

Commonwealth of Kentucky

Court of Appeals

NO. 2015-CA-000878-MR

BOARD OF TRUSTEES OF THE
KENTUCKY RETIREMENT SYSTEMS

APPELLANT

v.

APPEAL FROM FRANKLIN CIRCUIT COURT
HONORABLE THOMAS D. WINGATE, JUDGE
ACTION NO. 14-CI-01259

CITY OF FORT WRIGHT, KENTUCKY

APPELLEE

OPINION
AFFIRMING

** ** * * * * *

BEFORE: KRAMER, CHIEF JUDGE; NICKELL AND THOMPSON, JUDGES.

NICKELL, JUDGE: The Board of Trustees of the Kentucky Retirement Systems brings this appeal from two Franklin Circuit Court orders denying the Board's motion to dismiss a class action complaint filed by the City of Fort Wright. The complaint alleged various improprieties in the Board's choice of investments and payment of management fees, and sought declaratory and injunctive relief. The

sole issue on appeal is whether the Board may invoke the defense of sovereign immunity.

The City and its employees participate in the County Employees Retirement System (CERS). CERS is a public retirement system created under Kentucky Revised Statutes (KRS) 78.510 *et seq.* CERS is administered by the Board of Trustees of the Kentucky Retirement Systems. *See* KRS 78.780.

The City filed a class action complaint against the Board in Kenton Circuit Court, on behalf of itself and all other participants in CERS. The complaint¹ alleged the Board had violated its statutory and fiduciary obligations by placing CERS funds in unauthorized and high-risk “alternative assets” investments, and the Board had paid substantial management fees (exceeding \$50 million over a period of five years) in connection with these inappropriate investments. The complaint sought a declaration of the rights of the parties, to enjoin the Board from investing CERS assets in funds that are not registered pursuant to the Federal Investment Company Act of 1940, 15 U.S.C. Sec. 80a-1 *et seq.*, and to enjoin the Board from using CERS assets to pay management fees for such investments. It sought an accounting from the Board for the previous five years and a segregation and reallocation of investment assets in the three funds the Board administers: CERS, the Kentucky Employees Retirement System (KERS) and the State Police Retirement Systems (SPRS).

¹ The record does not contain a complete copy of the complaint. The complaint referenced by the appellant’s brief consists of only the first twelve pages of that document.

The Board moved to dismiss. The Kenton Circuit Court transferred the case to the Franklin Circuit Court which entered an order denying the motion to dismiss. The Board then moved the court specifically to address its sovereign immunity defense. The trial court issued another order expressly ruling sovereign immunity did not bar this action. This appeal followed.

An interlocutory appeal is permissible under these circumstances because “an order denying a substantial claim of absolute immunity is immediately appealable even in the absence of a final judgment.” *Breathitt County Bd. of Educ. v. Prater*, 292 S.W.3d 883, 887 (Ky. 2009). Whether a particular defendant is protected by immunity is a question of law which is reviewed *de novo*. See *Rowan County v. Sloas*, 201 S.W.3d 469, 475 (Ky. 2006).

“Kentucky Retirement Systems is a statutorily created agency of state government, KRS 61.645(1), administered by a board of trustees that manages and administers the retirement funds of the [CERS], the [KERS] and the [SPRS].” *Commonwealth v. Kentucky Ret. Sys.*, 396 S.W.3d 833, 837 (Ky. 2013). Through its Board, Kentucky Retirement Systems performs an “integral state function through the administration of the various retirement systems, which is essential to the personnel function of state government and the state’s political subdivisions, and thus is entitled to immunity under sovereign immunity law unless waived.” *Id.*

In *Commonwealth v. Kentucky Ret. Sys.*, our Supreme Court discussed three circumstances under which a waiver of sovereign immunity is possible: (1) existence of an express statutory waiver; (2) breach of a contract claim brought

against the Commonwealth; and (3) declaratory judgment is sought. We address each circumstance in turn.

I. Statutory Waiver

KRS 61.645(2)(a) provides the Board can “sue and be sued in its corporate name.”

