate any recovery of Trust assets to the Tier 3 Trust Plaintiffs by re-calculating their Upside Sharing Interest because the Trustee is required to apply the Trusts funds "solely" as provided by statute (KRS § 61.515(2)(b)) and "[f]or the exclusive purpose of providing benefits to members and beneficiaries" (KRS § 61.650(1)(c)(2)(b)). Moreover, redress is available to the Tier 3 Trust Plaintiffs in light of the courts' "broad equitable powers" to "remedy breaches of trust." *Katsaros*, 744 F.2d at 282; *see also Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993) ("'equitable relief' can … mean … whatever relief a court of equity is empowered to provide"). The power of the Trustee and the courts to allocate any recovery is well recognized. *See* RESTATEMENT (THIRD) OF TRUSTS § 107, Gen. Cmt. e.

As such, the Tier 3 Trust Plaintiffs have alleged that each of them "has suffered harm—injury in fact—and damages caused by … [the Hedge Fund Sellers'] misconduct, … redressable in this lawsuit via the relief sought for the KRS trusts." ¶ 200. Based on similar allegations, courts have consistently found redressability for purposes of constitutional standing in cases where retirement plan beneficiaries

assert claims for breaches of fiduciary duties. *See*, *e.g.*, *Evans v. Akers*, 534 F.3d 65, 74 (1st Cir. 2008) (finding redressability where the plan's fiduciaries could allocate the recovery "to the individual accounts injured by the breach"); *Harris v. Amgen, Inc.*, 573 F.3d 728, 736 (9th Cir. 2009) (same); *see also LaRue v. DeWolff, Boberg & Assocs.*, 552 U.S. 248, 256 (2008) ("authoriz[ing] recovery for fiduciary breaches that impair the value of plan assets in a participant's individual account"). In *In re Mutual Funds Investment Litigation*, the court held that plan-wide relief gave rise to redressability because, where "the aggregation of individual accounts defines the assets of the plan," "it is the plan assets in ***the individual accounts*** that are restored[.]" 529 F.3d 207, 218–19 (4th Cir. 2008) (emphasis in original).

Arguing the contrary, the Hedge Fund Sellers attempt to distinguish *Mutual Funds* by (again) insisting that the Tier 3 Hybrid Cash Balance Plan is a defined-benefit plan where the benefits are fixed. *See* Pet. at 21. The Court should (again) reject this assertion because it disregards the plan design under KRS § 61.597 and directly contradicts the Tier 3 Trust Plaintiffs' allegations of the reduction of their Upside Sharing Interest (¶¶ 25, 105, 196). *See* Point II.B., *supra*, at 6–10; *cf. Overstreet*, 603 S.W.3d at 262 (recognizing that, in a defined-contribution plan, "the value of [the plan] assets has [an] impact on [the plan beneficiaries'] right to be paid benefits"). Thus, the *Mutual Funds*, *Evans*, and *Harris* line of cases squarely applies and supports a finding of redressability here.

On this point, the Hedge Fund Sellers' reliance on *Steel Co.* and *Nichols* is misplaced because plaintiffs there sought relief that could not remedy their alleged

injury.[15] In *Steel Co.*, an association of individuals interested in environmental protection sued a manufacturing company for past violations of statutory reporting requirements. 523 U.S. at 86. But none of the requested relief, including civil penalties for past violations, would directly cure the association's alleged deprivation of information under the environmental laws. *Id.* at 105–110. In *Nichols*, a claimant of unemployment insurance benefits challenged the constitutionality of a statute permitting non-attorney representation of employers in administrative proceedings. 635 S.W.3d at 49. But the causal connection between the denial of plaintiff's unemployment benefits and the non-attorney representation of the employer was too tenuous for a finding of redressability. *Id.* at 51–54. In contrast to *Steel Co.* and *Nichols*, a recovery to the KRS Trusts—an allocation by the Trustee of the recovery—would directly benefit the Tier 3 Trust Plaintiffs. ¶¶ 25, 105, 200; *see also* KRS §§ 61.515(2)(b), 61.650(1)(c)(2)(b). *Steel Co.* and *Nichols* are therefore inapposite.

* * *

In sum, the Tier 3 Trust Plaintiffs have alleged an actual, concrete injury, caused by the Hedge Fund Sellers, that is redressable by a court judgment awarding damages and equitable relief to the KRS Trusts. ¶¶ 25, 105, 195–197, 200–206; *see also Overstreet*, 603 S.W.3d at 249 & n.1. They have constitutional standing to bring these breach-of-trust claims for the KRS Trusts. The Court should deny this Writ Petition as the Circuit Court acted well within its jurisdiction.

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[15] *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83 (1998); *Ky. Unemployment Ins. Comm'n v. Nichols*, 635 S.W.3d 46 (Ky. 2021).

## B. The Court Should Deny the Writ Petition Because, Under the Common Law of Trusts, the Tier 3 Trust Plaintiffs Are Entitled to Sue Third Parties for Participating in the Trustee's Breaches of Trust

Under the guise that the Tier 3 Trust Plaintiffs somehow lack a "property interest" in the KRS Trusts (Pet. at 22), the Hedge Fund Sellers claim that the Circuit Court erred in applying the common law of trusts and recognizing the Tier 3 Trust Plaintiffs' right to sue for recovery of Trust assets. This so-called "trust standing" argument has nothing to do with constitutional standing or subject-matter jurisdiction. *See*, *e.g.*, *Booker-El v. Superintendent, Ind. State Prison*, 668 F.3d 896, 900 (7th Cir. 2012) (rejecting the argument that plaintiff lacks standing because he lacks "a property interest … [and] has no remedy in federal court … [because] this argument conflates standing with the merits of the case"); *see also Denney v. Deutsche Bank AG*, 443 F.3d 253, 264 (2d Cir. 2006) ("an injury-in-fact need not be capable of sustaining a valid cause of action under applicable tort law"). The Court should reject the Hedge Fund Defendants' "trust standing" argument. In any event, as discussed below, the Circuit Court correctly upheld the Tier 3 Trust Plaintiffs' right to sue.

