

March 9, 2011

New Patronage Capital Case Hits North Carolina Coop

The number of patronage capital cases continues to rise. From 2009 to 2011, at least 10 cases have been filed against electric cooperatives over patronage capital (or capital credits). In fact—just this past February—another patronage capital case was filed in North Carolina. This is the first known patronage capital case of this kind to be filed in that state.

This Legal Alert reports on the North Carolina suit and provides an update on the other patronage capital suits filed against cooperatives. Most cases are in active litigation. Of particular note is the *Capps* suit in Arkansas, in which the Supreme Court of Arkansas recently affirmed a lower court decision that exclusive jurisdiction to adjudicate patronage capital claims rests with the Arkansas Public Service Commission.

Jackson v. South River Electric Membership Corp. (North Carolina) (11-CvS-152)

On February 9, 2011, a new patronage capital class action complaint was filed in Sampson County, North Carolina. The class consists of the estates of deceased members of the coop (approximately 3,000) whose accumulated capital credits were allegedly discounted at retirement and converted to permanent equity by the South River Electric Membership Corp. (SREMC).

According to the complaint, SREMC provides electric service to more than 40,000 members in five North Carolina counties. At issue is more than \$1.5 million of the deceased class members' alleged property. SREMC has not yet filed its answer.

This case reflects the trend to limit plaintiff classes to *either* current members *or* former/deceased members—rather than both current *and* former members—in order to avoid claims of inherent conflicts within the plaintiff class.

Update on Other Patronage Capital Cases

This Legal Alert also provides the following update on the nine patronage capital cases filed in 2009-2010.

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.” At issue is more than \$170 million of patronage capital.

On April 14, 2010, the Circuit Court in Benton County, Arkansas, dismissed all claims relating to a monetary refund of patronage capital, holding that the exclusive jurisdiction to adjudicate such rights rested with the Arkansas Public Service Commission. On April 30, at the request of the plaintiffs, the court dismissed the plaintiffs' remaining equitable (nonmonetary) claims. These equitable claims sought to change the cooperative's election procedures, distribution of funds, and other functions.

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On February 9, 2011, the Supreme Court of Arkansas—concluding that capital credits were “public” rather than “private” rights and that the Arkansas Public Service Commission had exclusive jurisdiction to adjudicate those rights—affirmed the decision of the appellate court.

The CoServ Lawsuits

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

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, converting the remaining \$54 million into “permanent” equity that belongs to CoServ.

The Brady and Confer suits were initially removed by CoServ to federal court, but were recently remanded back to state court. Litigation remains ongoing. In the Glover case, the trial court granted certification of the “voting class” but denied certification of the “equity class”—which was the proposed class that sought changes in the retirement of CoServ’s patronage capital. The trial court’s ruling on the equity subclass certification has not been appealed, although issues relating to the voting class are currently on appeal in the Texas Court of Appeals (Second Judicial District).

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

On May 21, 2009, the plaintiffs (former coop 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. This case was later removed to federal court.

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 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 a Rural Utilities Service (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 also asserted a third-party counterclaim against RUS, claiming that RUS should indemnify Edisto for any amounts it has to pay the plaintiffs. RUS moved for dismissal on the ground of sovereign immunity.

On March 30, 2010, the federal district court in South Carolina granted a RUS motion to dismiss the third-party complaint on the grounds of sovereign immunity. The court also granted the plaintiffs' motion to remand, finding in part that the federal regulations cited by Edisto did not expressly preempt the state court action because the action dealt with internal corporate governance. The case was ordered remanded to the South Carolina Court of Common Pleas.

Edisto appealed these rulings to the U.S. Court of Appeals for the Fourth Circuit. While Edisto later dismissed its appeal involving the RUS third-party claims, Edisto's appeal of the remand order is still pending.

Burks v. White River Valley Electric Cooperative (Missouri) (1031-CV10307)

On July 12, 2010, two former members of the White River Valley Electric Cooperative filed a class action suit based on White River's failure 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. The plaintiffs contend that White River possesses "millions of dollars" in capital credits.

This is the second complaint filed by these same plaintiffs. The first case was filed in 2009 and proposed a class of both former members and current members who had been members 20 years or more and whose capital credits had not been returned. The plaintiffs voluntarily dismissed the first case after White River filed a motion to dismiss. Among other arguments, White River pointed out that a conflict of interest existed between the current and former members of the proposed class, because returning capital credits as demanded by the plaintiffs would force current members to pay more for electric service. As noted above, the second complaint proposes a class of only former members.

