PART II. BYLAW ANALYSIS

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EXECUTIVE SUMMARY

From a "big picture" perspective, we are proposing a transformational change at Socorro Electric Cooperative. Members are to be commended for demanding reform. *The principles of reform won the battle* – new Bylaws, new policies, attention to member service and, hopefully, a new commitment to the concept of "cooperation" inherent in every successful rural electric cooperative.

The proposed Bylaws will provide a comprehensive solution for most of the issues and disputes facing Socorro Electric Cooperative. Ultimately, each of the proposed changes is driven by a commitment to openness, transparency and democratic control. If adopted, Socorro Electric will be in a position to become an industry leader (throughout the state and country) in the area of cooperative governance. More importantly, the Members of Socorro Electric will have a cooperative they can trust and rely on for affordable and reliable power.

ANALYSIS OF PROPOSED BYLAWS

Cooperative bylaws establish the basic ground rules for cooperative operation. Effective bylaws are easily accessible to everyone, user friendly, anticipate potential problems, and establish the solution before conflicts arise. In our view, and as echoed by a wide range of interested parties, Socorro's current Bylaws are inadequate to meet the Cooperative's needs. As such, we are proposing modernized Bylaws, which will include a number of significant adjustments to current rules and practices.

We offer brief commentary and explanation on many of the provisions. However, in the interests of efficiency, we skip some sections that are more utilitarian in nature.

TABLE OF CONTENTS AND DEFINED WORD INDEX

With improved transparency being one of the many goals of this process, we view the proposed Table of Contents and Defined Word Index as being more than "window dressing." If Members, Trustees and Cooperative staff are going to work harmoniously toward solutions, the ground rules need to be *easily accessible* for everyone to follow. (These same principles will extend to the "Service Rules and Regulations" booklet that we will also propose.)

SECTION 2.01 – MEMBERSHIP ELIGIBILITY

We propose a relatively standard Membership Eligibility provision for Cooperative Bylaws, which anticipates a common area of confusion at many cooperatives. In particular, Cooperatives operate under the principle of "*one member, one vote*." While separate legal entities (incorporated businesses, for example) have the right to enter into contracts, and can sue and be sued, individuals operating under a trade name are still individuals (under the law and these proposed Bylaws), meaning they can only contract, sue, and be sued, in the individual's name. So separate businesses can be separate members. However, individuals cannot have multiple memberships under their own name or under one or more trade names. That is a basic principle of Cooperative law.

Unlike current practices, this analysis requires that the Cooperative also ensure that service to a proprietorship is in the name of the member (perhaps with a "d/b/a," but not necessarily) rather than in the name of the business. Adherence to this point will promote fairness and avoid confusion and conflict in establishing the voter-eligibility list specifically required elsewhere in the proposed Bylaws. Again, membership is open to any natural person or *legal entity*; it has to be one or the other.

By implication of its terms, the Bylaw provision also prevents confusion over whether security light accounts and other secondary services away from the primary residence will give rise to a second vote -- they do not under the new Bylaw proposal. Further clarification on the issue of members voting on their own behalf and also on behalf of separate legal entities will be addressed elsewhere in the Bylaws and corresponding analysis.

Finally, Socorro is struggling to collect on unpaid bills and bad debts, which could impair the Cooperative's relationship with lenders. The second paragraph of Section 2.01 establishes that persons or entities with unpaid bills will not be eligible for membership until unpaid debts are satisfied.

We will provide additional detailed analysis of the interplay between membership eligibility and voting in Section 4.08, below, which is the proposed section on "voting."

The current Bylaws address "membership" in **Article I, Section 1**. We note that the current section on membership is significantly more permissive than what we propose, allowing for membership by "sole proprietorships" according the express terms. This is permitted under New Mexico law, but we do not view it to be a "best practice."

SECTION 2.05 – JOINT MEMBERSHIPS

We propose updating the provisions for joint membership, modernizing the scope of the language and providing details about the rules and consequences of a joint membership. In particular, and in a nod toward more openness and inclusiveness, we include a rule that will allow one joint member to serve on the Board, even if the other member is disqualified from such service. There is a potential downside to such permissiveness – the eligible spouse having a tendency to cloud business issues with personal grievances -- but we believe the concerns would be best addressed in an election campaign as opposed to a Bylaw disqualification.

The current Bylaws address the issue in **Article I, Section 3**. While this section is based on a former industry model, our version proposes the most recent industry model for best practices.

SECTION 2.07 – EFFECT OF DEATH, LEGAL SEPARATION OR DIVORCE UPON A JOINT MEMBERSHIP

Misunderstandings frequently occur in the industry with regard to the effect of a death, legal separation or divorce on a joint membership. This section aims to provide clear guidance on the issue. Although the Cooperative's current treatment of circumstances where one party of a joint membership dies would qualify as a "best practice" from a strictly financial standpoint, we propose a change from current practices that will be more accommodating to members. Under our proposal, the joint membership will split and the capital credits will divide between the two resulting singular memberships, but with both resulting accounts continuing to be responsible for all debts on the former joint account. The estate of the deceased will then have a choice of taking a "special retirement" of *discounted* capital credits, or alternatively, allowing the capital credits to run the remainder of the retirement cycle for payment under the same terms and conditions as all other capital credits.

The current Bylaws address the issue, at least in part, in **Article I, Section 5**.

SECTION 2.11 – WIRING OF PREMISES; RESPONSIBILITY THEREFOR; LOAD MANAGEMENT DEVICES; RESPONSIBILITY FOR METER TAMPERING OR BYPASSING AND FOR DAMAGE TO COOPERATIVE PROPERTIES; EXTENT OF COOPERATIVE RESPONSIBILITY; INDEMNIFICATION

Meter tampering exposes the membership to higher utility prices as a result of theft – a dollar one person doesn't pay is a dollar more everyone else must pay. Tampering can also result in severe injury or death to the person, *i.e.*, criminal, tampering with Cooperative facilities.

The Cooperative should take a zero-tolerance approach to the issue. Meter tampering should be prosecuted whenever possible.

The current Bylaws do not contain any similar provision.

SECTION 2.12 – MEMBER TO GRANT EASEMENTS TO COOPERATIVE AND TO PARTICIPATE IN, IF REQUIRED, COOPERATIVE LOAD MANAGEMENT PROGRAMS

Easement grants are fundamental to the success of rural electric cooperatives. Today's services exist, in part, because past members granted the necessary easement to establish the system. It is unfair for any member to rely on Cooperative services if the member is unwilling to contribute to the Cooperative in the same manner.

The current Bylaws address easements in **Article 1, Section 3(h)**.

SECTION 3.04 – TERMINATION BY DEATH OR CESSATION OF EXISTENCE; CONTINUATION OF MEMBERSHIP IN REMAINING OR NEW PARTNERS; LIMITATIONS ON TRANSFER OF INTERESTS

The proposed Bylaw provision provides part of the answer to one of the contested member issues the Cooperative is facing, *i.e.*, should a legal entity member be afforded a complete refund of capital credits when a business is being dissolved? This provision establishes a mechanism for that member to transfer the credits to another person or legal entity. (The issue will be addressed in great detail, however, in Section 8.03, below).

This partial solution needs to be seen in the broader context of generational equity that underlies the entire capital-credits financing structure for rural electric cooperatives. For example, a newly-established business joins the Cooperative and immediately benefits from the equity past and current members have contributed for the duration of the retirement cycle as part of the cost of the electric service. While for-profit utilities or municipal systems would simply

keep these margins (or "profits") forever, the Cooperative model requires return *but only after the capital contribution has run the retirement cycle*. That is the essence of the cooperative business model. It is simply not fair, and in our view would be illegal, for some former business members to have the right to immediate withdrawal of their capital contributions on a non-discounted basis. That would be almost like a retroactive refund to the departing member since the capital contribution was part of the cost of receiving service. Unfortunately, the industry sometimes fails to explain the complex nature of capital credits in an easy-to-understand manner so there is all-too-frequent confusion and conflict on these points. (Likewise, we recognize that this short explanation is insufficient in and of itself, but the matter will receive more detailed attention later in the Bylaws and corresponding analysis).

Again, the proposed Section 2.07 addresses the effect of death on a joint membership.