### 1. The Common Law Authorizes Trust Beneficiaries to Sue Third Parties for Participating in the Trustee's Breaches of Trust

By statutory design, the KRS Board is the sole Trustee of the Trusts. The Trustee and KRS officers bear rigorous fiduciary duties to protect Trust assets for the exclusive interest of KRS beneficiaries. *See* KRS §§ 61.515(2)(b), 61.650(1)(c)(2)(b). As the Supreme Court put it, "a fiduciary duty is the 'highest order of duty imposed by law.'" *Abbott v. Chesley*, 413 S.W.3d 589, 600 (Ky. 2013) (quoting *In re Sallee*, 286 F.3d 878, 891 (6th Cir. 2002)); *see also Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8

(2d Cir. 1982) (Friendly, J.) ("[t]he fiduciary obligations of the trustees to the participants and beneficiaries of the plan are … the highest known to the law").

As alleged in the Complaint, the Trustee has breached its fiduciary duties and is thus the culpable core wrongdoer. ¶¶ 16–17, 326, 368–372. Under settled law, a third party who knowingly participates in a trustee's breach of trust is liable to the trust via a direct suit by trust beneficiaries; and the beneficiary is the real party in interest to bring and prosecute the suit. *Smith v. Ayer*, 101 U.S. 320, 327 (1879). "***The law exacts the most perfect good faith from all parties dealing with a trustee respecting trust property***." *Id.* Kentucky has recognized the remedy since 1873. *See generally Prather v. Weissiger*, 73 Ky. 117 (Ky. Ct. App. 1873) (permitting beneficiary to sue trustee and a third party who participated in the breach of trust). Kentucky imposes joint and several liability on knowing participants and aiders and abettors for all damages caused. *Steelvest*, 807 S.W.2d at 485.

Kentucky follows the RESTATEMENT OF TRUSTS. *E.g.*, *Hoheimer v. Hoheimer*, 30 S.W.3d 176, 179 (Ky. 2000); *Ladd v. Ladd*, 323 S.W.3d 772, 778 (Ky. Ct. App. 2010); *Cook v. Holland*, 575 S.W.2d 468, 472 (Ky. Ct. App. 1978); *accord Osborn v. Griffin*, 865 F.3d 417, 440 (6th Cir. 2017). The Kentucky Constitution provides that the common law shall be in effect in this Commonwealth until repealed or altered by the legislature. KY. CONST. § 233. "Any repeal of common law must be clear and expressed"; repeals by implication are impermissible. *Commonwealth of Ky. Natural Res. & Envtl. Prot. Cabinet v. Neace*, 14 S.W.3d 15, 19 (Ky. 2000) (citing *Benjamin v. Goff*, 314 Ky. 639, 641 (Ky. Ct. App. 1951)). Under longstanding Kentucky law,

litigants are entitled to avail themselves of both statutory and common-law remedies. *See also Instone v. Frankfort Bridge Co.*, 5 Ky. 576, 580 (Ky. Ct. App. 1812). Nothing in Kentucky's pension statutes alters the common law of trusts.

Federal case law supports the unbroken line of common-law precedents permitting trust beneficiaries to sue third parties directly for assisting trustees' breaches of trust. Under ERISA,[16] beneficiaries may directly sue third parties who knowingly assist the trustees in breaching their fiduciary duties in a direct action for damages or equitable relief for the trust. *Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238, 250 (2000) ("beneficiaries may … maintain an action for restitution … and disgorgement of the third person's profits"); *Lowen v. Tower Asset Mgmt.*, 829 F.2d 1209, 1220 (2d Cir. 1987) ("parties who knowingly participate in fiduciary breaches may be liable … as fiduciaries … for recovery against non-fiduciaries"); *Fink v. Nat'l Sav. & Trust Co.*, 772 F.2d 951, 955–57 (D.C. Cir. 1985) (same); *Fremont v. McGraw-Edison Co.*, 606 F.2d 752, 759 (7th Cir. 1979) (same).

A plan member is entitled to pursue plan-wide misconduct. *See Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 591–92 (8th Cir. 2009). "[A] plaintiff may be able to assert causes of action which are based on conduct that harmed him, but which sweep more broadly than the injury he personally suffered." *E.g.*, *id.* at 592; *Fallick v. Nationwide Mut. Ins. Co.*, 162 F.3d 410, 423 (6th Cir. 1998) (a plan representative is authorized to prosecute claims for all plans "regardless of the representative's lack of

[16] *Overstreet* "borrows heavily from" federal decisions interpreting the Employee Retirement Income Security Act of 1974 ("ERISA"). *See* 603 S.W.3d at 263.

participation in all … plans involved"); *see also Cassell v. Vanderbilt Univ.*, 2018 U.S. Dist. LEXIS 181850, at *7 (M.D. Tenn. Oct. 23, 2018) (permitting plaintiff to proceed "on behalf of the plan or other participants even if the relief sought sweeps beyond his own injury").

Continued prosecution of this separate lawsuit is vital. This lawsuit ***and only this lawsuit*** can recover all the Trusts' investment losses and funding declines, plus the "exorbitant fees," plus punitive damages, plus equitable monetary relief, such as restitution or disgorgement, payable to the Trusts to make the Trusts whole. *See*, *e.g.*, *Patmon v. Hobbs*, 495 S.W.3d 722, 731 (Ky. Ct. App. 2016) (wayward fiduciaries must "completely disgorge [themselves] of any benefits received"). It is this lawsuit or nothing for the KRS Trusts and their 420,000 beneficiaries.

The Tier 3 Trust Plaintiffs are uniquely positioned to redress the injury to the Trusts and were doing so before the Petition was filed. In the Circuit Court, they filed a motion in June 2024 to direct the KKR-Prisma Defendants to return to the Trusts wrongfully withheld Trust funds, plus interest, and a statutory penalty amounting to $770 million. *See* Ex. 9.

The Hedge Fund Sellers say that the Tier 3 Trust Plaintiffs lack a "property interest" in the KRS Trusts. Pet. at 22. They are wrong. Tier 3 members contribute thousands of dollars via payroll deductions into the Trusts—to fund their ***own individual accounts*** within the Trusts (¶¶ 25, 105). While their benefits are not guaranteed and are subject to the overall solvency of the Trusts, their accounts belong to them. *E.g.*, ¶¶ 25–26, 202. It is their property sitting within the larger Trusts. All

public employees have a property interest in the retirement funds administered by KRS by virtue of their personal contributions—mandated by statute. *Commonwealth ex rel. Armstrong v. Collins*, 709 S.W.2d 437, 446–47 (Ky. 1986).

