STATE OF NEW MEXICO
THIRTEENTH JUDICIAL DISTRICT
COUNTY OF VALENCIA

SOCORRO ELECTRIC COOPERATIVE, INC.,

Plaintiff,

v.

CHARLENE WEST, et al.,

No. D1314-CV-2010-0849
Judge: Mitchell

Defendants,

And

CHARLES WAGNER, individually and on behalf of those similarly situated, et al.,
Cross Claim Plaintiff,

v.

SOCORRO ELECTRIC COOPERATIVE, INC., et al.,
Cross Claim Defendants.

MOTION TO DISMISS CLAIMS AND FOR JUDGMENT ON THE PLEADINGS BASED ON FAILURE TO PLEAD UNDER RULE 1-009(b)

Cross Claim Defendants Socorro Electric Cooperative, Inc. *et al*, by and through their counsel of record, Kennedy & Han, P.C., hereby brings this, Cross Claim Defendants' Motion to Dismiss Claims. [1, 2] As is discussed in detail below, the Cross Claim in the current matter violates the express pleading requirements established Rule 1-009(b), NMRA 2011, regarding

[1] The current Motion is being filed concurrently with a Motion to Dismiss based on Lack of Standing, a Motion to Dismiss based on Failure to Properly Plead under Rule 1-009(b), a Motion to Dismiss for Failure to Join an Indispensible Party, and a Motion for Partial Summary Judgment as to Claims Based on Denial of Voting Rights. The Defendants hereby incorporate all statements of fact and arguments of law contained in these various Motions as if fully set forth herein.

[2] For purposes of simplicity and ease of reading, Cross Claim Defendants are referred to throughout this Motion as "Defendants." Cross Claim Plaintiff is similarly referred to only as "Plaintiff".

averments of fraud. To the extent that Plaintiff has failed to properly plead his averments and allegations of fraud and fraudulent concealment, he has failed to state a claim under Rules 1-012(c) and 1-009(b), NMRA 2011. On these grounds, each of the various claims brought by Plaintiff Wagner must be dismissed.

In support of this Motion, Defendants state as follows:

I. Introduction.

On or about August 24, 2010, Plaintiff filed an unverified Cross Claim and Request for Class Action Certification in the current matter. The Cross Claim was brought against the Socorro Electric Cooperative, Inc. (hereinafter "Cooperative") as an independent corporation, and against fourteen individuals. Thirteen of these individuals are current or past Trustees of the Cooperative, and one individual is a past general manager of the Cooperative.

Focusing strictly on the unverified Cross Claim, the pleading contains, in total, sixteen "counts," each brought against fifteen individual Defendants, creating a total of *240 separate claims* which must now be litigated before this Court.[3] None of these claims are plead with particularity. However, a review of the unverified Cross Claim in its entirety reveals that the pleading contains *no* particular factual pleadings upon which *any* claim could be made. Apart from recitations of portions of New Mexico's Rural Electric Cooperative Act, the Cooperative's Bylaws, and properly filed IRS documents, the Cross Claim contains only general allegations and speculation as to hypothetical wrong-doing by the Defendants. Several fundamental accusations are brought on the basis of "information and belief," with no factual support or information. See, eg, Cross Claim, at ¶38.

[3] Defendants recognize that at least two of the "counts" (ie, Counts 1 and 16) presented by Plaintiff contains no language indicating an actual cause of action. This fact, however, only adds to the confusion surrounding this Cross Claim.

Additionally, each of the 240 claims presented in the Cross Claim appears to be rooted in an averment of "fraudulent concealment," which is presented at Sec.4, ¶¶ 25-27 of the Cross Claim and is repeated in relation to almost every "count". In addition to the averments of "fraudulent concealment", the various "counts" contain numerous unspecified, general averments of breach of fiduciary duty and fraud. These "counts" contain no particular statements of fraudulent behavior or actions on the part of *any* of the named Defendants. In fact, the "counts" do not mention *any* individual Defendant by name nor do they discuss *any* actions of the individual Defendants.