SECTION 3.06 – BOARD ACKNOWLEDGMENT OF MEMBERSHIP TERMINATION; ACCEPTANCE OF MEMBERS RETROACTIVELY

This section also addresses a frequent industry problem, *i.e*., continuing service in the name of a deceased or otherwise departed former member. The provision provides a mechanism for cleaning up the Cooperative's membership roles and ensuring proper allocation of margins.

The current Bylaws do not contain a comparable section.

SECTION 3.07 – MEMBERSHIP LIST

For a variety of reasons, including transparency and effective democratic control, it will be important for the Cooperative to maintain a current list of members, while at the same time being respectful of each member's privacy interests. This has also been a specific subject of controversy at Socorro Electric:

> Charlene Wagner stood up to introduce another proposal that allows trustee candidates to have the names of members in their districts for campaigning purposes. The motion carried with resounding ayes and two nays.

Osterreich, Elva "Wagner wins SEC District II election held in Alamo" *El Defensor Chieftan* 14 Nov. 2013. (Obviously, in our view, the "nay" votes were a mistake.)

This section strikes the appropriate balance between privacy and the information access needed for democratic control.

The current Bylaws do not contain any substantive treatment of the issue.

ARTICLE IV – MEETING OF MEMBERS

We respectfully submit that the Cooperative's structure for member meetings are expensive, counterproductive and have spawned (and continue to perpetuate) many of the controversies that embroil the Cooperative in "Jerry Springer"-like conflict. We propose a number of specific and substantial changes, below, which will bring Socorro *into the mainstream* of industry practices. We are basically proposing that Socorro should conduct member meetings in the same way they are conducted at the *vast majority* of electric cooperatives throughout the country.

For sake of comparison, the current Bylaws address the Meeting of the Members in **Article III.**

SECTION 4.01 – ANNUAL MEETINGS

This section retains the substance of the current Bylaws but moves it into a comprehensive section to address meeting issues.

The current Bylaws address issues of Annual Meetings in **Article III, Section 1**.

SECTION 4.02 – SPECIAL MEETINGS

The proposed section on Special Meetings will allow the Board to call a meeting. However, in the interests of democratic control, the section also allows Members to call a special meeting. The current Bylaws address the issue of Special Meetings in **Article III, Section 2**.

As will be discussed in further detail under Section 5.03, we do not propose a continuation of District Meetings. In our view, such meetings are anti-democratic because they actually *exclude* members from voting on issues in which they hold an interest – the selection of Trustees that will nonetheless owe fiduciary duties to the excluded member. While we understand that difficulties in communication and travel may have supported the idea of district meetings in earlier times, travel and communication are now much easier to accomplish.

SECTION 4.03 – NOTICE OF MEMBER MEETINGS

This section provides comprehensive treatment concerning the rules for Notice of a Member Meeting. Notice is especially important, and has been a hotly disputed issue at Socorro Electric on issues involving Bylaw amendments. Genuine democratic control *requires* effective notice so everyone can have time in advance to study any proposed Bylaw amendment and determine if they are in favor or opposed.

Effective notice, combined with ballot initiatives for amendments, will also address the quorum challenge at several of the recent meetings. If Members favor a proposed change, they can attend the meeting or mail in their ballot. Alternatively, for Members that do not favor the proposal, they can either attend and vote "no" or mail in their no vote. In any event, every vote matters – a decision not to vote yes or no will leave the decision entirely in the hands of those that do participate in the democratic process. Finally, notice will provide an opportunity to fully explore proposals, for parties to cooperatively negotiate improvements to the language when

warranted, and for all interested parties to provide a campaign of pro and con commentary.

SECTION 4.04 – RECORD DATE

Establishment of the Record Date is another important component of the meeting process. In the interests of democratic control, we are proposing a relatively short time frame for the notice deadline. To the extent reasonably possible, this will ensure that the largest group of members – including new members to the system – receive notice of the meeting. The other point to keep in mind, however, is that record-date notice is arguably a formality -- notice of the meeting should also be widely distributed through the magazine, perhaps on electric bills and possibly through general news sources.

The Record Date for determining members entitled to vote is *more* important than formal notice. The proposed Bylaw section will require up-to-date Cooperative records to ensure that new members joining the day before the meeting will be entitled to participate in the meeting.

Finally, the proposed Bylaw preserves the efficacy of the prior formal notice for any adjournment of the meeting. The provision will save considerable expense on the cost of holding meetings open through adjournment.

The current Bylaws contain no similar provision, although they do address notice in more general terms.

SECTION 4.05 – MEMBER MEETING LIST

The Member Meeting List is, essentially, a near up-to-the-minute list as generally required in the proposed Section 3.07. In the interests of effective democratic control, we propose industry-standard special-access rules with respect to the Member Meeting List.

We note that this has been an area of concern for members:

> Watkins then spoke, telling the council it really bothers her how easily co-op elections can be manipulated. She said SEC management controls records, not letting member/owners see them beforehand; ballots are given to a third party vote machine person and co-op employees count the quorum at meetings.
>
> "Who knows what numbers?" Watkins said. "I mean, it's a flawed system, and if you mistrust the people it's really a problem."
>
> Watkins said at one meeting, she asked a guy who was running a voting machine what date was on the list of voters that he had. He told her the list wasn't dated. Watkins said the list should be up to date every election, and the list should include what date it was completed.
>
> Watkins said another concern was about commercial votes. She said U.S. Department of Agriculture regulations specify all commercial votes must have incorporated entities standing behind them.
>
> "I know for a fact that some of the votes are just made-up businesses that don't even exist," Watkins said. "So that needs to be cleaned up and needs to be kept clean every election.

London, Laura "City keeps up a dialog about co-op franchise" *El Defensor Chieftan* 12 Dec. 2013.

We anticipate that our proposal will solve these concerns. The current Bylaws do not contain any similar provision.

SECTION 4.06 – RESERVED

This section serves a placeholder for future amendments. While many cooperatives would have a section on Member Action by Written Consent, we do not believe that the traditional section – being more cumbersome than the proposed meeting provisions – has any real or potential applicability to Socorro Electric Cooperative.

SECTION 4.07 – MEMBER QUORUM

This section preserves the status quo, found in **Article III, Section 6** of the current Bylaws, of a 3% quorum. However, to avoid litigation and to further promote democratic control, we propose more detailed treatment of the issue.

There is obviously a significant amount of controversy among the members of Socorro Electric Cooperative about reaching a quorum to implement Bylaw changes. While we understand the frustration of those looking for change, a member's absence must not be used to effectively amplify the vote, power and influence of a relatively small contingent of members that remain at a meeting. Otherwise, a small contingent of members could implement changes that the majority actually – and perhaps strongly – opposes. There is nothing democratic about efforts to play the system in this manner.

Speaking as a member, Anne L. Dorough expressed this position eloquently, as follows:

> I want to know that my ballot will be used to record the choices I have indicated and not to declare my presence at a meeting where I am not actually in attendance and, therefore, cannot vote to protect my rights. I do not want my ballot used as a means for other people to discuss and vote on issues in my absence with which I may or may not agree. My ballot should be used for recording my vote and only for that purpose.

Dorough, Anne L. "Opinion: A mail-in co-op vote should count only as intended." *El Defensor Chieftan* 21 Nov. 2013.

SECTION 4.08 – VOTING

The proposed section follows industry standards, allowing all non-suspended members to vote, and further allowing spouses to vote the membership in the event of a singular membership held by a married person. This section also works hand-in-hand with tightening membership eligibility provisions. In combination, these provisions will effectively address the issue of individuals exercising multiple votes during an election.

A recurring point of argument, conflict and controversy at Socorro Electric has been the issue of members casting multiple votes and voting by non-person entities:

> "A few of the business votes, within the city limits, are not backed up by a city business license."

Watkins, Marie, "Opinion: Co-op members investigate" *El Defensor Chieftan* 1 Dec. 2012.

> "I noticed that Milton Ulibarri was standing to vote. He does not live in District IC; he is a Trustee from District III. So I said, "sit down, Milton." Then Mr. Wade informed me that Mr. Ulibarri has a hard light in District IV. You call this membership? I don't. This is selfish abuse."

Eric K. "Bear" Albrecht, "Opinion: SEC election determined by yard lights" *El Defensor Chieftan* 10 Oct. 12.