Indeed, the Tier 3 members' property interest in the Hybrid Cash Balance Plan is created by statutory design. The Plan's enabling statute provides the option to all Tier 3 members to "take a refund of [their] account balance," including at least the member portion of their accumulated Upside Interest credits. *See* KRS § 61.597(5)(a), (7)(c). Consistent with this "refund" provision, KRS offers the option to Tier 3 members who leave the Commonwealth's employ to "withdraw" their "accumulated account balance," including, at a minimum, "the member's contribution, interest, and upside Sharing Interest":

> What if I leave my job?
>
> * * *
>
> OPTION 2: ***Withdraw your account***
>
> Vested refund (60+ months of service): Members who are vested are eligible for a refund of their accumulated account balance. ***The accumulated account balance is the total of all member contributions***, Employer Pay Credits, and ***all interest credited*** to both amounts.
>
> Non-vested refund (less than 60 months of service): Members who are not vested are eligible for a refund of the ***member portion of the account balance***. This includes the member's contribution, interest, and ***Upside Sharing Interest***. A non-vested refund does not include the Employer Pay Credits, Upside Sharing Interest, or the interest on the pay credit balance.

Ex. 10 at 11. The Tier 3 members' right to withdraw the accumulated account balance is conclusive proof of their "property interest" in the KRS Trusts. *See*, *e.g.*, *Segal v. Rochelle*, 382 U.S. 375, 381 (1966) (holding that "refund claims … constituted

'property'"); *Laurain v. United States*, 579 F. Supp. 2d 991, 993 (M.D. Tenn. 2008) ("[the] right to withdraw funds is considered a property interest").

The Hedge Fund Sellers pretend this lawsuit is only about the few "thousands of dollars" the Tier 3 Trust Plaintiffs have lost in their individual accounts and ultimate pension payments. Based on this false premise, they say that this lawsuit cannot redress harm to the Trusts. But this argument has nothing to do with "redressability." Rather, the Hedge Fund Sellers are challenging the merits of the Tier 3 Trust Plaintiffs' legal theory—that trust beneficiaries have a right to sue for breach of trust to restore all lost or improperly diverted trust assets. Under the Restatement of Trusts and ERISA authorities, this breach-of-trust lawsuit can recover for "***any loss***," *i.e.*, all the losses caused by the Trustee's breaches of duties—participated in and furthered by the Hedge Fund Sellers, including exorbitant fees, lost investment opportunities, diminished returns, and Trust funding declines. RESTATEMENT (SECOND) OF TRUSTS § 326 (1959). Put differently, this action can recover ***whatever is necessary*** to make the Trusts whole, plus punitive damages. *Id.*; RESTATEMENT (THIRD) OF TRUSTS §§ 100, 107 (2012); *see also* ¶¶ 1, 17, 394–396.

**2. The Circuit Court Correctly Applied the Common Law of Trusts Because the Pleaded Facts Show Significant Misconduct and Breaches of the Trustee's Fiduciary Duties, Participated in and Aided and Abetted by the Hedge Fund Sellers**

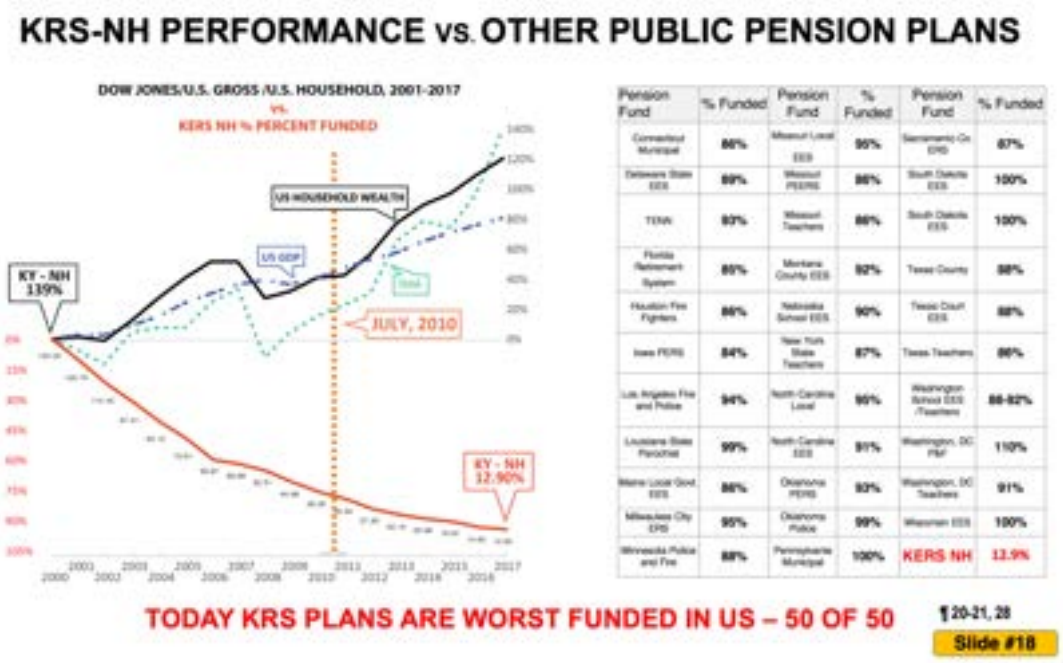
Under the guise of challenging standing, the Hedge Fund Sellers seek a redo of the motion-to-dismiss proceeding and an interlocutory review of Judge Wingate's order denying their motions to dismiss. They distort the facts that are actually pleaded and upon which the Tier 3 Trust Plaintiffs' standing was upheld:

> Kentucky is in the midst of a financial crisis … and at least one recent headline said it succinctly: "*Unfunded Pensions Could Spell Disaster for Kentucky*."
>
> This is not new. The KRS Board of Trustees has been trying to deal with this looming pension crisis since the mid-2000s. …
>
> … ***KRS leadership acted only in self-interest***, ***leaving future generations in the state to pay for their mistakes because of poor investment decisions***. …
>
> ***This sort of irresponsible action must be stopped in American pension fund management*** ….

¶ 5 (quoting Christopher Burnham, *Kentucky Retirement Systems: a Case Study of Politicizing Pensions*, FORBES (June 28, 2018)) (emphases in original); ¶¶ 18–38.

