

**IN THE SUPERIOR COURT OF COBB COUNTY
STATE OF GEORGIA**

EDGAR “BO” POUNDS, et al.,

Plaintiffs,

vs.

DWIGHT BROWN, et al.,

Defendants.

Civil Action No. 07-1-9408-48

**DEFENDANT COBB ELECTRIC MEMBERSHIP CORPORATION’S
MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION
TO STAY AND REQUEST FOR IMMEDIATE HEARING**

Defendant Cobb Electric Membership Corporation (“Cobb EMC”) submits this Memorandum of Law in Support of Its Motion to Stay Plaintiffs’ lawsuit, showing the Court as follows:

I. PRELIMINARY STATEMENT

Under both relevant case law and the reasoning behind the Georgia Code, this Court has broad discretion to stay a derivative lawsuit to allow a corporate defendant to determine — through a special litigation committee — if the lawsuit is in the company’s best interests. Here, Plaintiffs have filed a derivative suit, in which any recovery would be on behalf of Cobb EMC, against a related company and certain officers and directors of Cobb EMC for breaches of duties owed to Cobb EMC. On October 18, 2007, before Plaintiffs filed this suit, Cobb EMC’s

Board of Directors (the “Board”) created a special litigation committee (the “Committee” or “Special Committee”) for the express purpose of investigating and evaluating the claims set forth in this lawsuit and a related, similar lawsuit. A copy of the Board’s October 18th resolution is attached as Exhibit 1 to the Motion to Stay. This Court should stay Plaintiffs’ lawsuit for 120 days, or to until the Committee has completed its investigation, whichever occurs first, to allow the Committee to determine if the continuance of the case is in the best interests of Cobb EMC.

Under Georgia case law, the Committee’s recommendations and the Board’s decision thereof will determine whether Cobb EMC will undertake prosecuting the claims on its own or move to dismiss Plaintiffs’ derivative action. Allowing Plaintiffs’ suit to proceed before the Committee has made its recommendation, however, would subvert the reasons behind having the Committee in the first place. If Plaintiffs’ suit were to go forward at this point, the Board would be unable to determine if the suit is in Cobb EMC’s best interests, and Cobb EMC would be exposed to potentially costly litigation of unfounded or frivolous claims that may be ultimately dismissed. Further, allowing Plaintiffs to conduct discovery would interfere with the Committee’s investigation and unduly disrupt Cobb EMC’s operations.

If the Court were to stay this lawsuit, Plaintiffs will not be prejudiced. As discussed below, Plaintiffs' dominant allegations of wrongdoing occurred 10 to 13 years ago. After waiting this long to bring their lawsuit, Plaintiffs will not be prejudiced by a short stay to allow the Special Committee to conduct its investigation.

As a part of the stay, Cobb EMC requests that the Court postpone the time that all Defendants have to answer Plaintiffs' Complaint until 30 days after the stay has been lifted. Because Plaintiffs have apparently already served some, if not all, of the individual Defendants — and because, as discussed below, Plaintiffs have already initiated discovery — Cobb EMC requests that the Court treat this Motion as a motion under Uniform Superior Court Rule 6.7 and grant Cobb EMC an immediate hearing on the Motion.

II. STATEMENT OF FACTS

Defendant Cobb EMC is a nonprofit electrical cooperative that it is owned by its members and provides electrical power to its membership in several counties in Georgia, including Cobb County. This is the second of two similar derivative cases brought against Cobb EMC. Both of these lawsuits were presumably spurred by a series of newspaper stories that ran in the Atlanta Journal Constitution, beginning late summer of this year, primarily concerning the relationship between

Cobb EMC and Defendant Cobb Energy Management Corporation (“Cobb Energy”), a for-profit affiliate of Cobb EMC.

The first suit was filed on September 12, 2007 by Sims and John Maddox against Cobb EMC, Cobb Energy and Dwight Brown, the CEO of Cobb EMC and Cobb Energy. On October 16, 2007, the Maddox plaintiffs amended their complaint. The Maddox plaintiffs brought their suit on behalf of themselves and a purported class of “all persons similarly situated and also on behalf of the General Public of the State of Georgia.” (*See* Intro. to Maddox Compl.) The Maddox plaintiffs generally alleged that the defendants, and “others who will become known through discovery . . . have improperly squandered, mismanaged, and converted the resources of Plaintiffs.” (*Id.* at ¶ 3.) Based on these vague allegations, the Maddox plaintiffs asserted derivative claims (that is, claims on behalf of Cobb EMC) against Cobb Energy, Brown, and the other defendants “who will become known through discovery.” Despite the requirement in O.C.G.A. § 46-3-272(a) that the Maddox plaintiffs deliver, 30 days before filing their derivative suit, a written demand to Cobb EMC setting forth the plaintiffs’ claims and the basis for these claims, the Maddox plaintiffs did not send a demand letter to any of the defendants at any point before filing their complaint. After Brown and Cobb Energy moved to dismiss the Maddox lawsuit based on, among other

things, the plaintiffs' failure to deliver the necessary demand, the Maddox plaintiffs unilaterally dismissed their case.

Two days after the Maddox lawsuit was initially filed, Plaintiffs from this lawsuit sent a demand letter, attached to the Motion to Stay as Exhibit 2, under O.C.G.A. § 46-3-272(a) to the Cobb EMC Board, demanding that the Board institute legal proceedings encompassing many of the claims ultimately pled in Plaintiffs' derivative action and the Maddox lawsuit. On October 22, 2007, Plaintiffs filed this lawsuit "on behalf of Cobb EMC against certain of its officers and directors seeking to remedy Defendants' violations of state law, including breaches of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets, unjust enrichment, money had and received and violations of Georgia Electric Membership Corporation Act." (Compl. at ¶ 1.) Plaintiffs also seek damages and other relief against Cobb Energy and certain of its officers and directors. (*Id.*)

In their Complaint, Plaintiffs allege that the acts and omissions at issue occurred between 1994 and the present. (*Id.*) While, at first glance, Plaintiffs appear to allege a multitude of wrongs, the crux of most of their claims is that Cobb EMC did not have the authority to create Cobb Energy. (*See id.* at ¶¶ 25-56.) Cobb EMC created Cobb Energy in 1997. (*See id.* at ¶ 30.)

As derivative cases, this lawsuit and the Maddox suit seek to recover from third parties on behalf of the corporation, Cobb EMC. Because Cobb EMC is the ultimate beneficiary of any recovery that might be had against third parties, the law allows Cobb EMC to decide first whether it will take on the claims.¹ Toward that end, on October 18, 2007, several days before Plaintiffs filed this suit, Cobb EMC's Board created the Committee for the express purpose of independently investigating and evaluating the claims set forth in this lawsuit and the Maddox lawsuit. (*See* Ex. 1, Resolutions of Cobb EMC Board.)

The Special Committee is composed of disinterested and independent directors of Cobb EMC. (*Id.*) Its members are former Department of Transportation Board Member Johnny Gresham, Vice President of Lummus Supply Company's Wholesale Division Don Barnett, and Al Forney, Jr., owner of Fortney Sales in Kennesaw. