jy

FILED IN MY OFFICE
DISTRICT COURT CLERK
11/26/2012 5:42:05 PM
PHILLIP ROMERO

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.

RESPONSE:

ADDRESING MATTERS RAISED IN PLAINTIFFS'S LETTER TO THE COURT

The current Response letter is presented to the Court pursuant to the Court's letter of August 14, 2012. Defendant's Response addresses certain matters raised by Plaintiffs in their briefing letter filed on or about November 5, 2012. As will be discussed in detail below, Plaintiffs' 3 ½ page letter does not address the substantive issues related to appropriate remedy which prompted the Court to issue its August 14th letter, contains no discussion of New Mexico case law or statute, and grossly misrepresents the case law which is cited.

I. Failure to Address Fiduciary Duty Cause of Action.

As a preliminary matter, Defendant would point out that Plaintiffs have wholly failed to address their breach of fiduciary duty claims (Counts 1 and 4 of Plaintiffs' proposed First Amended Cross Claim). This is perhaps because recent persuasive case law from the Texas Court of Appeals has expressly ruled that electric cooperatives owe ***no*** fiduciary duty to their members. See, *Denton County Elec. Coop., Inc. v. Hackett*, 368 S.W.3d 765 (Tex. App. Fort Worth 2012) (Courtesy Copy provided to court). The only fiduciary duty which ***might*** be subject to a lawsuit would be that owed by the trustees/directors of the cooperative to the cooperative itself, but the *Denton County* plaintiffs only brought suit against the cooperative, not the directors. *Id*. at 783. Similarly, in the current suit, Plaintiffs are attempting to bring suit *only* against the Defendant Cooperative. There are ***no*** allegations of fraud or other wrongdoing on the part of Defendant's individual trustees.

While the *Denton County* ruling focused on specific features of Texas statute, Defendant believes that, should this case move forward, a similar "lack of duty" ruling will be found under New Mexico law. At the very least, the *Denton County* suit highlights the general principle that, even where a fiduciary duty exists, suits by a cooperative's members against the cooperative for mismanagement and breach of fiduciary duty are *derivative actions*. *Id.,* citing *McCarthy v. Middle Tenn. Elec. Membership Corp.,* 466 F.3d 399, 403,410 (6th Cir. 2006).

II. Enforcement of Contract Between SEC and Plaintiffs.

Apparently abandoning their breach of fiduciary duty claims (as they earlier abandoned their fraud-based claims), Plaintiffs focus on their purported breach of contract claims. Interestingly, Plaintiffs have never stated which provisions of the Cooperative's Bylaws

Defendant has allegedly violated. Rather than directly address this seemingly central issue, Plaintiffs repeatedly direct the Court to the Alabama Supreme Court case of *Baldwin County Elec. Membership Corp. v. Catrett*, 942 So.2d 337 (Ala. 2006). Plaintiffs argue that *Baldwin County* establishes the principle that a court may amend and enforce a corporation's bylaws by judicial mandate. However, a simple reading of the decision reveals that the Alabama Supreme Court crafted a much narrower ruling which was appropriate for the procedural context of the case before them, which focused on a trial court's discretion to issue a preliminary injunction.

The *Baldwin County* case focused exclusively on a dispute between certain members of an electric cooperative over voting procedures for the election of the board of trustees and the cooperative's procedure for approving or amending minutes of the annual meetings. *Id*. at 339-340. In that limited context, the Alabama Supreme Court ruled that the members could bring a direct action against the cooperative to enforce the personal right of each member to proper voting procedures. *Id.*

In the current suit, *none* of the asserted causes of action address voting rights. Plaintiffs' causes of action address breach of contract and breach of fiduciary duty as related to alleged excessive compensation and retained capital. *Baldwin County* specifically states that claims for the return of improperly held assets are derivative in nature, because "if the allegations are true, [the assets] would by law have to be returned to the corporation as the assets are not solely [the plaintiffs'] but belong to the corporation." *Id*. at 346, quoting *Green v. Bradley Const. Inc.* 431 So.2d 1226, 1229 (Ala. 1983). For this reason alone, any conclusions reached in the *Baldwin County* matter are inapplicable to the current suit.