These deficiencies in the Cross Claim are in direct violation of New Mexico's Rule of Civil Procedure 1-009(b) and of the common law pleading requirements established by the business judgment rule. These fundamental deficiencies make proper discovery and litigation of the matter virtually impossible, since the Defendants have no clear understanding of the time, place or nature of the claims being made against them. Under these circumstances, each of the claims contained in Plaintiff's 16 "counts" should be dismissed.

II. Standard of Review.

Defendants have brought the current Motion as a motion to dismiss under Rule 1-012(c), NMRA 2011 so as to enforce the particularity requirements contained in Rule 1-009(b), NMRA 2100. New Mexico case law indicates that state courts address a plaintiff's failure to plead as required by Rule 1-009 on the same basis as a motion to dismiss. See, eg., *Meiboom v. Watson*, 2000-NMSC-004, ¶4.; *Delgado v. Costello*, 91 N.M. 732, 734, 580 P.2d 500, 502. Similarly, under the Federal Rules of Civil Procedure, the 10th Circuit considers motions brought for failure

to plead fraud with sufficient particularity as motions to dismiss for failure to state a claim. See, *Grossman v. Novell, Inc.,* 120 F.3d 1112, Fn. 5 (10th Cir. 1997).

III. Statements and Arguments of Law.

A. Failure to State a Claim as to Averments of Fraud.

In addition to the pleading deficiencies presented it the other various Motions filed concurrently with the present Motion, the current Cross Claim fails to meet the basic pleading requirements of Rule 1-009(b), NMRA 2011, concerning averments of fraud. Rule 1-009(b) expressly states that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." This rule is substantially similar to Federal Rule of Civil Procedure 9(b), which provides that "[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake."

Federal courts have been quite explicit when discussing the policy behind the heightened pleading standard for matters of fraud. The U.S. Supreme Court has stated that heighten pleadings are required because claims of fraud "raise a high risk of abusive litigation." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 554, 127 S.Ct. 1955, 1973 n. 14 (2007). The heightened pleading rule is intentionally designed to protect defendants from "spurious charges of immoral and fraudulent behavior." *U.S. ex rel. Bledsoe v. Cmty. Health Sys. (Bledsoe II),* 501 F.3d 493, 509 (6th Cir. 2007). The rule also prevents vindictive plaintiffs from conducting large-scale "fishing expeditions" based on nothing more than generalized allegations. *U.S. ex rel. Atkins v. McInteer,* 470 F.3d1350, 1360 (11th Cir. 2006). Before making public charges of fraud, parties are required to conduct a greater than normal pre-litigation investigation, "because public

charges of fraud can do great harm to the reputation of a business firm or other enterprise (or individual)." *U.S. ex rel. Fowler v. Caremark RX, L.L.C.*, 496 F3d 730, 740 (7th Cir. 2007).

While this heightened pleading requirement does not require a party to explain or present each and every detail of his claim of fraud, the party bringing allegations of fraud in New Mexico courts must present sufficient facts that fraud is "necessarily implied" from the pleading. See, *Steadman v. Turner*, 84 N.M. 738, 740 507 P.2d 799, 801 (1974). The underlying facts must be plead in such a manner as to "leave no doubt in the defendants' minds as to the claim asserted." *Delgado v. Costello*, 91 N.M. 732, 735 580 P.2d 500, 503 (1978). By way of example, in a recent matter arguing that fraud was not plead with sufficient particularity, the New Mexico Supreme Court upheld the pleadings as proper because they stated particularized instances of fraud were alleged in detail and the rules alleged to have been violated were stated with specificity. See, *In Matter of Stein*, 2008-NMSC-013, ¶46.

In order to provide defendants with notice of the specific conduct with which they are charged, federal courts have consistently held that, at a minimum, allegations of fraud must "allege the time, place, and content [of the fraud], the fraudulent scheme, the fraudulent intent of the defendants, and the injury resulting from the fraud." *U.S. ex rel. Bledsoe v. Cmty. Health Sys. (Bledsoe I),* 342 F.3d 634, 643 (6th Cir. 2003). Where a defendant's allegations include a "complex and far-ranging fraudulent scheme," then the defendant is required to, at a minimum, provide specific representative examples of the alleged fraudulent conduct. See, *Bledsoe II*, 501 F.3d at 510. In short, averments of fraud must provide the accused with "the who, what, when, where and how." *Borsellino v. Goldman Sachs Group, Inc.,* 477 F.3d 502, 507 (7th Cir. 2007).