> "I also have rental property in the new District IV, which is under a sole proprietorship, and eligible to vote in District IV, according to the bylaws."

Ulibarri, Milton, "Opinion: Trustee Speaks for himself" *El Defensor Chieftan* 17 Oct. 2012.

During our investigation, we specifically confirmed that Mr. Ulibarri's "Milton Ulibarri Investment Properties" does in fact hold a separate membership in District 4. This gives rise to a peculiar analysis of Mr. Ulibarri's vote, above. We find that Ms. Watkin's concerns are *entirely valid* in principle but Mr. Ulibarri's statement and defense of the vote was also 100% accurate under the Bylaws as they exist today and as they were in effect at the time of that meeting.

The current Bylaws provide the following:

> **Section 1. Requirements for Membership.** Any person, firm, limited liability company, partnerships [sic] *sole proprietorship*, association, corporation, or body politic or subdivision thereof may become a member in The Socorro Electric Cooperative, Inc. (hereinafter called the "Cooperative") by,
>
> (a) filing a written application or statement for membership therein;
>
> (b) agreeing to purchase from the Cooperative electric energy as herein specified;
>
> (c) agreeing to comply with and be bound by the Articles of Incorporation and By-Laws of the Cooperative and any rules and regulations adopted by the Board of Trustees provided, however, that no person, firm, association, corporation or body politic or subdivision thereof shall become a member unless and until he/she or it has been accepted for membership by the Board of Trustees or the members. No membership in the Cooperative shall be transferable, except as provided by these By- Laws.

(Italicized emphasis added).

These permissive bylaw standards are also consistent with the New Mexico Rural Electric Cooperative Act, which provides in pertinent part that "[t]he bylaws may prescribe additional qualifications and limitations in respect of membership." § 62-15-8(A).

Under the Bylaws we propose, however, this circumstance would not be allowed to exist. Again, in our view, separate legal entities are by definition *separate* from the individual who controls the entity and should be eligible for a separate membership. Among other characteristics, the separate legal entity can sue and be sued in its own name, and can independently contract for membership it is own name. The membership is separate, paying its own bill and its own facilities charges, even if the entity has a member perform the task of voting on its behalf. On the other hand, from a legal and contracting perspective, a proprietorship is really a person doing business, sometimes "doing business as" (or "d/b/a") some other name.

Going forward under the Bylaws we propose, the Cooperative should merge proprietorships and their corresponding capital credits to the membership of the individual owner(s). Alternatively, the proprietorship could become a legal entity with the Secretary of State so it can remain as a separate entity.

For practical purposes, the Cooperative will need to clean up its membership rolls on this issue. During any member meeting where voting will take place, the proposed Credentials and Elections Committee, overseeing the Cooperative's review of eligibility, should have ready access to the Secretary of State's website so it can confirm in seconds whether a "proprietorship" is a separate legal entity. If the entity shows up on the Secretary of State's web portal, and absent other compelling evidence, then it will qualify as a separate legal entity. The Committee will also need to verify whether mail-in ballots can be counted as proper votes. Hopefully, however, the rolls will be cleaned up before the ballots are mailed.

Detailed treatment concerning voting for Trustees will be found in the proposed Section 5.03, concerning Elections. The current Bylaws address voting in **Article III, Section 7**.

SECTION 4.09 – ACCEPTING AND REJECTING MEMBER VOTING DOCUMENTS

Proposed Section 4.09 aims to balance competing concerns involving integrity of corporate votes. The proposal generally tracks the ABA 1987 Model Act, which is a "gold standard" for non-profit governance. However, in the circumstances of Socorro, we find that the burdens of requiring "notarized" voting documents (common among electric cooperatives and other non-profits) would lead to disenfranchisement so we excluded those typical provisions.

In furtherance of member control of elections and balloting, however, we propose explicit delegation of these authorities to the Credentials and Elections Committee.

The current Bylaws do not contain express provision on the acceptance and rejection of voting documents. However, if presented with the issue, we would expect a Court to reach the same basic result under the "business judgment" rule.

SECTION 4.10 – PROXIES

New Mexico law limits the applicability of proxy voting at cooperatives. We propose maintaining the status quo, *i.e.*, disallowing proxies, as set forth in the current **Article III, Section 7**.

SECTION 4.11 – AGENDA, ATTENDANCE, AND ACTION AT MEMBER MEETINGS

Cooperative meetings should be orderly and dignified events; they are not platforms for political speeches or partisan actions. The proposed Bylaw sets forth a *standard* agenda for meetings and specifies the scope of matters that can be brought before meetings.

The "new business" section provides an opportunity for Members to address matters of

Cooperative-wide concerns for the Trustees. Such sessions should generally run according to the same rules that govern citizen appearances before the City Council; the City of Socorro can be a model in this regard.

The current rules for "order of business" are established in **Article III, Section 10.**

SECTION 4.12 – CREDENTIALS AND ELECTION COMMITTEE

Our proposal in Section 4.12 builds on the current **Article III, Section 14,** by establishing that the members, through the Credential and Elections Committee, are the "final word" and ultimately responsible for ensuring the *fairness and integrity* of Trustee elections.

We disagree with the specificity in the current Bylaws of requiring an "accounting firm" to conduct the elections. That task would generally fall outside of the realm of expertise for most accounting firms and there are other firms specifically dedicated to the integrity of corporate elections. Nonetheless, we applaud the intention behind the current Bylaw provision. Rather than eliminating or replacing the amendment, we instead polish and amplify its provisions through this new section.

ARTICLE V – TRUSTEES

Board meetings at Socorro have been compared to the "Jerry Springer Show," and rightly so. *They are an embarrassment to the Cooperative, the community and the electric cooperative industry*.

In our view, the Board structure contributes to the grandstanding and jockeying for political power, which are counterproductive to the goals of providing reliable electric power at the lowest possible cost consistent with sound business judgment. We address these issues, below.

SECTION 5.01 – NUMBER AND GENERAL POWERS

Socorro Electric Cooperative has an unfortunate history of wasteful spending with respect to the Board of Trustees, which was one of the reasons the number of Trustees on the Board was cut back to five. (A statement of the past expenditures is attached hereto as **Exhibit A**). With this small number (five is the bare minimum allowed under New Mexico law), however, the Board has further crumbled into dysfunctional factions.

Most people we spoke to during our investigation – members, employees, managers and Trustees – agreed that there should be at least seven members on the Board of Trustees. In fact, early reports on the reform movement indicate an original goal of "[s]lashing the number of trustees from 11 to seven." Cole, Thomas J. "Group Targets Co-Op Trustees" *Albuquerque Journal*, 25 April 2008. We also agree. By setting the number of Trustees at seven, there will be more incentive to cooperate rather than "conquer." While there will be no guarantees, we also hope that voices of cooperation, and *respectful* disagreement when warranted (in harmony with the proposed Board policy), will emerge on the Board and the Membership.

Article V, Section 1, of the current Bylaws establishes the number and powers of the Board.

SECTION 5.02 – QUALIFICATIONS

We propose enhanced qualification standards to help ensure the integrity of individual Trustees and the Board. Without adequate industry training, Trustees cannot develop the skill set and knowledge base they need to be effective in their roles. This will have the eventual effect of putting too much control in the office of the General Manager since the Board will not have the capacity to provide effective oversight and governance. (We also touch on this issue under the section involving Trustee compensation, since that section can further hinder adequate training.)

While we are not suggesting that it is currently the case with Socorro, it can be dangerous to allow disgruntled former employees to run for the Board. There is risk in such situations that personal feelings or vendettas from the employment relationship could cloud business judgments that are supposed to focus solely on the best interests of the membership. For this reason, some cooperatives have up to lifetime bars against Board service by former employees. We are proposing a more modest approach, which would establish a five-year "cooling off" period for service by former employees.

Trustees will also be required to adhere to accepted principles of conduct during their tenure. When Trustee conduct gets out of line with these principles, the Trustee exposes the Cooperative to potentially significant legal and financial risk, and becomes a liability to the Cooperative. In our view, such Trustees should be deemed disqualified from continued Board service.