Perhaps more importantly, the *Baldwin County* decision explicitly refuses to address the argument that trial courts are not empowered to interfere with the internal management of a

corporation by amending corporate bylaws. *Id.* at 348-349. The Alabama Supreme Court held that the *Baldwin County* defendants had failed to preserve that argument for review. *Id*. However, an analysis of the primary Alabama case on this issue, *Fairhope Single Tax Corp. v. Rezner*, 527 So. 2d 1232 (Ala. 1987), demonstrates that *Baldwin County* is the exception and not the rule. In *Rezner*, the Alabama Supreme Court clearly held that: 1) courts of equity will not interfere with the internal business management of corporate assets by the board of directors absent allegations of fraud or maladministration which is injurious to the corporation itself; 2) the business judgment rule applies to non-profit corporations; 3) the trial court erred when it attempted to use its equitable powers to make changes to the internal management of a corporation; 4) the trial court erred when it enjoined management's attempt to make business decisions; and, 5) the trial court erred in making changes to corporate policies. *Rezner*, 527 So.2d at 1235 – 1236.

In light of these clear statements, *Baldwin County's* ruling, if applicable at all, must be limited to circumstances where a trial court finds an "irreconcilable conflict" within a corporation's bylaws themselves. See, *Baldwin County*, 942 So.2d at 342. Even under these circumstances, courts have no "judicial mandate" to amend and enforce bylaws. Rather, courts have a duty to interpret bylaws so that no provision of the bylaws, as written and passed by the membership, is arbitrarily disregarded. *Id.*

Therefore, to the extent that Plaintiffs have failed to give any analysis of New Mexico law, have misstated the holdings and conclusions of their primary case, and have failed to inform the court of contrary authority cited and dismissed for procedural reasons within that primary case itself, Defendant asks that the Court disregard the statements presented by Plaintiffs.

III. Applicability of the Business Judgment Rule.

In their letter, Plaintiffs make the blanket statement that "[w]hen the SEC fails to act in good faith and with fair dealing, the business judgment rule is not implicated." Plaintiffs attempt to support this statement with an unanalyzed string citation to various state court rulings from around the country. Plaintiffs specifically fail to present applicable federal court rulings on the issue or to present binding New Mexico precedent. As to the state court cases which *are* presented to this Court, many of them contain holdings which are completely in opposition to Plaintiffs' assertions.

For example, in *Mueller v. Star Valley Ranch Assn*., 124 P.3d 340 (Wyo. 2005), the Wyoming Supreme Court clearly stated that "it is a general rule that courts of equity will not interfere in questions of corporate management or policy. They are reluctant to undertake the management of a private corporation, and, in the absence of fraud…they generally refuse to interfere, and allow the majority of the stockholders to rule, leaving dissatisfied stockholders to redress their grievances by ordinary corporate methods." *Mueller*, 124 P.3d at 351, quoting *Smith v. Stone*, 128 P. 612, 619 (Wyo. 1912). The Wyoming court goes on to state that the business judgment rule is standard of judicial review which imposes a "*presumption* that business decisions are made by disinterested and independent directors on an informed basis and with a good faith belief that the decisions will serve the best interests of the corporation." *Id*. (Emphasis added). If plaintiffs do not overcome this presumption, then "the business judgment rule prohibits the court from going further and examining the merits of the underlying business decision…[and]…prevents a factfinder, in hindsight, from second-guessing the decisions of directors." *Id.* Furthermore, approval of a business activity by "a majority of independent, disinterested directors almost always bolsters the presumption that the business judgment rule

attaches" to the business activity in question. *Id.* at 352. Finally, the *Mueller* decision expressly states that "[w]hether a corporation should pursue a claim through litigation is a matter for the business judgment of the Board." *Id.* at 353. Plaintiffs wholly fail to address any of these issues raised in the case they have elected to cite to this Court.

The Wyoming law above is substantially similar to New Mexico law, which holds 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 a result of their independent discretion and judgment, and uninfluenced by any 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 judgment for that of the directors to enjoin or set aside the transaction*** or to surcharge the directors for any resulting loss." *White on Behalf of Banes Co. Derivative Action v. Banes Co*., 116 NM 611, 615, 866 P.2d 339, 343 (1993) (emphasis added).