Apart from generalized averments of fraud and breach of fiduciary duty, the current Cross Claim relies heavily on generalized averments of "fraudulent concealment," presumably in

order to escape the relevant 4 year statute of limitations on claims of fraud. In the specific context of fraudulent concealment allegations, a plaintiff has the express burden of pleading the underlying fraud with particularity, while additionally showing: 1) why he or she failed to discover the cause of action before the running of the statute of limitations; 2) that he or she exercised due diligence in regards to his or her claim; and, 3) that an affirmative act by the defendant frustrated discovery of the cause of action notwithstanding plaintiff's due diligence. *Continental Potash, Inc. v. Freeport-McMoran*, 115 N.M. 690, 698, 858 P.2d 66, 74 (1993).

B. Averment of Fraudulent Concealment and Statute of Limitations.

Plaintiff's first averment of fraud is contained Sec. 4, ¶27, which attempts to circumvent the regular rules associated with the statute of limitations by claiming fraudulent concealment on the part of each of the 15 separate Defendants. See, Cross Claim, p. 9. However, in direct contradiction to the requirements of Rule 1-009(b), the paragraph makes nothing more than a broad, highly generalized claim of fraudulent behavior. The paragraph does not discuss *any* Defendant by name. It does not state what each Defendant is alleged to have actually done. It does not state when the Defendants are alleged to have committed any particular acts of fraud. Perhaps most importantly, the paragraph does not state how Defendants have "concealed" their acts from the Cooperative's members, its auditors, and its financers. The only allegation contained in the paragraph simply states that the General Manager (apparently Defendant Pineda), has refused "on several occasions" to release requested documents. Even accepting this allegation as true, these facts do not "necessarily imply" a finding of fraud. The paragraph does not state when the documents were requested and refused, the nature of the documents, the

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number of documents, or the reasons provided by the General Manager for refusing to produce requested documents.

Additionally, Paragraph 27 fails to address the three other issues required to satisfy a pleading of fraudulent concealment under *Continental Potash*. Plaintiff has not stated why he (or, in fact, *any* of the members of the purported class Plaintiff seeks to have certified) failed to discover the causes of action against each Defendant before the running of the relevant statute of limitations. Plaintiff has not provided a description of the efforts he (or any member of the Cooperative) took in order to exercise due diligence in regard to bringing the claims against the numerous Defendants. Finally, Plaintiff has failed to allege the requisite affirmative act ***by each Defendant*** which frustrated discovery of Plaintiff's cause of action.

Where Plaintiff has utterly and wholly failed to meet the basic, clearly established requirements of a "fraudulent concealment" claim, this Court is authorized dismiss all claims which rely upon these averments based on Plaintiff's failure to state a claim upon which relief may be granted.

C. General Averments of Fraud.

Apart from the generalized, improper averments of fraudulent concealment, Plaintiff's Cross Complaint is pervaded by unsubstantiated, non-particular statements and allegations of fraud. These averments inform, and are inextricably linked to, each claim brought by Plaintiff. These pervasive violations of the Rule 1-009(b) pleading requirements necessitate the total dismissal of all claims contained in the Cross Complaint.

i. Excessive Compensation Counts.

Plaintiff's first set of claims, contained in "counts" 1 – 4, address issues of allegedly excessive compensation. Plaintiff attempts to bring three separate theories of liability as to the issue of compensation, but each of the three is fundamentally rooted in Plaintiff's wholly unsubstantiated allegations of fraudulent behavior. Plaintiff avers that the Trustees have wasted the Cooperative's assets and have engaged in self-dealing transactions. See, Cross Complaint, ¶38. These allegations are completely unsubstantiated, and they contain no specific factual allegations which would allow each individual Defendant to understand what he or she is actually being accused of doing. Similarly, Plaintiff alleges "on information and belief" that the Socorro Electric Cooperative and the Trustees are defrauding the members by underreporting compensation, per diem and travel expenses. See, Cross Complaint, ¶39. Here again, there are no specific allegations. The very fact that Plaintiff resorts to an "on information and belief" allegation is *prima facie* evidence that Plaintiff has not conducted the required pre-litigation investigation into his allegations, that he is not in possession of the particular facts necessary to support these allegations, and that he cannot provide even a few specific representative examples of the alleged fraudulent conduct.