SECTION 5.03 – ELECTION

As previously suggested, district-only elections, while they might have made sense from a historical perspective, have outlived their usefulness at Socorro Electric Cooperative. Socorro is in a small minority of cooperatives that still uses district-only elections, rather than at-large voting for all seats. With the extraordinarily dysfunctional conditions at SEC, the obvious question is, "*What are we doing differently at Socorro that might be contributing to the problems we face*?" One of the glaringly obvious differences is district-only elections for Trustees. In fact, only three of the 15 other New Mexico electric distribution cooperatives (Mora-San Miguel EC, Kit Carson EC, Jemez Mountain EC) use district-only voting.

We are especially concerned that district-only elections allow a candidate to win an election by appeal to a localized and relatively small group of members rather than focusing on

the broader interests of the entire membership. These circumstances result in increased partisanship, which is detrimental to the Cooperative's business goals. Indeed, partisanship can be seen in the distracting arguments over when and where the district meeting will be held and who gets to speak at the meeting, which further fuels the problems at Socorro. See, for example, West, Charlene "Opinion: Co-op District IV meeting fails to address concerns" *El Defensor Chieftan* 7 Nov. 2013.

District-only elections also add enormous cost to the Cooperative. Rather than holding one Annual Meeting, the Cooperative faces the cost and inconvenience of holding one (or more) district meetings for each district, each year. For recent years, just the labor costs for separate district meetings are inevitably and necessarily excessive:

2013 District Meeting Labor Costs

$ 9,191.30 District I
$14,819.58 District II, trustee election
$15,749.47 District III, trustee election
$ 7,022.29 District IV
$13,253.05 District V
$60,035.69

Despite these costs, newspaper accounts show that the members do not demonstrate any particularly high level of interest in these meetings. "Only 16 people attended and 12 of those were of the reform group." West, Charlene "Opinion: Co-op District IV meeting fails to address concerns" *El Defensor Chieftan* 7 Nov. 2013. While some members obviously take a high level of interest in the nuances of cooperative governance and politics, the reality is that the majority of members will find these costs (staggering on a per attendee basis) nowhere near offset by whatever benefit some members might see in Socorro's uncommon method of conducting member meetings.

Despite the absence of any Board elections during the year, the cost of conducting district meetings were even higher during 2014:

$8,110.02 District I (21 of 57 registered; **$386.19**/registrant; no quorum)
$17,054.18 District II (39 and 70 of 59 registered; **$243.63**/registrant; quorum)
$12,954.84 District III (87 of 67 registered; **$148.91**/registrant; quorum)
$8,209.70 District IV (23 of 57 registered; **$356.94**/registrant; no quorum)
$8,870.74 District V (28 of 53 registered; **$316.81**/registrant; no quorum)
$63,063.68

Finally district-only voting causes confusion with respect to the Trustee's fiduciary duties. The Trustee is bound to look out for the best interests of the Cooperative. However, an electoral allegiance to a district can give rise to obvious conflicts with the duty to the whole.

From our perspective, members are already voting with their feet on whether they want district meetings – they don't, because they generally don't show up to the meetings. When something is expensive, counterproductive, time consuming, unappreciated by the members, and provides no clear advantages, Socorro should stop doing it. District-only voting is one of those things.

SECTION 5.04 – TENURE

The proposed tenure provisions track customary industry standards. While the concept of "term limits" can have some surface appeal, and while we recognize that they are the rule under the current Bylaws, the reality is that cooperatives benefit from highly trained and experienced Trustees. We believe term limits are counterproductive. Indeed, while we have enjoyed speaking to a number of thoughtful and well-intentioned members about the issues facing Socorro Electric Cooperative, very few of these members are in a position to make the time commitment needed to run for a seat and serve on the Board. If we have good people serving, the Bylaws should offer fair opportunities for challenge but should not force them to give up the office. On the other hand, if Trustees are falling short in their service to the Cooperative, they

should stand for election every three years so the members can make a change.

The current section on Trustee tenure is found in **Article 5, Section 2**.

SECTION 5.05 – DECLARATION OF CANDIDACY

Most electric cooperatives throughout the country use nominating committees to identify prospective candidates for Board elections and/or member petitions to gain a spot on the ballot. However, Socorro has a long history of using a simple declaration of candidacy (**Article V, Section 4**), which is entirely consistent with principles of democratic control.

SECTION 5.06 – TRUSTEE DISTRICTS

Generally speaking, the industry's pattern of at-large trusteeships tied to residential districts is intended to (a) spread trustees among the communities and areas being served by the Cooperative; (b) encourage trustees to serve and be responsive to all members, without regard to the member's residency or other characteristics; (c) prevent trustees from obtaining or maintaining a seat by attempting to serve the interests of a narrow constituency; (d) allow any and all members, regardless of residence, to campaign and vote against any sitting trustee who is perceived to be acting contrary to the best interests of the Cooperative; (e) minimize the likelihood of potentially destructive and polarizing infighting regarding districting or re-districting; and (f) encourage the members to seek out information from each candidate who could potentially have responsibility for setting policy for the members' utility business.

At one time, district-only elections tended to serve some purpose when fewer people had vehicles or other means of travel and lacked access to means of electronic communication. Those circumstances are now uncommon and should no longer drive the design of Socorro's Bylaws.

Our proposal for at-large elections of Trustees from residential districts follows the majority approach for the industry (in the State and across the Nation) and is intended to accomplish the objectives enumerated above. This method works at other cooperatives; *Socorro Electric Cooperative should do what works*.

SECTION 5.07 – VOTING FOR TRUSTEES

The proposed Section 5.07 provides the implementing rules for the principles set out in the preceding section. Basically, members will be entitled to cast one vote in each contested election, without regard to residential districts. All Trustees owe duties to the entire Cooperative, *i.e.*, all the members, so all members should be entitled to vote in all Trustee election contests.

SECTION 5.08 – REMOVAL OF TRUSTEES BY MEMBERS

We propose standard industry language with respect to the Bylaw provision for Removal of Trustees by Members. While provisions such as this provide an important safeguard for ensuring the integrity of Board governance, removal should not be taken lightly. Absent urgent and compelling reasons for action, as opposed to vague and factually unsupported claims of "breach of fiduciary duty" and the like, petitions for the removal of Trustees are divisive, wasteful and further erode the public's confidence in SEC's ability to establish effective self-governance.

SECTION 5.09 – REMOVAL OF TRUSTEES BY BOARD

We propose only narrow grounds by which the Board can act to remove one of its Trustees.

SECTION 5.10 – VACANCIES

We propose standard industry language with respect to filling vacancies. In contrast, we find that the current provisions for vacancies, as set forth in **Article V, Section 5**, are costly and administratively burdensome.

SECTION 5.11 – TRUSTEE COMPENSATION

In our view, it is important for cooperatives to pay their trustees a level of compensation sufficient to attract and retain talented professionals, executives and community leaders to the board. While most cooperatives are non-profit entities, they are *not* charities and their trustees should not be expected to volunteer their time and talents. Indeed, the reality is that cooperatives must *compete* with other worthy causes and entities to attract the individuals best suited to direct the organization.

The current system of Trustee compensation is incoherent and opaque. According to the amended Bylaws:

> **Section 7. Compensation.** Trustees shall not receive any salary for their services as such, except that members of the cooperative [sic] may, by resolution, or by amendment to these By-Laws authorize a fixed sum for each day or portion thereof spent on Cooperative business, such as attendance at meetings, conferences, and training programs or performing committee assignments when authorized by the Board. If authorized by the Board, trustees may also be reimbursed for expenses actually and necessarily incurred in carrying out such Cooperative business or granted a reasonable per diem allowance by the Board in lieu of detailed accounting for some of these expenses. No trustee shall receive compensation for serving the Cooperative in any other capacity, close relative of a trustee [sic] shall receive compensation for serving the Cooperative [sic], unless the payment and amount of compensation shall be specifically authorized by a vote of the members or the service by the trustee [sic] or his/her close relative shall have been certified by the Board as an emergency measure. (Refer to resolution dated 6/10/67 attached at the end of these By-Laws). [sic]
>
> All expenses incurred by the Trustees of The Socorro Electric Cooperative, Inc., on behalf of a trustee [sic] shall not exceed $10,000 per year, with the exception of the President f [sic] the Board of Trustees for which the limit shall be $15,000 per year. This sum includes but is not limited to: per diem payment, insurance,

> travel, conference fees, meals-regardless [sic] of whether those payments are made based on a schedule of payments or as reimbursement of actual expenses, and regardless of whether those payments are made directly to a trustee [sic] or on behalf of the trustee to accomplish business for the SEC.