This scandal enriched Wall-Street banks with over $300 million "exorbitant hedge fund fees" for Black Box Hedge Funds that lost hundreds of millions of dollars in several years, and over their 10-year life earned less than cash in free bank accounts. A $2 billion surplus turned into a $26 billion deficit. Funded status—139% at one time—collapsed to 13%, leaving the Trusts in a "death spiral" and "essentially [in] bankruptcy." ¶¶ 18–22, 31. Yet, other honestly managed public pension funds remained well funded. ¶¶ 28–38.

The damage to the KRS Trusts will never be overcome—absent the multi-billion-dollar recovery for the Trusts this breach-of-trust lawsuit—and only this lawsuit—promises. Today, the largest KRS fund is still just 21% funded. The KRS plans have $40 billion in obligations and just $16.5 billion in assets, a $23.3 billion deficit. *See KRS Annual Comprehensive Financial Report for the Fiscal Year Ended in June 30, 2023*, at 15, 20 (Dec. 6, 2023).




Prudence, honesty, and the "sole interests" of the Trust beneficiaries were cast aside with KRS's "alternative investments,"[17] of which the $1.8 billion "Black Box" Hedge Fund allocations ($1.245 billion in 2011 and $600 million more in 2016) were by far the largest and worst investments ever made. ¶¶ 29–30, 262–266, 278–283.

When KRS plunged toward insolvency in 2016–2017, Commonwealth officials and new individual Trustees came in, did a "deep dive" and were "shocked." ¶ 36. They confirmed years of fiduciary failures by the Trustee, *i.e.* its "***cover up catch up scheme***," "***excessive investment risks*** to chase unrealistically high investment returns," and how the Hedge Fund Sellers took "***exorbitant fees***." The conduct was "***morally negligent***," "***irresponsible***," even "***criminal***." ¶¶ 35–38, 61–69.

[17] Alternative investments are investments other than traditional stocks and bonds—anything Wall Street can create and sell for a profit.

## COMMONWEALTH OFFICIALS CONDEMN THE CULPABLE TRUSTEE'S MANIPULATION OF ACTUARIAL ASSUMPTIONS


"...PAST ASSUMPTIONS WERE OFTEN MANIPULATED UNREASONABLY HIGH INVESTMENT EXPECTATIONS ... FUNDING BASED ON FALSE PAYROLL NUMBERS.

THE RESULT WAS TO PROVIDE A FALSE SENSE OF SECURITY TO THE PENSION PLANS.

KRS HAS TAKEN ON SIGNIFICANTLY MORE INVESTMENT RISK OVER THE LAST DECADE TO CHASE UNREALISTICALLY HIGH INVESTMENT RETURNS.

LACK OF REALISTIC AND RATIONAL ACTUARIAL ASSUMPTIONS HELPED OBSCURE THE DISTRESSED FINANCIAL STATUS OF THE PLANS"

**"WHAT HAS BEEN DONE IN OUR PENSION SYSTEMS HAS BEEN CRIMINAL. IT HAS BEEN NEGLIGENT. IT HAS BEEN IRRESPONSIBLE. IT IS SHAMEFUL"**

H-L 8.25.17;

¶36-37,61-69

Slide #1

## 2016 - NEW KRS BOARD - FRESH EYES - DEEP DIVE

**Shocked • Assumptions Ridiculously High • Blatantly Incorrect • Wildly Overstated • Aggressively Wrong • Fantasyland Numbers**

- KRS... "payroll growth, investment returns and inflation assumptions
- "Actuarial assumptions
- When you use re... ...een used for the last 10 years ... gonna go up"

*ridiculously high*

*blatantly incorrect or wildly overstated*

*fantasyland numbers*

*Exorbitant fund fees*

*shocked*


**March 5, 2017**

"... most important, is that the actuarial assumptions are realistic ... the Board's No. 1 responsibility is to set the rates on investment returns, payroll growth and inflation. These three numbers determine the actual liability and required actuarial payments by the legislature"

"One of the first things [new KRS board] did was to undertake an examination of 10-year historical rates. We were shocked to find that the actuarial assumptions used by the previous board were 30% to 80% percent higher

*too afraid of the political consequences to use the accurate numbers for these assumptions*

**June 18, 2018,**

The new leadership ... terminated

*helped hide the true pension costs and liabilities from Kentucky taxpayers*

and liabilities from Kentucky taxpayers.

The massive increased deficit numbers are largely a result of new assumptions which replaced **optimistic assumptions** used by boards in the past that **led to the accumulation of billions in unfunded liabilities**

H-L 2.16.17;

**NEW TRUSTEES FIRE PEDEN AND END HEDGE FUND ADVENTURE**

**"EXORBITANT" HEDGE FUND FEES**

- "Exorbitant Hedge Fund Fees"– Farris, June 25, 2018/Feb

*Exorbitant Hedge Fund fees*

- Former KRS Trustee: "can't get [fees] from anywhere besides public pension plans. Corporate plans are too smart to pay these outrageous fees. **The only stupid people are the taxpayers of Kentucky for letting these people get away with this."**

**"WE HAVE BEEN AGGRESSIVELY WRONG IN OUR ASSUMPTIONS FOR MANY, MANY YEARS" ADVENTURE**

¶ 36-37, 61-69

Slide #2

The Black Box Hedge Fund Fees were "exorbitant." ¶ 56. "[P]ast assumptions were manipulated" to help "hide the true pension liability." ¶ 36. Investment return assumptions were "ridiculously high, blatantly incorrect or wildly overstated." *Id.* This "helped obscure the distressed financial status of the plans," and "led to the accumulation of billions in unfunded liability." ¶¶ 36, 62.

The road to perdition began after the stock market declines in 2001–2002. The Trustee began more aggressive investment approaches, called "alternative investments" to try to boost investment returns and offset declining funding levels. It didn't work. In 2006, the Trustee was told the Trusts had "***significant*** [***and***] ***substantial funding problems***," and could not invest their way out of the problems. ¶¶ 229–231.

So, in 2006 the KRS Investment Committee evaluated even more exotic "alternative investments" called "hedge funds." It rejected hedge funds as investments for trust funds from a "fiduciary standpoint," because of their "secrecy," "unconstrained" investments and "higher risk and exposure." ¶ 43. There were too many "red flags." *Id*. ***KRS was*** "***not interested in hedge funds***." ¶ 43.