Plaintiff next makes the unsubstantiated allegation that Defendants have defrauded the Internal Revenue Service by failing to report, or reporting inaccurate information, to the IRS. See, Cross Complaint, ¶45. This is a very serious allegation, yet it is entirely unsubstantiated. Plaintiff has presented *no* specific incidents of fraudulent reporting. Similarly, Plaintiff's claims of "longstanding behavior" which fraudulently concealed matters from the membership are completely unsubstantiated. See, Cross Complaint, ¶¶ 47, 55, & 59.

ii. "Wasteful Spending" Counts.

Plaintiff next presents three additional "counts" which supposedly stem from "wasteful spending" but which fully overlap with Plaintiff's "excessive compensation" counts. In the context of "wasteful spending" Plaintiff again generally alleges that the Defendants defrauded the Cooperative members by "receiving advances for mileage even though the Trustee(s) did not drive, excessive hotel room charges, excessive money spent on dinners, and excessive money spent on training schools and traveling." See, Cross Complaint, ¶64. Plaintiff claims that the Defendants' "conduct involved self dealing, dishonesty, disloyalty and fraudulent concealment." See, Cross Complaint, ¶65. Again, throughout these counts *no* individual Defendant is actually named, and Plaintiff does not refer to *any* specific time, place or incident. Plaintiff actually goes on to affirmatively state that he has *no facts* to support his allegations of fraudulent, wasteful spending. See, Cross Claim, ¶71. Instead of presenting the facts as required by Rule 1-009(b), Plaintiff asks the Court to take the extraordinary step of ordering an "independent accounting" into the complete financial history of a substantial corporation and 14 individual Defendants based on nothing more than Plaintiff's vague, unsupported allegations of fraud. This request is made despite the fact that, as a Trustee of the Cooperative, Plaintiff is fully aware that annual financial audits are conducted of the Cooperative's records and that a full forensic audit has recently been performed.

iii. "Denial of Voting Rights" Claims.

Plaintiff's claims regarding "denial of voting rights" raise similar issues of inadequate pleading in relation to averments of fraud. Although Plaintiff is avoids the use of the word "fraud" (other than to make an additional unsupported claim of "fraudulent concealment"), Count 12 raises clear averments of fraudulent behavior by asserting that Defendants "have

manipulated the [voting] rules to create a system of scheming quorum calls and an ineffective means of having proposals heard…." Cross Claim, ¶87. Following these generalized allegations, Counts 13 – 15 simply refer to "the above and foregoing conduct" without providing any specific discussion of the alleged conduct. *Id.* at ¶¶88 – 94.

If Plaintiff intended to present allegations of fraudulent behavior in counts 12-15, then he needs to make particular averments and statements as to each named Defendant. Alternatively, if Plaintiff merely seeks to bring suit against the Defendants to in an effort to change the two Bylaws cited in ¶87 of the Cross Claim, then Plaintiff needs to satisfy the pleading requirements under RECA, §62-15-9(H) by asserting particular facts as to Plaintiff's pre-litigation efforts to propose and effect changes to the Bylaws. As currently presented, counts 12 – 15 fail to meet the pleadings requirements of both Rule 1-009(b) and §62-15-9(H), and they should be dismissed.

D. Patronage Capital and the Business Judgment Rule.

i. Definition and Calculation of Patronage Capital.