The second complaint also added a new defendant—Associated Electric Cooperative, Inc. (AECI). Under a three-tier system, AECI supplies power to six regional generation and transmission cooperatives (G&Ts), that in turn provide power to distribution cooperatives, including White River. The plaintiffs allege a conspiracy among White River, two of the G&Ts (Kamo Power Cooperative and Sho-Me Electric Cooperative), and AECI to withhold payments of capital credits. The plaintiffs assert that these cooperatives maintain high equity-to-asset ratios and high patronage capital balances. (The G&Ts are not named as defendants.)

AECI and White River have both filed motions to dismiss and motions to transfer venue. Among other defenses, the defendants claim that AECI does not belong in the case, because it does not dictate the manner, method or timing of the payment of capital credits, and that the plaintiffs' claims are barred by the business judgment rule. 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.

Cobb EMC moved to dismiss the original complaint, as well as a later amended complaint, on various grounds, including the discretion vested in the cooperative to manage its own affairs. Litigation remains ongoing.

Mitchum v. Aiken Electric Cooperative (South Carolina) (2010-CP-02-00206)

In this case, the plaintiff class consists of former customers of South Carolina electric cooperatives whose patronage capital has not yet been refunded. Citing S.C. Code Ann. § 33-49-460, the purported class argues that “cooperative principles to which all South Carolina cooperatives claim to adhere require them to operate at costs [and] to refund revenue above costs to the owner/customer as an overcharge or ‘patronage’.” These former customers also complain that the cooperatives favor the interests of current customers, exclude former customers from participating in cooperative governance, and make no attempt to locate former customers, thereby allowing a forfeiture of those customers’ capital credits.

The allegations are made against all South Carolina electric cooperatives (other than Edisto), which the plaintiff class argues are necessary parties “since all have interests which would be affected by a South Carolina court’s interpretation of the lawfulness and propriety of their bylaws and business dealings with respect to the rights and pecuniary interests of members who are former customers.” South Carolina cooperatives have not yet filed any responsive pleadings. The case was filed in Aiken County, South Carolina. Litigation remains ongoing.

Canales v. Nueces Electric Cooperative (Texas) (2010DCV-5008-E)

On March 30, 2010, two members of the Nueces Electric Cooperative (NEC) filed a class action complaint alleging that, unlike most other cooperatives in Texas, NEC does not regularly return patronage capital to its members. The plaintiff class is defined as all current members of NEC. The plaintiffs also raised corporate governance and transparency claims. According to the complaint, NEC has more than 18,000 retail customers. At issue is more than \$38 million in patronage capital.

The district court in Duval County later transferred venue to the district court of Nueces County, Texas. The court did not issue any rulings on the merits. Litigation remains ongoing.

Burgess v. Santee Electric Cooperative (South Carolina) (2010CP4500278)

On August 6, 2010, three members filed a class action complaint against Santee Electric Cooperative. The complaint raises a host of corporate governance, compensation, election, and transparency claims. In addition, the complaint alleges that Santee Electric failed to adhere to the requirements regarding the allocation and retirement of patronage capital. On November 22, 2010, Santee Electric filed its answer, which included a range of defenses from the business judgment rule to the failure to exhaust administrative remedies.

Socorro Electric Cooperative v. West et al. (New Mexico) (D-1314-CV-0201000849)

On June 29, 2010, Socorro Electric Cooperative filed a claim for declaratory relief against its members, alleging that it was not a public entity and therefore not subject to the requirements of the New Mexico Open Meetings Act and the New Mexico Inspection of Public Records Act.

On August 23, 2010, member Charles Wagner filed a cross claim and class action certification request, alleging that Socorro’s treatment of patronage capital was unlawful. The member also raised corporate

governance claims, including wasteful spending and excessive compensation. The plaintiff class consists of current members of Socorro. At issue is more than \$16 million in patronage capital.

Socorro later filed a voluntary dismissal against all defendants/members who had not filed an answer or responsive pleading. Socorro has further denied the allegations in its member's complaint and has raised various defenses including the business judgment rule. Litigation remains ongoing.



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

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