Then, the "resolution" on the issue provides the following:

> **RESOLUTIONS**
>
> **RESOLUTION FIXING COMPENSATION FOR TRUSTEES**
>
> BE IT RESOLVED, that we, the members of The Socorro Electric Cooperative, Inc., in this Annual Meeting duly assembled, and in accord with the provisions of Section 7 of Article V of the By-Laws [sic] of this Cooperative, hereby fix the sum of $15.00 plus Insurance as the compensation to be paid to each member of the Board of Trustees for each day or portion thereof spent on Cooperative business, such as attendance at Board meetings and meetings, conferences, and training programs or performing committee assignments, when authorized by the Board.
>
> 6/10/67

Since the Bylaw limit for total expenditures combines the meeting fee and expenses, it makes sense to consider the entire menu of how meeting fees and expenses actually work in practice:

- $15.00 meeting attendance, regardless of location inside or outside of New Mexico (Bylaw).
- $45.00 "per diem" for expenses (Current Policy No. 108(6)).
- Mileage at IRS rate (policy).
- $15.00 meal expense for Trustees travelling outside of their district (Current Policy No. 108(7)).
- $140.00/day for "meals and incidental expenses" for travel *within the state*, plus the "reasonable going rate of a room at the meeting headquarters hotel or motel" regardless of whether that lodging is actually used. (Current Board Policy No. 108(8)).
- $200.00/day "for expenses" incurred during out-of-state travel, plus "whatever the going rate for a room at the meeting headquarters hotel" regardless of whether that lodging is actually used. (Current Board Policy No. 108(9)).

There are no requirements for Trustees to document their expenses, so in practice, Trustees can essentially pocket the difference between the "expense" related payments and the

actual expenditures.

As general guideposts, compensation and expense practices for trustees/directors at electric cooperatives should be shaped by the relevant enabling statute (and, depending on the state, any other controlling statute), the organization's bylaws and sound industry business practices, including *transparency and accountability* to the members.

Since New Mexico law does not speak to the issue of Trustee compensation with any specificity, we propose mechanisms and criteria for evaluating Trustee compensation. In furtherance of openness and transparency, we further advise the Members of how they can easily access information concerning Trustee compensation.

Finally, although allowed under New Mexico law, we do not recommend that Trustees at Socorro be permitted to participate in employee benefit plans. (None are currently participating, but we do not want to leave this window open for future consideration). Such participation tends to blur the distinction between hired employees and elected Trustees, drives up the cost of maintaining benefit plans for employees, and sometimes creates improper incentives for wanting to remain in office. Indeed, insurance benefits were a primary driver for why one of the Cooperative's former Trustees received nearly $36,000.00 in compensation – both he and his family were receiving health care coverage through the Cooperative. Cole, Thomas J. "One Electric Co-Op Spent More Than $275,000 on Its Elected Directors" *Albuquerque Journal 23 March 2008*.

We recognize that Members expended considerable effort with respect to recent Bylaw amendments, including the changes to the current section on compensation, **Article V, Section 7.** Frankly, we agree that the Members' historic concerns over wasteful spending and

compensation practices (as reviewed in detail elsewhere in this report) were justified.[1] At this juncture, however, the question is whether the recent revision of this section overshoots the mark. In our view, it does. There are a number of thoughtful Members who would make excellent candidates for the Board. Most, however, have other commitments that will not allow them to essentially volunteer their time to Cooperative service – and at $15/day it is essentially volunteer work. Members should be willing to spend what amounts to a few dollars per account so Board service remains a viable option for the types of candidate the Board needs to attract.

Finally, we note that Chairman Ann Dorough is an almost peculiar exception to our comments on the general inadequacy of Trustee compensation. In preparing to run for the Board, Ms. Dorough took it upon herself to become a certified Parliamentarian, meaning she has a professional-level of expertise in *Robert's Rules of Order*. She paid the cost of this training on her own. Then, during her first year of service, she recognized the importance of becoming NRECA certified as a Trustee. However, since there is a $10,000.00 cap on per Trustee expenditures, Ms. Dorough personally incurred approximately $3,700.00 in out-of-pocket expenses. Nonetheless, and while we admire her commitment, it is unrealistic to think that other prospective candidates for the Board would be willing to make that level of personal financial sacrifice. (With this background, we are also discouraged by some of the hateful personal attacks against Ms. Dorough.)

SECTION 5.12 – TRUSTEE CONDUCT

The provisions on Trustee Conduct track prevailing models in the industry and establish the criteria by which calls for removal should be judged.

[1] "We cannot allow the board to revert to its gluttonous ways." Myers, Herbert, "Opinion: Meeting Location still sore point" *El Defensor Chieftan* 2 Feb. 2013.

On a broader level, we find that Trustee conduct has been appallingly bad, which reflects negatively on almost every facet of the Cooperative's interests – employee relations, legal affairs, willingness of Trustees to serve, community relations, calls for dissolution, etc.

For example, in terms of Socorro's relationship with the City, the following passage provides a painful glimpse of how poorly the Cooperative is perceived in its own community:

> Councilor Ernest Pargas attended the co-op's District III meeting and attempted to describe the proceedings.
>
> "I can't even say the words to describe — it was like children were just throwing tantrums when they didn't get their way," Pargas said.
>
> "They're dysfunctional, that's the word," Sherry McGuire, a citizen attending the meeting, offered.
>
> . . . .
>
> Bhasker said he found it unbelievable that certain people were allowed to control the SEC meeting with tantrums and dysfunctional behavior. He said if a City Council meeting became as unruly as last Saturday's SEC meeting, he would recess the meeting or "hit 'em with my gavel."
>
> Pargas said he ventured out of his comfort zone to vote and fulfill his duties as an SEC member/owner "and that's the 'Jerry Springer Show' that I got."
>
> …
>
> "We have to demand some level of credibility for a company that does business in Socorro that we give a franchise to," Bhasker said.

London, Laura "Pargas: Co-op meeting a 'Jerry Springer Show'" *El Defensor Chieftan* 21 Nov. 2013.

Inappropriate conduct by Trustees is also having a *direct impact* on Members' pocketbooks. Most recently, on December 8, 2014, Federated Rural Electric Insurance Exchange gave notice that it will either be raising rates or dropping coverage on the Director, Officers and Managers (DOM) insurance policy. (A copy of the letter is attached as **Exhibit B**.)

None of these unfortunate issues would have arisen if there had been adherence to the Bylaw and policy proposals we are presenting.

SECTION 5.18 – CONFLICT OF INTEREST TRANSACTION

Again, we are proposing relatively standard language with respect to conflicts of interest. Given the importance of the topic, we also propose detailed treatment of conflict of interest issues as part of the proposed Board policies.

The current Bylaws contain no similar provision.

ARTICLE VI – MEETINGS OF TRUSTEES

The most significant aspects of the proposed Article VI are found in Sections 6.07 and 6.08, dealing with Open Meetings and Closed Meetings. We recognize that the Member initiative added **Article VI, Section 5**, to the current Bylaws to establish purported obligations under the Open Meetings law. However, that provision is difficult to apply in many instances and impossible to apply in others – the Act itself *does not apply* to private corporations like Socorro Electric Cooperative. The Court touched on this point in *Charlene West, et al., v. Socorro Electric Cooperati*ve, D-0725-CV-2112-89, at pages 138, lines 21-25 (December 12, 2012):

> Not to criticize Mr. Wagner unfairly, but just throwing in IPRA and the Open Meetings Act was inartful. It would have been better to make some very specific changes. But the intent was there, "Give us as broad as possible access."

We agree with intent of the reform movement but we also strongly agree with the Court's observation and recommendation. Therefore, we propose tailoring the statutory concept of "open meetings" and record access to the Cooperative setting.

ARTICLE VII – OFFICERS; MISCELLANEOUS

The proposed provisions of Article VII are not particularly noteworthy, with the exception of Section 7.11. These proposed provisions regarding committee meetings are interrelated with the proposal to increase the number of Trustees to a total of seven.