In April 2010, after losses in the 2008–2009 financial crisis, the Trustee got a "Bombshell Report" that the Trusts faced the risk of "running out of assets." ¶ 42. The Trustee was warned that "[a]dopting a significantly more aggressive investment strategy [would] substantially increase the chance of the catastrophic event of depletion of all assets in the near future." *Id.*; *see also* ¶¶ 250–252. Put another way, there is no reasonable investment strategy available to the KRS Board that would allow the plan to invest its way to significantly improved financial status "without also assuming unacceptable risks to the asset base of the plan." ¶ 252.


By 2010, the "alternative investments" made to try to "catch up" had engulfed the Trustee in corruption. ¶¶ 40–41, 255–256. In 2010, as part of a major "national scandal" (¶ 40), $13–15 million in secret diversions of Trust monies to third parties without disclosure to, or approval by, the Trustee in connection with getting KRS Trust monies placed in certain "alternative investments" were discovered. This included millions in improper sidekicks of Trust funds by Blackstone to a placement agent, Park Hill, founded by Schwarzman.[18] ¶¶ 40, 90–93. Several pension fund

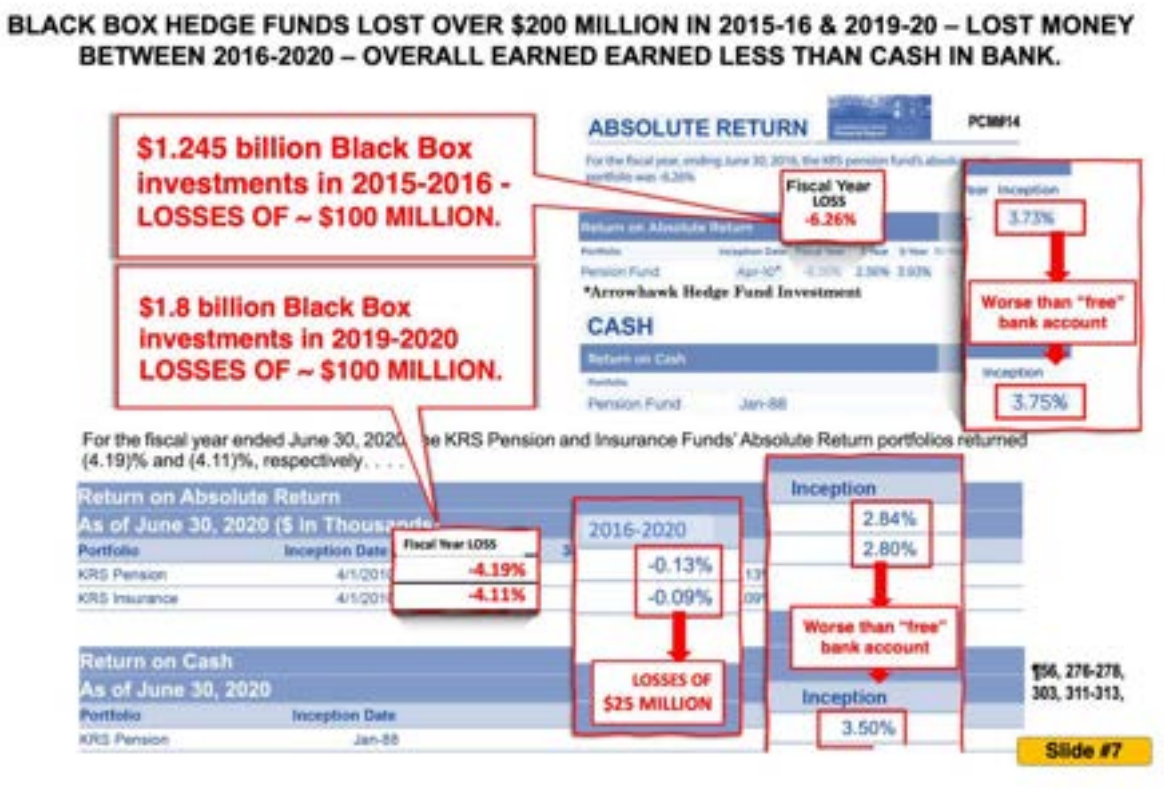
[18] *See* Crit Luallen, *Examination of Certain Policies, Procedures, Controls, and Financial Activities of Kentucky Retirement Systems* (June 28, 2011).

figures and fixers went to jail.[19] At KRS, the CIO and the CEO/ED were terminated. ¶ 40. The Board Chair was kicked off the Investment Committee. *Id.* KRS's operations were in "chaos" and its finances in "crisis" in 2010–2011. ¶¶ 40–41, 233; Report at 8, 51, 67.

During this "chaos," the Culpable Trustee greatly increased the risk allocation of the Trusts' investments. Fearing that since KRS "members do not understand sophisticated market strategies," "they won't understand a lower rate of return" which "will create anxiety," it rejected the "more conservative" portfolio recommended by its investment advisor that did not project out future investment returns at 7.75%. ¶¶ 47–48, 262. It picked the most aggressive, riskiest investment allocation possible to show "higher projected returns." ¶ 87. This was the "cover-up and catch-up scheme." Disaster followed. ¶¶ 236–237.

[19] *See*, *e.g.*, Zach O'Malley Greenberg, *Secret Agent*, FORBES.COM (May 23, 2011); Mary Williams Walsh, *Pension Advice For Hire, More States Start Inquiries Into Conflicts of Interest*, THE N.Y. TIMES (May 6, 2009); Rebecca Moore, *KY Audit Details Questionable Placement Agent Activities*, PLANSPONSOR (June 29, 2011).


Contrary to the Hedge Fund Sellers' factual assertions in the Petition, these were neither "highly profitable" nor "indisputably profitable" investments. The Complaint alleges that the Black Boxes lost hundreds of millions of dollars between 2015 and 2020. ¶¶ 56, 78, 276–278, 312. The Black Boxes carried exorbitant fees every year, which diminished investment returns every year. ¶¶ 9, 36, 279–283, 313–317. These losses and subpar returns and exorbitant fees adversely impacted the Trusts' annual investment returns in each of those years and negatively impacted both the current account balances and ultimate pension payouts of the Tier 3 Trust Plaintiffs (¶¶ 202–206), while contributing to funding levels falling to 13% and the deficit soaring to $26+ billion. ¶¶ 18–78, 229–325.




