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Patronage Capital Lawsuits Against Electric Cooperatives on the Rise

In 2009-10, at least five class action lawsuits have been filed against electric cooperatives over patronage capital (or capital credits) and are in active litigation. Depending upon the lawsuit, the plaintiffs allege that the cooperatives breached their obligations to members and violated state law by:

- Failing to retire capital credits altogether.
- Involuntarily discounting capital credits.
- Retiring capital credits only upon the death of a member.
- Preferring current members over former members in retiring capital credits.

Some of the complaints also include allegations regarding:

- Mismanagement of the cooperative's affairs.
- Unauthorized activities funded with members' capital.
- Overcompensation of officers and directors.
- Violation of cooperative principles by withholding information from members and rigging director elections.

These class action suits seem to be part of a coordinated effort. In some of the suits, the plaintiff members are represented by common law firms based in New York and Texas.

Capps v. Carroll Electric Cooperative Corporation (Arkansas) (2009-1773-02)

On June 10, 2009, a member of Carroll Electric Cooperative Corporation filed a class action complaint against the cooperative in an Arkansas state court, alleging that "Carroll Electric has refused and continues to refuse to refund capital ('patronage capital') that rightfully belongs to class members." (Carroll Compl. ¶ 1) At issue is more than \$170 million of patronage capital.

In its answer, Carroll Electric relied principally on the business judgment rule. Carroll Electric also pointed out that, as the Arkansas Code seemingly contemplates, its patrons benefit from patronage capital in the form of significantly lower rates. It also defended its high equity ratio of 57.5%, explaining that such a ratio was prudent given Carroll Electric's business environment.

On November 20, 2009, plaintiffs filed a Second Amended Class Action Complaint, which Carroll has since denied. The litigation remains ongoing.

The CoServ Lawsuits

- In re *Denton County Electric Cooperative, Inc. d/b/a CoServ Electric* (Texas) (2009-30003-211) ("Brady" suit)

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- *In re Denton County Electric Cooperative, Inc. d/b/a CoServ Electric* (Texas) (2009-30075-211) (“Confer” suit)
- *Denton County Electric Cooperative, Inc. d/b/a CoServ Electric v. Glover* (Texas) (2009-10087-16) (“Glover” suit)

In the spring of 2009, three class action petitions were filed in a Texas state court against Denton County Electric Cooperative (“CoServ”) based on CoServ’s alleged practice of “discounting” class members’ capital credits, as well as allegations of mismanagement and rigging of director elections. CoServ filed to remove two of the cases (the Brady and Confer suits) to federal court.

The essential claim in all three petitions is that CoServ supposedly retired \$75 million in patronage capital to its members and former members, but in actuality distributed only \$21 million in cash, and without disclosure converted \$54 million of the patronage capital into permanent equity that belongs to CoServ. The plaintiffs recognize that it may be appropriate to discount capital credits paid out prematurely because of death, bankruptcy or other exigent circumstances. But they claim that “it is another thing altogether for the Defendant or any other cooperative to systematically discount tens of millions of dollars in capital credits that belong to its members, without their consent, so that the cooperative can improve its balance sheet.” (Compl. ¶ 64.)

The Brady and Confer cases were initially removed by CoServ to federal court, but were recently remanded back to state court. Litigation in these cases remains ongoing.

Mansfield v. Edisto Electric Cooperative, Inc. (South Carolina) (09-cv-01645)

On May 21, 2009, the plaintiffs (former cooperative members) filed this class action suit against Edisto Electric Cooperative in the state court of South Carolina, based on Edisto’s practice of returning patronage capital only upon the death of members.

The plaintiffs allege that, according to Edisto’s bylaws, patronage capital is not payable to the plaintiffs until their death and then is payable at the pleasure of Edisto without interest. The plaintiffs further allege that Edisto has the ability to refund patronage capital to current and former members, and is required by law to do so.

In response, Edisto has relied on the business judgment rule, applicable statutes of limitation, federal preemption and other defenses. Its federal preemption defense is based on 7 C.F.R. § 1717.617, which provides that if an RUS borrower is required by its loan documents to obtain RUS approval before retiring any patronage capital, approval is given if, after the distribution, the borrower’s equity will be 30% or more of its total assets. Edisto has also asserted a third-party counterclaim against RUS, claiming that RUS should indemnify Edisto for any amounts it has to pay the plaintiffs. RUS has moved for dismissal on the ground of sovereign immunity.

This case has been removed to federal court, which has not yet ruled on plaintiff’s request to remand to state court or to dismiss for lack of jurisdiction.

Burks v. White River Valley Electric Cooperative (Missouri) (09DG-CV00140)

On September 24, 2009, two former members of the White River Valley Electric Cooperative filed a class action suit based on White River's refusal to refund capital credits. The plaintiffs allege that White River has not refunded any capital credits in more than two decades. The proposed class consists of all former members of the electric cooperative, as well as all current members who have been members for 20 years or more and whose capital credits have not been retired. The plaintiffs contend that White River possesses "millions of dollars" in capital credits.

White River has objected to class certification and has filed a motion to dismiss. White River relies on the business judgment rule, arguing that the payment of capital credits rests with the sound discretion of the board. White River further points out that a conflict of interest exists between the current and former members of the proposed class, because the return of capital credits would force the current members of the cooperative to pay more for electrical service. Litigation remains ongoing.

Shea v. Cobb Electric Membership Corporation (Georgia) (10100353-48)

On January 15, 2010, two former members of Cobb EMC, and the estate of a deceased member, filed a class action complaint against the cooperative in a Cobb County, Georgia, superior court. The proposed class seeks the return of approximately \$150 million in capital credits. The complaint alleges that Cobb EMC has not returned capital credits since 1976. This class consists solely of former members who claim that current members are unjustly enriched at their expense. They contend that if need be, Cobb EMC should raise the rates charged to current members in order to have sufficient funds to return capital credits to former members. The complaint also alleges that Cobb EMC has failed to distribute capital credits received from "generation and transmission" cooperatives, including Oglethorpe Power Corporation.

Cobb EMC has not yet filed its answer.

Conclusion

Electric cooperatives vary widely in their policies governing the retirement of capital credits. Some cooperatives retire capital credits on a regular basis, and some do not. Some cooperatives retire capital credits only for deceased patrons. Several cases reference the National Rural Electric Cooperative Association's recommendations regarding capital credits. The increase in litigation over the capital credits issue shows, at a minimum, that cooperatives should ensure that their capital credits policies are in keeping with all legal requirements. These lawsuits also suggest that cooperatives may want to re-examine their capital credits policies.



If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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