Under the current Bylaws, the Cooperative is hamstrung from operating by committee. As a result, the Cooperative faces unnecessary per diem costs with respect to preliminary inquiries and work efforts, is burdened by unnecessary formality, and perhaps most importantly, these are time-commitment barriers to service for members that have much to offer but limits on the amount of time they can give to the Cooperative.

While many cooperatives also use an "executive committee" for routine matters, we do not advise that approach for Socorro. Accordingly, the placeholder Section 7.12 is "reserved."

SECTION 8.03 – RETIRING AND REFUNDING CAPITAL CREDITS

Unfortunately, there is widespread confusion from many directions about the nature of capital credits and the role of patronage capital in the industry. We see this confusion driving some of the conflicts at Socorro Electric Cooperative. As members of Socorro Electric determine how they wish to proceed, and as they evaluate some of the ongoing conflicts at the Cooperative, it can be helpful to dig into the unique nature of capital credits in the overall financing structure underlying the cooperative business model.[2] This can be "heavy lifting" but it will be impossible to clear confusion on the issue and understand the true nature of capital credits without digging into *exactly* what capital credits are, and what they are not.

[2] While we do not aim to become "too legal" in this report, we recognize that many of the outside entities commenting on Socorro's practices have keyed in on capital credits disputes. Hopefully, some of the in-depth analysis of capital credits will be useful in any continuing discussions and resolving disputes on such issues. If there is going to be agreement, it needs to start at a baseline of what capital credits are, and also what they are not.

The Rural Development program of the United States Department of Agriculture, which was established as part of the federal Rural Electrification Act of 1936, 7 USCS §§ 901 et seq., recognizes that Cooperatives may set their own rules on whether capital credits payments for deceased former members should be discounted. For example, the Q&A section of the Rural Development program's website provides for the following:

> **Q. The electric cooperative says I have to die to be paid my capital credits (cooperative stock dividends). Is that true?**
>
> **A.** Not necessarily. The cooperative capital credit retirement policy varies by cooperative. A cooperative generally establishes a retirement cycle, normally 10-15 years, for the retirement of capital credits. Under a 15 year retirement cycle, capital credits that were assigned in 1990 would be retired in 2005. It should be noted, however, that before capital credits are retired, the cooperative management is required to insure that the cooperative has the financial ability to make such retirements. *In addition to the normal retirement cycle, capital credits of a deceased member are normally paid. This payment may be a full value or at a discounted value. The policy varies by cooperative*. To determine what your cooperative's policies are with respect to the retirement of capital credits you can ask the management of your cooperative or you could check the cooperative bylaws.

http://www.rurdev.usda.gov/RUS_FAQ.html (emphasis added).

At their essence, "[p]atronage capital, a concept unique to cooperative organizations, accounts for excess revenues over expenses under a scheme defined by state law and the cooperative's by-laws." *In re Eastern Maine Electric Coop., Inc.*, 125 B.R. 329, 332 (Bankr. D. Me. 1991); *In re Axvig*, 68 B.R. 910, 915 (Bankr. D. N.D. 1987) (nature of credits governed by state law and bylaws). Cooperatives retain the patronage capital for general business operations and system expansion, often times in accordance with lender requirements for prudent financial management. *See, generally, Claassen*, 208 Kan. 129, 133-134 (Kan. 1971). This means that a cooperative receives the margins and will hold them through the retirement cycle, regardless of whether a person or entity remains as a member for the duration of that cycle. That is basically the business deal – a small portion of the light bill is set aside for long-term financing.

Many courts have considered the unique characteristics of patronage capital credits in a variety of different contexts. *See, e.g.*, *Eastern Maine*, 125 B.R. 329, 336-339 (Bankr. D. Me. 1991) (reviewing decisions). For example, in 1962, the Supreme Court of Mississippi stated:

> It is well settled that equity credits allocated to a patron on the books of a cooperative do not reflect an indebtedness which is presently due and payable by the cooperative to such patron. Such equity credits represent patronage dividends which the board of directors of a cooperative, acting under statutory authority so to do, has elected to allocate to its patrons, not in cash or other medium of payment which would immediately take such funds out of the working capital of the cooperative, but in such manner as to provide or retain capital for the cooperative and at the same time reflect the ownership interest of the patron in such retained capital. The interest will be paid to the patron at some unspecified later date to be determined by the board of directors of the cooperative.
>
> The word "capital" is intended to denote that capital which is of a nature comparable to the earned surplus of a conventional business corporation. The patron has no right to offset such equity credits, not being an indebtedness which is presently due and payable, against an indebtedness which is presently due and payable by him to the cooperative.

Clarke County Cooperative v. Read, 243 Miss. 879, 884-885, 139 So. 2d 639, 641 (1962).

Likewise, in *Atchison*, the Supreme Court of Kansas explained that:

> Equity credits are not an indebtedness of a cooperative association which is presently due and payable to the members, but represent an interest which will be paid to them at some unspecified later date to be determined by the board of directors. Such equity credits represent patronage dividends which the board of directors of a cooperative, acting under statutory authority, has elected to allocate to its patrons, not in cash or other medium of payment, which would immediately take such funds out of the working capital of the cooperative, but in such manner as to provide or retain capital for the cooperative and at the same time reflect the ownership interest of the patron in such retained capital.

Atchison, 241 Kan. 357, 359-360, 736 P.2d 917, 919 (Kan. 1987) (*citing*18 Am. Jur. 2d, *Cooperative Associations* § 23).

At their core, these decisions recognize that a cooperative member's interests are *significantly different* than those associated with traditional equity stake in a business:

> [The Cooperative's] organization, and the members' place in it, create a far different relationship than that which results from an investor's volitional act of choosing among a variety of investment opportunities and selecting one enterprise in which to put money at risk. The objective in acquiring membership in the cooperative is, rather, to obtain electric service. The other attributes and benefits of membership, including the ability to vote for management and, ultimately to realize benefits from excess revenues less expenses, might be characterized as merely consequential. Under the securities law definition of equity security, the members might well not be considered to be equity security holders.

Eastern Maine, 121 B.R. 917 (Bankr. D. Me. 1990).

> Unlike stock interests, capital credits "constitute an interest of the patron in the cooperative which is *contingent* and *not immediately payable*." This interest becomes vested only when the board of directors, in the exercise of its sound discretion, determines that such payments can be made in cash without causing undue financial hardship to the cooperative.

Eastern Maine, 121 B.R. 917 (Bankr. D. Me. 1990) (citing *Evaneko,* 191 N.W.2d 258, 261 (N.D. 1971).

Courts decline to interfere with a cooperative's capital credits retirement cycle, even in the most compelling and sympathetic of circumstances. For example, the "happenstance" of bankruptcy cannot compel cooperatives to retire capital stock outside of the normal schedule. *In re Axvig*, 68 B.R. 910, 916-17 (Bankr. D.N.D. 1987) (citing *In re Schauer*, 62 B.R. 526, 531 (Bankr. D. Minn. 1986); In *re Cosner*, 3 B.R. 445, 449 (Bankr. D.Or. 1980). Indeed, federal bankruptcy trustees have no power whatsoever to compel a cooperative to make retirements out of order; *to do so would delay the other members in obtaining timely retirements*. *Id.* at 917.

Although the bankruptcy code specifically deals with "liquidation or estimation and treatment of future, putative, unliquidated, contingent and other such claims, . . . [t]he category of allocated, unretired patronage capital rights . . . is distinct from even those elusive creatures." *Eastern Maine,* 125 B.R. 329 (Bankr. D. Me. 1991). In the former category of claims, "there exists or may come to exist a set of facts, capable of proof, that will require the debtor to

encounter liability, whether it chooses to do so or not." On the other hand, "[a]llocated patronage capital need not be paid unless [the Cooperative's] directors affirmatively vote to do so." *Eastern Maine*, 125 B.R. 329, 338 (Bankr. D. Me. 1991).

Arguments that (a) a refusal to retire capital credits impermissibly requires former members to maintain an equity position in the cooperative, (b) retirement would not have an adverse economic impact on the Cooperative, or that (c) the normal retirement cycle would create "administrative nightmares" for the court, are all to no avail. *In re Greensboro Lumber Co.*, 157 B.R. 921, 930-931 (Bankr. M.D. Ga. 1993). Likewise, arguments that the former members were forced to obtain service from a monopoly utility are of no consequence with respect to demands for early retirements. *Eastern Maine*, 125 B.R. 329, 337 (Bankr. D. Me. 1991) (lack of consumer choice "gives rise to no principled distinction").