The Hedge Fund Sellers claim that the Report clears them of liability. It does not. As alleged in the Complaint, that Report was rigged by KRS Executive Director, Chief Executive Officer, and Defendant—David Eager—to exculpate himself and the Hedge Fund Sellers. ¶¶ 11, 326–351. Eager's motion to dismiss the Complaint was denied. *Taylor*, slip op. at 11, 17–18. The Report did not evaluate the breach-of-trust claims as pleaded in the Tier 3 Trust Plaintiffs' Complaint. But the facts in the Report confirm the Trustee's breach of fiduciary duties in graphic terms. Even this rigged investigation found that these Hedge Fund Sellers gained inside access to the Trusts and worked with "conflicted" and "disloyal" KRS officials who "lied," were "dishonest" and "manipulated events" to "favor," and "benefit" the Hedge Fund Sellers. Report at 26, 32–33, 67, 74–78, 83. It also found "conflicts of interest,"

"improper procedures," "no due diligence over the final Hedge Fund Seller selection process," and $13–15 million in secret unapproved diversions of Trust monies, *i.e.*, "sidekicks," to third persons, all of which polluted the investment process. Report at 8, 20, 25–26, 32–33, 49, 51, 53, 57–58, 62, 67, 74–78. That is no exoneration.

### 3. The Circuit Court Properly Permitted This Breach-of-Trust Lawsuit to Proceed Alongside the Commonwealth's Lawsuit

#### a. The Two Lawsuits Are Different

The Hedge Fund Sellers argue the Commonwealth's taxpayer lawsuit, now being prosecuted by the AG's private counsel, renders this breach-of-trust case duplicative and unnecessary. They are wrong. These are two separate, competing and conflicting cases, both being prosecuted by private counsel.

Why do the Hedge Fund Sellers prefer defending the case by the AG's private law firms in the Taxpayer case as opposed to this breach-of-trust case? Because they know—as they have argued and are asserting in their answers in the Circuit Court—that the AG's case is defective, impaired, and subject to unique defenses, such as *in pari delicto*, lack of causation, and exculpatory contractual provisions binding on the Culpable Trustee. The Hedge Fund Sellers prefer that case to this breach-of-trust case because this case is simpler and stronger.

This case is essentially a strict-liability case. Defendants bear the burden of proof on liability—the propriety of the Black Box transactions—and damages under the most stringent legal standard:

> A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.

> Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions[.]

*Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928) (Cardozo, J.). Indeed, a defendant accused of the breach (or participating in others' breaches) bears the burden of proffering "clear and satisfactory evidence" to make an "affirmative showing of fairness and good faith" in the challenged transactions. *See Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 599 (1921).

> Any unfair transaction induced by a fiduciary relationship between the parties gives rise to a liability with respect to unjust enrichment of the fiduciary. Where such transaction is attacked, ***the burden of proof is on the fiduciary to establish the fairness of the transaction***, ***and to this end he must fully disclose the facts and circumstances***, ***and affirmatively show his good faith***.

*Newton v. Hornblower, Inc.,* 224 Kan. 506, 508 (Kan. 1978).

Because the Tier 3 Trust Plaintiffs are innocent victims of the breach of trust perpetrated by the Culpable Trustee, together with the participation and assistance of the other Defendants, the Culpable Trustee's misconduct cannot be imputed to them. *See Wilson v. Paine*, 288 S.W.3d 284, 287–88 (Ky. 2009) (following the non-imputation doctrine and refusing to impute the knowledge of corporate insiders to a claim asserted by the innocent corporation). The Tier 3 Trust Plaintiffs are not subject to a defense based on *in pari delicto*. *See Jo Ann Howard & Assocs., P.C. v. Cassity*, 868 F.3d 637, 647 (8th Cir. 2017) (affirming the trial court's order striking an *in pari delicto* defense to a claim asserted by innocent beneficiaries). Recognizing these important distinctions between this breach-of-trust case and the Commonwealth's case, Judge Wingate stated that "[a]t trial, the evidence, argument

and jury charge (***including any comparative fault question***) will be markedly different." *Taylor*, slip op. at 4–5.

The Hedge Fund Sellers' claim that the AG's case makes this breach-of-trust lawsuit "duplicative" is based on an erroneous assertion of litigation supremacy of the AG's lawsuit. Judge Wingate rejected this baseless claim:

> The "occupy the field" term of art is misplaced. There is no preemption issue in this case. Furthermore, the Court does not believe the claims asserted by the Tier 3 members are duplicative of the Attorney General's claims. A judgment [in one case] would not preclude the other. ***The two separate actions are subject to different defenses***, ***procedural and substantive***.

*Id.* at 4.

While the two cases share common facts, they are different. This breach-of-trust case is the superior vehicle to make the best and biggest recovery for Kentucky overall. This breach-of-trust case seeks compensatory and punitive damages, including the funding declines and disgorgement of the excessive fees. It also seeks equitable relief, *i.e.*, restitution and disgorgement of excessive fees and recapture of diverted Trust assets. This lawsuit alone can recover all the financial harm—payable to the Trusts. If this lawsuit is successful, the KRS Trusts will be much better funded. This will greatly reduce the Commonwealth's funding obligations going forward. ***This breach-of-trust case is the superior way to remedy these Hedge Fund Sellers***' "***significant misconduct***."

The Hedge Fund Sellers and the AG's private counsel have repeatedly mischaracterized the breach-of-trust claims as "identical to" and "duplicative of" the claims private counsel are attempting to assert for the taxpayers. Judge Wingate

rejected this claim:

> The fact that the Tier 3 case and the AG's case are similar in some respects should not come as a surprise. ***The two cases … are different and distinct in important respects***. First, the parties are not the same …. ***Discovery and motion practice will be affected by this difference***. ***At trial***, ***the evidence, argument and jury charge including any comparative fault question will be markedly different***. ***The Tier 3 members/beneficiaries have interests different from the interests of*** "***the Commonwealth***, ***the body politic***," ***to which the AG owes his*** "***primary obligation***." *Commonwealth ex rel. Hancock v. Paxton*, 516 S.W.2d 865, 868 (Ky. 1974). Second, the claims are not entirely the same. The central theory underlying this case — that the KPPA Board, as a whole and as the sole trustee of the KPPA trust funds committed breaches of trust, in collusion with the third-party defendants—***is different from the theory underlying the AG's case***. Third, the relief is not the same. While both the Tier 3 Trust Plaintiffs and the AG seek to hold the Hedge Fund Sellers and other third-party Defendants liable, the different theories of the case may well result in different remedies.

*Id*. at 4.

