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Plaintiff Class Sues All South Carolina Coops Over Patronage Capital

A case recently filed in South Carolina has upped the ante in the recent spate of patronage capital suits filed against electric cooperatives. In the new case, the plaintiffs have named as defendants *all* South Carolina electric cooperatives (other than Edisto, which is the subject of another patronage capital suit). This Legal Alert reports on the South Carolina suit and provides an update on other patronage capital suits filed against cooperatives.

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

Recent patronage capital lawsuits have targeted just one electric cooperative. But the complaint in *Mitchum et al. v. Aiken Electric Cooperative et al.*, which was recently served on the defendant cooperatives, significantly expands the potential pool of defendants.

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’.” (Compl. ¶¶ 13, 27.) 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 as to 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.” (*Id.* ¶ 9.) South Carolina cooperatives have not yet filed any responsive pleadings. The case was filed in Aiken County, South Carolina.

Update on Previously Reported Patronage Capital Cases

Presented below are updates on five 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.” (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 is prudent given Carroll Electric’s business environment.

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

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. On May 13, plaintiffs filed a notice of appeal.

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 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 suit, 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 South Carolina state court, 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 to do so by law.

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 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 has appealed these rulings to the U.S. Court of Appeals for the Fourth Circuit Court.

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.

On April 20, 2010, the plaintiffs filed an amended petition. On May 10, 2010, the plaintiffs voluntarily dismissed their case.

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 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. The plaintiffs have also requested that the assigned judge recuse himself, since he is a member of Cobb EMC. Litigation remains ongoing.

Conclusion

The *Mitchum* case brings to six the number of class action patronage capital lawsuits filed against electric cooperatives over the last two years. Moreover, the *Mitchum* suit significantly expands the potential pool of defendants. These lawsuits suggest that cooperatives may want to take another look at their capital credits policies.



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

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