Instead, it is well-established throughout the country that a cooperative's Board of Trustees has discretion to refuse requests and demands for payment outside of the normal cycle. *Eastern Maine*, 125 B.R. 329, 336-339 (Bankr. D. Me. 1991); *In re Great Plains Royalty Corp.*, 471 F.2d 1261, 1265 (8th Cir. 1973); *In re Beck*, 96 B.R. 161, 163 (Bankr.C.D. Ill. 1988); *In re Axvig*, supra, 68 B.R. at 912; *In re Cosner*, 3 B.R. 445 (Bankr. D. Or. 1980); *Claassen*, 208 Kan. 129, 490 P.2d 376 (Kan. 1971) (Court refuses to substitute its own judgment, retirement denied despite tax consequences); *Eastern Maine*, 125 B.R. 329, 336-339 (Bankr. D. Me. 1991) (no right to offset debts to the cooperative); *In re Lamar Farmers Exchange*, 76 B.R. 712, 716 (Bankr. W.D. Mo. 1987) (same); *Great Rivers Coop. v. Farmland Indus.*, 198 F.3d 685, 704 (8th Cir. Iowa 1999) (Court refuses to "institut[e] its own equity redemption plan for that of the board and [thereby] eviscerate[] the discretion specifically placed with the board of directors.")

Under this analysis, a patron's death provides no basis for a court to compel immediate payment. For example, in *Evaneko*, 191 N.W.2d 258, 260 (N.D. 1971), a deceased member's estate asked the "court to hold, as a matter of law, that the defendant cooperative must liquidate a member's interest in the cooperative on the death of such member." The court flatly rejected the demand, stating that "*it is difficult to see why the death of a member would automatically cause his interest to vest*." *Id.* at 262 (emphasis added). The Court in *Claassen*, 208 Kan. 129, 133-134 (Kan. 1971), reached the same general conclusion under similar facts. *See also*, *Atchison*, 241 Kan. 357, 363, 736 P.2d 917, 922 ("there is no logical ground upon which a member should be permitted to withdraw his interest at the expense of disturbing the financial condition or the life of the association," patron's extreme financial distress, including loss of home, farm and equipment, insufficient to support demand for equitable setoff of debts against capital credits); *Shadow v. Volunteer Electric Cooperative*, 223 Tenn. 552, 560, 448 S.W.2d 416, ___ (1969) (Board has discretion with respect to timing of distribution); *French v. Appalachian Electric Cooperative*, 580 S.W.2d 565, 570 (Tenn. Ct. App. 1978) ("The Chancellor's attempt to retain jurisdiction to review the defendant's financial decision is clearly erroneous. He is attempting to substitute his judgment for that of the defendant."); *Lill v. Cavalier Rural Elec. Coop*., 456 N.W.2d 527, 530 (N.D. 1990) (same analysis).

This "legal" background begs the more practical question of how should Socorro proceed on the issue? Basically, since the Cooperative uses a member-financing model to fund some of its costs for system growth and maintenance, the Cooperative is able to hold down its borrowing costs and avoid related expenses. Equally as important, to the extent outside financing is needed for large capital projects, the "skin in the game" approach to financing gives RUS or the handful

of private lenders serving the cooperative industry the confidence they need to make long-term financial commitments with Socorro Electric Cooperative.

While considerations of sympathy and some fairness-based arguments ("nobody chose to die" and sometimes the estate needs the money for burial) underlie the historic practice of accelerated payouts to estates of deceased persons, the modern trend recognizes the other side of the coin – it is unfair to move estates to the head of the line when other members and former members (some having moved out of the area) must wait several years for the general retirement to run its course. As the Court said in *Atchison*, 241 Kan. 357, 363, 736 P.2d 917, 922, "there is no logical ground upon which a member should be permitted to withdraw his interest at the expense of disturbing the financial condition or the life of the association." And again, part of the electric bill each month is a commitment to set some small percentage of money aside in capital credits to help in cooperative financing of the system – that's at the heart of what a cooperative is. So why should an estate that took advantage of a previous generation's capital be excused from abiding by their commitment to provide generational financing? That would be getting all the benefit of the cooperative business model but only paying a part of the cost. Estates that obtain a full payout before the cycle has run are basically cutting in line.

From an accounting and business standpoint, discounting seems to be the fairest option for everyone.[3] Perhaps more importantly, discounting will keep people focused on the actual

[3] Technically, the current Bylaws could also allow discounting if the Board chose to follow this path:

> Notwithstanding any other provision of the By-Laws, the Board of Trustees, at its discretion, shall have the power at any time upon the death or cessation of legal existence of any patron, if the legal representatives of his/her estate shall request in writing that the capital credited to any such patron be retired under the provisions of these By-Laws, to retire capital credited to any such patron immediately *upon such terms and conditions as the Board of Trustees, acting under policies of general application, and the legal representatives of such*

nature of capital credits, i.e., cooperatives cannot function if there is an automatic right to a refund at the end of the membership.

In terms of the discount rate, the most recent trend we are seeing would suggest that the discount rate should be similar to the return on capital for investor-owned utilities in the state. For New Mexico, that would be 10%. However, considering where Socorro is starting from (effectively, 0.00%), we are proposing a more modest approach.

Finally, we find some controversy on the question of whether there should be special retirements to disbanded businesses or other former members. For example, a company going out of business might look to the face value of their capital credits and think "well, if I can get this money now, I can pay off some or all of the company's debt and finally close out the books." (Discussed, generally, in *Board Turns Meeting Over to RUS Official*, Chieftain, March 26, 2014). One such dispute has received considerable press attention, and comments from the Attorney General, as well:

> She said SEC owes Trails End Market Inc., the corporation she once owned and presided over nearly 20 years, more than $26,000 in capital credits.
>
> . . .
>
> However, she said co-op personnel have repeatedly refused to cash out the credits so she can legally dissolve the corporation, pay off its debt and divide the funds up between her company's shareholders.
>
> . . .
>
> Frustrated that no one at SEC was listening to her complaints Foard went on a mission to bring attention to this matter. She filed a complaint with New Mexico Attorney General Gary King's office.
>
> In the latter part of October, the AG's office sent a letter to SEC addressed to

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> *patron's estate shall agree upon*; provided, however, that the financial condition of the Cooperative will not be impaired thereby.

> Herrera urging the co-op to honor Foard's request, so among other things, she could settle the market's business affairs.[4]
>
> Herrera said SEC has responded to the attorney general's request asking someone in the AG's office to supply the legal source that led to the conclusion that the capital credits should be repaid.
>
> Foard said SEC unwillingness to act on the attorney general's urging has prompted her to file a complaint that is still pending with the New Mexico State Secretary's Office.
>
> Public Regulation Commission chairman and District 5 representative Ben Hall said New Mexico legislators took away the commission's jurisdictional authority to regulate the finances of the state's 16 rural electric co-ops several years ago.
>
> But, he said, they are still responsible for regulating the service the utility provides to its members/customers.
>
> "The PRC is here to do what we can but our hands are kind of tied. But we are willing to help anybody that needs help," he said. "I wish I could do more."
>
> As of January 2011, the SEC capital credit account had more than $19 million, but in 2013 the co-op paid out nearly $1.5 million to cover retired capital credits.
>
> He said although the money is owed to members he "doubts that it is there."

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[4] Comments such as this tend to fuel a broader misunderstanding of the nature of capital credits. For example, and while we are not suggesting a direct correlation, another member's comments seem to illustrate a similar confusion:

> [The member] said he heard SEC had $10 million or $15 million accumulated over a period of about 30 years in its capital fund.
>
> "That's an awfully big cookie jar just sitting there," [the member] said. "What are they doing with that? Why aren't they retiring it on a formal, periodic basis? To me, that's an opportunity for temptation or whatever."

London, Laura "City keeps up a dialog about co-op franchise" *El Defensor Chieftan* 12 Dec. 2013.