At Counts 8 – 11, Plaintiff addresses purported violations in relation to the accumulation and payment of "patronage capital." While "patronage capital" is easily defined as excess revenues over expenses and can be conceptually understood as the "profit" that would be generated in a shareholder owned company, the steps and procedures required to account for, allocate and eventually distribute "patronage capital" are much more complex. Determining the amount of "patronage capital" generated in a particular fiscal year requires a series of business judgments by the Cooperative's managers, officers and Trustees. The RECA, at §62-15-20, provides a specific list of considerations that the Cooperative, acting through its various agents, must make in order to determine the amount, if any, of excess revenues available for distribution

as patronage capital. For example, the Cooperative must defray expenses associated with operation and maintenance of its facilities. The Cooperative must pay interest and principal obligations for loans coming due in the current year, while providing a reserve for future construction and acquisition, a reserve for working capital, and a reserve for long term debts. The Cooperative is also permitted to provide a fund for education on effective electric energy use and conservation and on other services made available through the Cooperative. Once these calculations are made, any remaining funds are to be distributed to the Cooperative's membership on a pro rata basis. See, RECA, §62-15-20(A) – (F), NMSA 1978. However, the RECA does not provide for any particular timeframe for the distribution of funds, nor does it require a cooperative to maintain a patronage capital retirement plan.

ii. Fraud, Business Discretion and the Business Judgment Rule.

The operations required by §62-15-20 inherently call for the exercise of business judgment on the part of the Cooperatives employees, managers, officers and Trustees. For example, determining a "reasonable reserve for working capital" is necessarily a business decision. See, §62-15-20(D). As business decisions, these actions are protected by the business judgment rule, which precludes the courts from interfering with the discretion of corporate directors "on questions of corporate management, policy or business." See, *Sampson v. Hunt*, 233 Kan. 572, 584 (1983). New Mexico courts have provided a more extensive definition of the business judgment rule, asserting that:

> "If in the course of management, directors arrive at a decision, within the corporation's powers and their authority, for which there is a reasonable basis, and they act in good faith, as the result of their independent discretion and judgment, and uninfluenced by any other consideration other than what they honestly believe to be the best interests of the corporation, a court will not interfere with the internal management and substitute its own judgment for that of the directors." *Diiaconi v. New Cal Corp.*, 97 N.M. 782,788, 643 P.2d 1234, 1240 (N.M. 1982).

The business judgment rule imposes a *presumption* on the court that corporate directors and officers have acted within the boundaries of their sound business judgment. See, *Brehm v. Eisner*, 746 A.2d 244, 251 (Del. 1999). When considering matters premised on the acts of a corporate board, "a court will not apply 20/20 hindsight to second guess a board's decision, except in rare cases [where] a transaction may be so egregious on its face that the board approval cannot meet the test of business judgment." *Brehm v. Eisner*, 746 A.2d 244, 260 (Del.Supr. 2000). In order to overcome this presumption, a disgruntled shareholder (or member, in the case of a cooperative), must affirmatively demonstrate that the particular directors, trustees, or officers have engaged in *fraud or self-dealing* which creates a conflict with their business judgment. See, *Sampson v. Hunt*, 233 Kan. at 584-585 (emphasis added). Thus, a pleading which necessarily implicates the business judgment rule must also contain particularized averments of the fraud or self-dealing that has occurred.

New Mexico courts have applied the presumptions of the business judgment rule as an affirmative defense to liability, upon which a jury may be properly instructed at trial.[4] See, *McMinn v. MBF Operating Acquisition Corp.*, 2007-NMSC-40, ¶12. However, neither the *McMinn* decision nor any other New Mexico opinion has comprehensively addressed implications of the business judgment rule in matters of pleading, particularly when the rule interacts with Rule 1-009(b). Where New Mexico courts have not considered a novel issue of law, the Court is permitted to look to the federal courts and sister state courts for persuasive authority. See, *State v. Gutierrez*, 2005-NMCA-093,¶11; *State v. Gutierrez*, 2007-NMSC-033, ¶16 (citing persuasive authority from Arizona, Delaware, New Jersey and Texas).

[4] For purposes of the record, Defendants assert that the business judgment rule applies with equal strength to *all counts* contained in the Cross Claim. By electing to assert and discuss the protections of this rule in the context of claims related to patronagecapital, Plaintiff *does not waive* the right to assert the rule as an affirmative defense to Plaintiff's other claims at any appropriate time during the litigation of this matter.