It is often stated that the state is immune from suit unless there has been an express waiver allowing suit. This is generally true, at least in tort cases. And a waiver will be found “only where stated by the most express language or by such overwhelming implications from the text as will leave no room for any other reasonable construction.” *Withers v. University of Kentucky*, 939 S.W.2d 340, 346 (Ky. 1997) (quoting *Edelman v. Jordan*, 415 U.S. 651, 673, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1974)).

Id., 396 S.W.3d at 837.

The Board argues the “sue and be sued” language permits actions against the Board only in limited circumstances when an additional, express statutory waiver is applicable. Thus, as to employers such as the City, the Board argues only one statute permits an action by the City against the Board—KRS 61.598(5)—which allows an appeal by an employer from a Retirement Systems’ calculation of the actuarial cost to be paid by employers for large increases in an employee’s creditable compensation, referred to as “pension spiking.” Similarly, when it comes to Retirement Systems members, the Board argues additional statutory authority is required for waiver of its immunity, such as that found in KRS

61.615(5) and KRS 61.645(16) which allow judicial review of the Board's administrative decisions in matters relating to member disability and other benefits.

But the Supreme Court of Kentucky has construed the phrase "sue and be sued" more broadly, stating

[w]hile such language is not a blanket waiver of sovereign immunity, such as to allow a tort claim, it has been read to "have reference to suits respecting matters within the scope of the duties of the Board [that 'may be sued']." *Wallace v. Laurel County Bd. of Educ.*, 287 Ky. 454, 153 S.W.2d 915, 917 (1941). This suggests that suits deciding the duties and obligations of government agencies subject to various statutory schemes are allowed.

Id., 396 S.W.3d at 836-37 (footnotes omitted).

The opinion of the Supreme Court does not stipulate an additional express statutory waiver, such as those cited by the Board, is required to invoke the waiver found in KRS 61.645(2)(a). Consequently we are reluctant to impute such a requirement to the statute. The City's complaint seeks to determine and clarify duties and obligations of the Board and thus, falls squarely within the parameters of the waiver as delineated by our Supreme Court.

II. Breach of Contract

The Board also acknowledges existence of a statutory waiver of immunity in KRS 45A.245, which provides, "[a]ny person, firm or corporation, having a lawfully authorized written contract with the Commonwealth . . . may bring an action against the Commonwealth on the contract[.]" The Board agrees this waiver applies to Retirement Systems members who may bring an action against the

Board based on the right to receive a benefit pursuant to the inviolable contract provision of KRS 61.692(1), which provides:

[f]or members who begin participating in the Kentucky Employees Retirement System prior to January 1, 2014, it is hereby declared that in consideration of the contributions by the members and in further consideration of benefits received by the state from the member's employment, KRS 61.510 to 61.705 shall, except as provided in KRS 6.696 effective September 16, 1993, constitute an inviolable contract of the Commonwealth, and the benefits provided therein shall, except as provided in KRS 6.696, not be subject to reduction or impairment by alteration, amendment, or repeal.

The inviolable contract inures only to members, not to participating employers in CERS, such as the City.

The Board concludes that because there is no express waiver of immunity in any statute in favor of the City, and because the City is not a party to the “inviolable contract,” its suit is barred. As we have already stated, however, allegations in the City's complaint relate to the duties and obligations of the Board, and thus fall within the scope of the waiver contained in KRS 61.645(2)(a) as it has been delineated by the Supreme Court. Furthermore, the complaint seeks a declaratory judgment, a cause of action which is “simply different[,]” *Commonwealth v. Kentucky Ret. Sys.*, 396 S.W.3d at 839, for purposes of determining the availability of sovereign immunity.

III. Declaratory Judgment

“Sovereign immunity is founded on the notion that the resources of the state, its income and property, cannot be compelled as recompense for state action that harms a plaintiff through the ordinary suit-at-law process.” *Id.* at 836. The Supreme Court of Kentucky has held sovereign immunity may be waived when a declaratory judgment is sought, precisely because “a declaratory judgment is not a claim for damages, but rather it is a request that the plaintiff’s rights under the law be declared. There is no harm to state resources from a declaratory judgment.” *Id.* at 838. The City contends its suit falls squarely within this exception, as it seeks review of the propriety of a governmental action that will not result in the loss of public funds or property.