While the breach-of-trust lawsuit was filed by and for innocent victims, the AG's case is on behalf of allegedly culpable actors, implicating the *in pari delicto* conduct of the Commonwealth and its agency (KRS) that defeats or diminishes those claims. Judge Wingate's order denying the motions to dismiss in both cases reflected the procedural and substantive differences flowing from the "separateness" of the cases from "discovery and motion practice" to "evidence," "arguments," and "trial," including "comparative fault." *Taylor*, slip op. at 4–5.

These actions and agreements of the Culpable Trustee do not bind or encumber the Tier 3 Trust Plaintiffs' claims for damages to be paid to the Trusts, *see Jo Ann Howard*, 868 F.3d at 647 (affirming striking *in pari delicto* defense because "these defenses do not apply to innocent … beneficiaries of the … trusts"). The Trustee's

misconduct cannot be imputed to beneficiaries. *Biancalana v. T.D. Serv. Co.*, 56 Cal. 4th 807, 820 (Cal. 2013) ("[b]ecause the error was the trustee's alone, it cannot be imputed to the beneficiary").

The claims the AG farmed out to private counsel to try to prosecute face discomforting realities—the alleged *in pari delicto* conduct of the Culpable Trustee, defenses in the investment contracts the Culpable Trustee signed and the Commonwealth's underfunding of KRS. These actions harmed the Trust's finances, caused the Trustee to take the reckless investment risks central to this case—the "cover up and catch up" scheme, to try to make up for the accumulating financial impact of years of funding shortfalls. *See Sandoz, Inc. v. Commonwealth*, 405 S.W.3d 506 (Ky. Ct. App. 2012).

The AG's case is confused and endangered. It will be much easier to diminish or defeat on the merits. Private contingent fee counsel's claim of litigation exclusivity, echoed here by the Hedge Fund Sellers, reflects their fee ambitions, not the true interests of the Trusts or its beneficiaries. Those fee ambitions ought not be permitted to interfere with—let alone block—this breach-of-trust action by the Tier 3 Trust Plaintiffs for the benefit of the KRS Trusts.

**b. The Two Lawsuits Are in Conflict**

A lawsuit seeking damages to be paid to a trust is a trust asset. *See* RESTATEMENT (THIRD) OF TRUSTS § 107, Cmt. e (2012) ("cause of action … is itself a trust asset"). KRS's trust assets under law must be used "solely" "exclusively" for the Trusts and beneficiaries. KRS § 61.515. Any Tier 3 recovery is a trust asset, that belongs **exclusively** "solely" to the Trusts.

The taxpayer claims being prosecuted by the AG's private counsel directly conflict with and are adverse to these breach-of-trust claims. Any recovery the AG's private counsel does ever obtain in pursuing these claims must be placed in the Commonwealth's treasury pursuant to KRS § 48.005(3).

Neither the Courts nor the AG have the power to disobey KRS §§ 48.005(3) or 61.515. Monies to pay general obligations of the Commonwealth are not protected and segregated trust funds recovered on behalf of the KRS Trusts. Any net recovery on the breach-of-trust claims will go to the KRS Trusts—"trust funds to be held and applied solely" for the benefit of KRS and its members, KRS § 61.515(2)(b), allocated by the Trustee to the proper trusts and into individual Tier 3 accounts. KRS § 61.685.

### C. The Court Should Deny the Writ Petition Because Defending These Lawsuits Causes Neither Great Injustice Nor Irreparable Harm to the Wall-Street Hedge Fund Behemoths, Whose Business Model Involves Taking Advantage of Pension Fund Investors

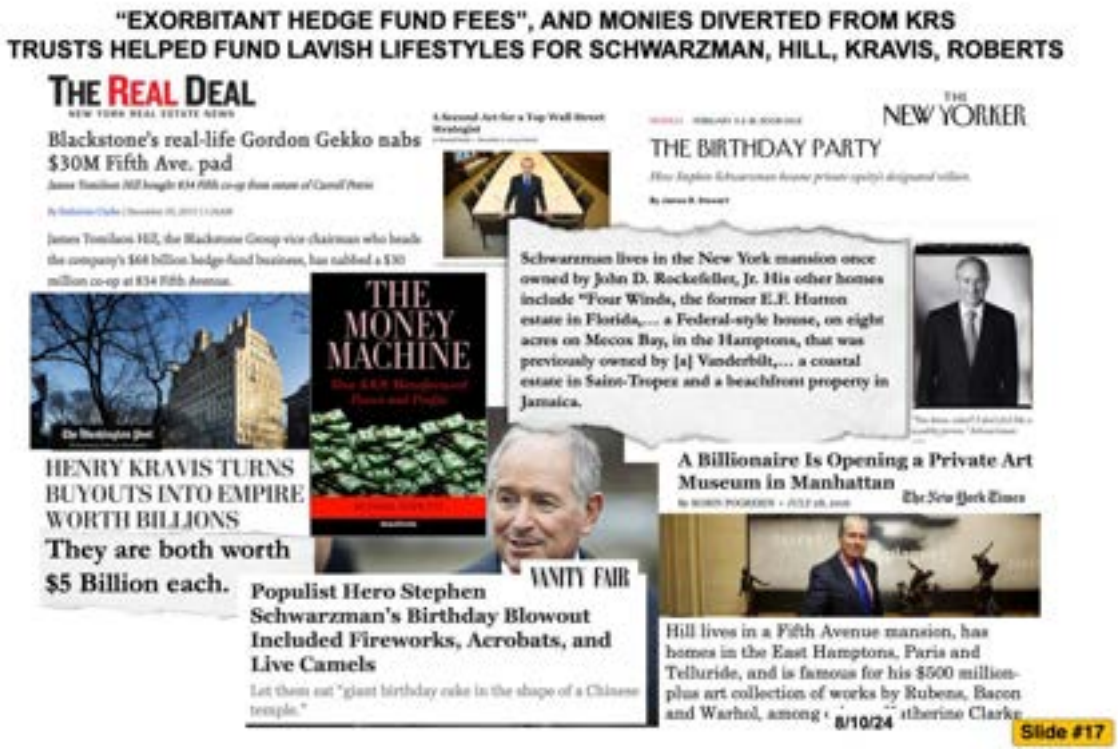
Writ Petitions are disfavored. Great injustice or irreparable harm must be shown. *See Beck v. Scorsone*, 612 S.W.3d 787, 791 (Ky. 2020) (petitioners must demonstrate that they "will suffer a 'great injustice or irreparable harm'"—"'harm of a ruinous nature,' … 'not mere expense, inconvenience, or loss of strategic advantage.'" *Id.* at 791 & n.12 (quoting *Robertson v. Burdette*, 397 S.W.3d 886, 891 (Ky. 2013)). The Hedge Fund Sellers cannot do so here.