As a court system long recognized for its special focus and consideration of corporate law matters, the Delaware state courts have developed a substantial body of case law regarding the business judgment rule. The leading case addressing the interaction of the business judgment rule with procedural pleading requirements is *Brehm v. Eisner*, 746 A.2d 344 (Del.Supr. 2000). In *Brehm*, the Delaware Supreme Court expressly recognized that the presumptions inherent in the business judgment rule interact with the rules of procedure in order to impose a clear pleadings standard for suits against directors, trustees and other corporate officers for business decisions. *Id.* at 249. Apart from merely pleading the bare requirements for suit, the presumptions of the business judgment rule require that a shareholder attempting to bring suit against corporate actors must plead sufficient particularized facts sufficient to raise a reasonable doubt that the challenged transaction was not the product of a valid exercise of business judgment.[5] *Id.* at 253. Such pleadings need to, at a minimum, present the instances of fraud or self-dealing that a plaintiff believes are in contradiction of the business judgment rule. This standard is expressly *not* satisfied by the use of conclusory statements or mere notice pleading. *Id.* at 254. In justifying this heightened pleading standard, the Delaware Supreme Court expressly recognized a need to deter costly, baseless suits by creating a screening mechanism to eliminate claims where there is only a suspicion of wrongdoing expressed solely in conclusory terms. *Id.* at 255.

An examination of the current Cross Claim shows that it contains no particularized allegations of fraud or self-dealing which would even begin to overcome the presumed propriety of the Defendants' business decisions in regards to patronage capital. Instead of presenting particularized allegations, the Cross Claim is filled with generalized, conclusory language and

[5] The *Brehm* case involved a shareholder derivative suit. As is fully discussed in Defendants' Motion to Dismiss of Lack fo Standing, Plaintiff has attempted to bring a *direct* suit against the Cooperative and its Trustees. However, even in the context of a direct suit, the pleadings issues surrounding fraud and the business judgment rule continue to apply.

assertions. In ¶18, Plaintiff accuses Defendants of "a variety of wrongful practices." Cross Claim, at ¶18. Plaintiff repeatedly makes accusations that Defendants "deceitfully" and "fraudulently" concealed wrongdoing, without specifying either the underlying wrongful acts or the acts of concealment, the time or place of the wrongful acts, and which of the numerous named Defendants is alleged to have engaged in the wrongful acts. Plaintiff makes particular statements as to compensation and work hours, but he presents no particular facts indicating that the methods of calculating compensation were the product of unreasonable or fraudulent business decisions. *Id.,* at ¶¶33-37. Instead, Plaintiff simply asserts the conclusion, based "on information and belief" that the overall compensation is higher than average and that it is therefore "unreasonable." Cross Claim, at ¶38. Plaintiff makes no specific factual allegations indicating waste of assets or self-dealing. *Id.* Plaintiff presents no particular factual allegations supporting the conclusory assertion that Defendants failed to report or reported inaccurate information to the IRS. *Id.* at ¶45. The list of unsupported, conclusory statements continues throughout the 33 page Cross Claim.

Under these circumstances, where Plaintiff has failed to plead sufficient particularized allegations of fraud or self-dealing necessary to overcome the presumption of proper business behavior embodied in the business judgment rule, Defendants request that all claims related to the allocation and distribution of patronage capital, in addition to Plaintiff's claims for excessive compensation and wasteful spending, be dismissed on the pleadings for failure to state a claim upon which relief can be granted.

IV. Conclusion.

WHEREFORE, based on the statements of fact and law presented above, Defendants request the Court Provide the following relief:

1) ORDER full dismissal of all claims for failure to state a claim upon which relief may be granted, based on Plaintiff Wagner's failure to comply with the pleading requirements of New Mexico Rule of Civil Procedure 1-009(B), NMRA 2011 and the business judgment rule; and,
2) ORDER any such other and further relief as this Court finds to be in the interests of justice.

Respectfully submitted,

KENNEDY & HAN, P.C.

/s/ Darin M. Foster

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CERTIFICATE OF SERVICE:
I certify that a copy of this
Motion was served by the Court's
electronic filing system to the following
counsel of record on this 25th day of January 2012.
Pro Se Litigants were served by 1st Class U.S. mail.

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