Far from being inapplicable, should this litigation continue, the business judgment presumptions will, in all likelihood, provide the standard of judicial review for the suit. As has previously been discussed in Defendant's Memorandum Brief in response to the Court's August 14th letter, where a corporate board, in its independent business judgment, determines that litigation is not in the best interest of the corporation, the board generally has the authority to request that the litigation be dismissed. See, eg, *Burks v. Lasker*, 441 U.S. 471 (U.S. 1979). Under these circumstances, when a corporate board petitions a court to dismiss a derivative action, the court is then limited to examining whether a plaintiff has overcome the presumption that the board acted independently, in good faith and exercised rational business judgment when concluding that continuing litigation was not in the best interests of the firm. *Id*. at 474-475.

IV. Review of Requested Relief.

Through the entirety of their 3 ½ page briefing letter, Plaintiffs disingenuously fail to address their own causes of action and requested forms of relief. Plaintiffs continually focus on the issue of voting rights, an issue that has been amply addressed by Defendant. At least since the issuance of the Court's June 2011 "Order on Hearing on Partial Merits", filed June 24, 2011, Defendant SEC, its trustees, officers and counsel, have been working to revise the voting districts and put into practice the member-enacted changes to the corporate Bylaws discussed in that Order. Plaintiffs and their counsel are well aware that voting districts have been re-drawn, voting procedures have been updated, that voting has occurred under these new procedures in certain districts, and that a rotational voting plan has been enacted by the Board of Directors.

By improperly focusing on a largely moot issue, Plaintiffs fail to provide any guidance to the Court as to their remaining causes of action and requests for relief. As stated above, persuasive case law suggests that Defendant, as a non-profit electric cooperative, owes *no* fiduciary duty to its members, and Plaintiffs have not brought any claims against any individual directors/trustee, officers or managers. Plaintiffs have not presented any argument to the contrary. Plaintiffs instead focus on alleged contractual violations, but they have not addressed the nature of the alleged contract between Defendant and its individual members, nor have they stated which Bylaws have allegedly been breached. Plaintiffs have not demonstrated how this alleged breach relates to matters of excessive compensation or retained capital. Plaintiffs have not addressed their actual claims for relief, namely accounting and disgorgement. Even presuming that Plaintiffs can properly establish an individual cause of action for breach of contract, Plaintiffs have not addressed the simple legal fact that accounting and disgorgement are equitable remedies that must be brought as derivative actions.

V. Conclusion.

As discussed more fully in Defendant's Memorandum Brief, the Court has correctly identified and requested briefing as to the serious issues of judicial authority raised in Plaintiffs' proposed First Amended Cross Claim. However, Plaintiffs have failed to provide the Court with any such guidance. Plaintiffs' response letter fails to present *any* statement of New Mexico law, fails to analyze the cases which are presented, contains grossly incorrect conclusions of law, and wholly ignores the actual claims and requests for relief being presented by Plaintiffs. Instead, Plaintiffs limit themselves to addressing the largely moot issue of voting rights.

Two claims for relief in this suit continue to fundamentally address the Court's authority in relation to business decisions and derivative actions: Plaintiffs' request for accounting and Plaintiff's request for disgorgement. Defendant has presented clear authority that, as equitable remedies which must be brought within a derivative action, these two requests for relief are required to be brought before the Board of Trustees for investigation and action before the filing of any lawsuit. To the extent that the Board acts in its proper business judgment and determines that the proposed litigation is not in the best interests of the corporation, then the Court's authority will be limited to reviewing whether Plaintiffs have overcome the presumption that the Board acted independently, reasonably, and in good faith.

Defendant SEC hopes that this memorandum briefing has addressed the concerns raised by the Court in its August 14th letter, and Defendant stands ready to provide additional briefing as requested by the Court.

Sincerely,

FOSTER & MOSS, P.C.

_/s/ Darin M. Foster_____

Darin M. Foster
620 Roma Ave, N.W.
Albuquerque, NM 87102
Counsel for Defendant SEC

CERTIFICATE OF SERVICE:
I certify that a copy of this Memorandum was served by the Court's electronic filing system to the following counsel of record on this 26th day of November 2012:

William Ikard *I* Jordan Haedicke
Ikard Wynne LLP
2801 Via Fortuna, Bldg. 7, Ste. 501
Austin, TX 78746

Lee Deschamps
Deschamps & Kortemeier Law Offices, P.C.
P.O. Drawer 389
Socorro, NM 87801
575-835-0777
Fax 575-838-2922
Counsel for Cross Claim Plaintiffs

_/s/ Darin M. Foster_____
Darin M. Foster