The Board objects on two grounds. First, it argues the waiver of immunity in a declaratory judgment action is only permissible when a constitutional issue is at stake. In *Commonwealth v. Kentucky Ret. Sys.*, the plaintiffs—a group of county employees who were members of CERS—brought a declaratory judgment action challenging the constitutionality of a statute that significantly revised the terms of the public employee retirement plan. The Commonwealth and Kentucky Retirement Systems were named as separate defendants. Retirement Systems did not attempt to invoke sovereign immunity, but the Commonwealth moved for dismissal on that basis. The Supreme Court concluded the Commonwealth had waived its immunity, based on the interplay of the following factors: the “sue and be sued” language of KRS 61.645(2)(a); the fact the plaintiffs were parties to the “inviolable contract;” and terms of the Declaratory Judgment Act require all

persons having a claim or interest which would be affected by the litigation to be made parties. The Court did not rule that any single one of these factors was dispositive. It concluded the Commonwealth was a necessary party, because “[w]hen the action involves an alleged contract with the state, or the constitutionality of a statute, it is indisputable that the interest at issue is a state issue, not just an agency issue.” *Id.* at 838.

By contrast, the challenge in this case is brought by a participating employer, rather than a member or members, and it pertains directly to the Board’s investment strategies, rather than to the constitutionality of a statute affecting a member’s right to receive a retirement benefit. The interest at stake may not directly implicate a legislative enactment, but the reasoning of *Commonwealth v. Kentucky Ret. Sys.*—which supported finding a waiver of immunity—applies equally to this situation.

We do not have a government that is beyond scrutiny. If sovereign immunity can be used to prevent the state, through its agencies, from being required to act in accordance with the law, then lawlessness results. This review is qualitatively different from requiring the state to pay out the people’s resources as damages for state injury to a plaintiff.

Id. at 839. As a contributor to CERS on behalf of its employees, the City has an interest in requiring the Board to act in accordance with the law. For instance, its contributions are adjusted according to a statutorily-prescribed formula computed by amortizing the total unfunded actuarially accrued liability over a thirty-year period. KRS 61.565(1)(a). The amount of this liability is presumably directly

affected by the Board's management of the investments of Retirement Systems.

Thus, under the facts before us, we reject the Board's contention that a constitutional issue is required as a predicate to waiver of immunity in a declaratory judgment action.

For its second challenge, the Board argues the City's complaint, seeking a finding of breach of fiduciary duty and the remedies of an accounting and restitution which would harm the state financially, exceeds the bounds of a declaratory judgment action. These matters are beyond the limited scope of this appeal which exclusively addresses the issue of immunity. When considering a motion to dismiss, "allegations contained in the pleading are to be treated as true and must be construed in a light most favorable to the pleading party. The test is whether the pleading sets forth any set of facts which—if proven—would entitle the party to relief." *Mitchell v. Coldstream Labs., Inc.*, 337 S.W.3d 642, 644-45 (Ky. App. 2010) (internal citations omitted). In *Commonwealth v. Kentucky Ret. Sys.*, the declaratory judgment action was allowed to go forward although the Supreme Court acknowledged the immunity issue could become significant later in the litigation.

[I]n subsequent or contemporaneous actions to enforce declared rights, the immunity issue could be relevant if the revenue or property of the state would be affected. . . . [But] the underlying merits of any claim, such as the contract claim here, are not before the court in a declaratory judgment action.

Commonwealth v. Kentucky Ret. Sys., 396 S.W.3d at 839. Similarly, in the case *sub judice*, the underlying merits of the City's claim are not before this Court.

Based on our review of the record, we believe the Board's entitlement to sovereign immunity has been waived, as was correctly found by the trial court. Thus, for the reasons stated herein, the order denying the motion to dismiss is affirmed, and this declaratory judgment action is permitted to proceed against the Board.

ALL CONCUR.

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