The only "harm" the Hedge Fund Sellers claim is the expense and inconvenience of defending two lawsuits at the same time before one judge in a Kentucky court. As a matter of law, however, being required to defend lawsuits, without more, does not amount to sufficient hardship or harm necessary to justify

issuance of a writ. *See Osborn v. Wolfford*, 39 S.W.2d 672, 673 (Ky. Ct. App. 1931) ("in order to constitute the requisite 'great and irreparable injury' … the failure to succeed in the particular case should inevitably be followed by consequences of great and ruinous loss and for which there was no remedy"); *see also Lee v. George*, 369 S.W.3d 29, 33–34 (Ky. 2012) ("the delay and expense of appeals does not constitute irreparable injury").

If the Wall-Street Hedge Fund Sellers are caught between competing lawsuits, that is their own fault. They came to Kentucky, exploited the KRS Trusts and pocketed $300 million in exorbitant hedge fund fees. To them, this litigation is a cost of doing business—an inconvenience they have endured quite well over the years, given their wealth, size and power.

The $1.8 billion allocation of Trust funds to these Hedge Fund Sellers was a disaster for the Trusts. But not the Hedge Fund Sellers. They pocketed $300 million in "exorbitant" fees, and shared millions of dollars in secret placement agent "sidekicks." ¶¶ 40, 90–93. These monies helped fuel lifestyles of extravagance beyond comprehension.




While obstructing and delaying this litigation for years denying Kentucky's public employees from pursuing their claims on the merits, Defendants' over-the-top lifestyle rolls on. Schwarzman pockets a billion dollars a year. *See* Sam Dangreman, *The Affluenza Set*, AIRMAIL (Aug. 10, 2024). His triplex on Park Avenue was once owned by the Rockefellers. *Id.* He has an eight-plus acre estate out in the Hamptons. His waterfront estates in Palm Beach and Jamaica are worth $125 million; the beach estate in Nantucket, $23 million. *Id.* Most recently, he picked up a 2,500 acre estate in the English countryside for over $100 million and held a "housewarming" for 200 guests to his new 30,000 square foot, $27 million mansion at Newport, a lavish display "almost at the Gatsby level." *Id.*


Blackstone and KKR file reports with the SEC, which must disclose all material risks to the enterprise—including from litigation. Blackstone Inc.'s 2023 Form 10-K confirms litigation is simply a part of their business ***because of the way they do business***, "[***w***]***e are subject to substantial risk of litigation*** … the volume of claims and amount of damages claimed in litigation … have been increasing … the risk of third party litigation … arising from investor dissatisfaction with the performance of those investment funds, alleged conflicts of interest, the suitability … of our products … to the extent investors in our investment funds suffer losses … investors may have remedies against us … under … state law." Ex. 10 at 50. KKR is the same: "Litigation" is a key business "risk," "executive officers … may be named as defendants in litigation." Ex. 12 at 87–88; *see also* ¶¶ 274–275.

Blackstone states in its Form 10-K that these lawsuits are "totally without merit" and "based on information known by management, Blackstone does not have a potential liability related to any current legal proceeding or claim that would individually … materially affect its results of operations, financial position or cash flows." Ex. 11 at 215–16. KKR is the same. Ex. 12 at 361–62. These statements belie the Hedge Fund Sellers' claim that allowing this lawsuit to go forward will cause them "great and irreparable harm." *See* Pet. at 26–30.

The federal securities laws also require timely disclosure of any material event. If the lower court's May 1, 2024 rulings were so ruinous, why have these companies not made such disclosure? Because there is no material harm let alone "great and irreparable harm."

Defendants will lose this case if the facts now pleaded are proven. That is justice—not irreparable harm. They can easily defend this lawsuit in Kentucky. They have done so for seven years. If they are ever held liable, they can appeal. If the case is found to be frivolous, they can recover their fees. *See Sampson v. Murray*, 415 U.S. 61, 90 (1974) ("the possibility that adequate compensatory or other corrective relief will be available at a later date, in the ordinary course of litigation, weighs heavily against a claim of irreparable harm").[20]

[20] Under precedents from Kentucky and beyond, an injury is "irreparable" only if it cannot be undone through monetary remedies because "'mere injuries, however substantial, in terms of money, time and energy necessarily expended … are not enough.'" *Norsworthy v. Ky. Bd. of Med. Licensure*, 330 S.W.3d 58, 62 (Ky. 2009) (quoting *Sampson*, 415 U.S. at 90); *Monsanto Co. v. Geertson Seed Farms*, 561 U.S. 139, 141 (2010) (an injury is "irreparable" only if "monetary damages[] are inadequate to compensate for that injury").

## IV. CONCLUSION

This is not a case constrained by a limited fund with which to satisfy the claims against defendants. Proceeding with both cases—the AG's case and this breach-of-trust case—is the surest way to ensure that justice is done.

This case is squarely within the Circuit Court's subject-matter jurisdiction. Judge Wingate has the cases well in hand and will manage this litigation to prevent diversion of or duplication of recoveries and give both cases a fair shot at remedying the largest and worst financial scandal in Kentucky history. This Court should deny the Writ Petition and allow this breach-of-trust case to proceed before Judge Wingate.

Dated: August 29, 2024

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## WORD-COUNT CERTIFICATE

This response complies with the word limit of Rule 60(F) of the Kentucky Rules of Appellate Procedure because, excluding the parts of the response exempted by Rule 15(D), this response contains 13,794 words.

Michelle Ciccarelli Lerach (KBA 85106)

**Certificate of Service**

My signature below certifies that a true copy of this RESPONSE OF REAL PARTIES IN INTEREST TO THE HEDGE FUND SELLERS' WRIT PETITION was served on this 29th day of August, 2024: by overnight-mail delivery, postage prepaid, to Hon. Thomas D. Wingate, Circuit Judge, 48th Judicial Circuit, Franklin County Courthouse, 222 St. Clair Street, Frankfort, Kentucky 40601; and by electronic service to the persons listed below:

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