But again, the capital credits are only bookkeeping entries to reflect the patronage contributions to the system assets – the lines, poles, transformers, substations, rolling stock, office building, etc. The "cookie jar" is actually the infrastructure that delivers power to members; the money provides the long-term capital the Cooperative needs to exist. There is no bank account holding capital credits at Socorro or any other electric cooperative; that would be fundamentally at odds with the 501(c)(12) business model.

> Hall said it is standard operating procedure for a co-op to take 20 or 30 years to refund capital credits.

Jones, Barron, "Capital credits subject of latest co-op franchise hearing" *El Defensor Chieftan* 19 Dec. 2013.

> Foard said the corporation must close out all accounts before dissolving.
>
> "The Secretary of State says we cannot file for proper dissolution without claiming all our assets to pay off the debt," she said.
>
> The corporation, Foard said, must go ahead and request retirement of the capital credits so that the money comes into the corporation and all the debt is repaid before filing for dissolution.

Larson, John "Board turns meeting over to RUS official" *El Defensor Chieftan* 20 March 2014. Another member complaint states that the Cooperative should "release capital credits in a timely manner and when service is terminated."

Despite all of these arguments, the cooperative business and financing model leaves no room for any suggestion that business entities should be allowed an undiscounted payout, or any special treatment, when they go out of business. The Utilities Commission's informal comments on this point are unfortunate because they lead to further confusion about the nature of capital credits and because they foster animosity and ill will in the cooperative community.

We also note that the current Bylaws allow an entity to assign credits to another patron, such as the person that actually owns the business. Obviously, for purposes of assignment, nobody would be willing to pay the full allocation amount for a future expectancy interest, but by the same token neither should the Cooperative be required to pay "full price" for credits that will not be retired for years into the future.

Finally, we encountered several complaints about the *process* for refunding capital credits. For example, some members complained about the complexity of the requirements for

obtaining refunds to estates. This is a difficult issue because convenience to the estate will often times conflict with the Cooperative's need to ensure that it is not refunding money to an unauthorized party. The Cooperative must avoid getting in the middle of competing claims among heirs.

In our practice, we see a range of different ways that cooperatives throughout the country handle the administrative process for retirements to the estates of deceased former members. In our view, the most effective system involves directing the estate representative to the Clerk of Court to obtain formal authorization. While the process might seem cumbersome, we actually observe high member satisfaction with the process. To protect its own interests (*i.e.*, the interests of other members), the Cooperative should not make any retirements to estates without Court authorization. For ease of implementation, we are also providing a sample application form (**Exhibit C**) for estates to request a special retirement. While the form will need to be updated for consistency with New Mexico law on estate administration, the sample will provide a good starting point for the process.

ARTICLE IX – DISPOSITION OF COOPERATIVE ASSETS

We recognize undercurrents of interest in sale or merger of the Cooperative. Article IX contains ordinary and customary provisions relating to such proposals. As an editorial comment, however, we do not believe that sale of Cooperative assets would be in the best interests of the members of Socorro Electric. If these proposed Bylaws and policies are adopted and followed, and with good will from all involved, we see no reason why Socorro Electric cannot be restored to successful operations and governance. In any event, we are skeptical that the finances for any such sale, in whole or part, would make sense from a financial position. We further reject

suggestions that is should be up to the Cooperative, *i.e.*, the members, to bear the cost of the study.

SECTION 10.01 –BYLAW AMENDMENTS

Bylaw amendments have been one of the most contentious and needlessly expensive areas of dispute for the Cooperative. The reality, however, is that the process of implementing Bylaw amendments should be deliberate, democratic, simple and inexpensive.

Without question, New Mexico law gives the Members sole and exclusive authority to *approve or reject* proposed Bylaw amendments. That is an important tool when the Members need to reign in abusive Board practices. On the other hand, the statute does not state or suggest that Members are expected to do the legal drafting. In every instance, the Cooperative will benefit from having expert guidance and input on Bylaw proposals, both in terms of drafting and on the substantive legal and practical implications of the amendment or addition.

In order to advance a deliberative process, Members and Trustees should consider the following steps when evaluating amendments: ***(1) define the issue being addressed, in writing; (2) identify why the issue is a problem, in writing; (3) identify the legal parameters; (4) review solutions from sister Cooperatives; (5) determine interdependencies with other Bylaw provisions; (6) carefully evaluate costs; (7) determine if the benefits exceed the costs from the perspective of the average Member.***

Once the decision has been made to propose a Bylaw amendment to the members, then in the interests of *maximizing* democratic control, the proposed amendments should be presented as ballot questions so the entire membership can participate in the amendment process. Voice or hand votes are chaotic, subject to interference by ineligible voters, and deny members the opportunity to vote their conscience by secret ballot.

In any event, the Bylaws we are proposing through this review are comprehensive and guided by principles of transparency, accountability and active member participation; there will be no need for frequent revision and amendment.

SECTION 10.13 – MEMBER INSPECTION OF COOPERATIVE RECORDS

As with the issue of Open Meetings, the reform group succeeded in mandating access to Cooperative records. (See **Article VI, Section 5**, of the current Bylaws). Again, we agree with the spirit of the amendment, but take heed of the Court's observation that amendment itself is inartful. Socorro Electric is a private membership corporation; the Public Records act does not apply. The proposed Bylaw will achieve the transparency objectives of the amendment, but do so under appropriate Bylaw terms.

SECTION 10.14 – CONTRIBUTIONS, DONATIONS AND COMMUNITY ASSISTANCE

The Members have made their voice known on the question of contributions or donations to outside organizations:

- "And no donations to anyone. It's our money." Padilla, James, "Opinion: Just say 'no' to trustee's wants" *El Defensor Chieftan* 28 March 2012.
- Board "wants to give away our money to whatever suits their fancy." West, Charlene, "Opinion: Co-op members need to fight 'the monster'" *El Defensor Chieftan* 17 March 2012.
- Need clarification on resolution for "in-kind contributions to parties within the co-op's service area." Junger, Bev, "Opinion: Co-op needs to clarify resolution" *El Defensor Chieftan* 7 March 2012.

Another news article recounts the following:

> Members voted to restrict co-op donations to organizations two years ago, limiting them only to groups that serve children. As a result the co-op was forced to pull its sponsorship of events, such as the Socorro Open golf tournament, and contributions to adult service organizations.

Last, T.S., "Member-owners have 15 resolutions to consider at co-op annual meeting" *El Defensor Chieftan* 14 April 2012.

This is a difficult issue where people of good faith can have differing views and opinions. But the reform group correctly put their finger on the heart of the issue – when the Cooperative gives away money, they are essentially giving away the Members' money. We support charitable endeavors. However, the value of any contribution the Cooperative could make to any person or entity will be outweighed by the risk of continued disagreement and conflict on the Board of Trustees and among the members; *it's just not worth it*. If the Cooperative wants to make donations and contributions, the best solution for Socorro Electric Cooperative would be for members to make voluntary contributions for disbursement by a separately-incorporated and governed 501(c)(3) charitable corporation. Such entities are common in the industry, and usually rely on members to "round up" their electric bill to the next highest dollar, with the proceeds then distributed by a separate board.

However, suggestions that the Cooperative is prohibited from helping the City of Socorro with hanging holiday decorations, as we heard from one Trustee, is charitably described as "penny wise and pound foolish." (As a basic matter, the City is not a "civic organization" for which "in-kind donation" would be restricted under the terms of the current Bylaws.) The Cooperative is a corporate citizen of Socorro and the relationship is one that benefits everyone. There is nothing wrong with a bit of cooperation on both sides – that's the way it should be. Moreover, despite howls to the contrary, a Cooperative's participation in issues like economic

and community development is entirely legal under federal law. Indeed, for example, RUS specifically recognizes the goal of providing community support through, for example, the "REDLEG" program. http://www.rurdev.usda.gov/MN-RBS-REDLG.html. On the other hand, while recognizing the City's legal restrictions on allowing entities like Socorro Electric to operate without paying a franchise fee,[5] reciprocal cooperation on issues like franchise agreements and use of city facilities would be most welcome.

[5] A good description of that issue – the "anti-donation clause" can be found here: http://www.informedcynic.com/SEC/sec-docs-jan-2013-dec-2013/110113-Socorro%20Newsletter-SEC%20agreement.pdf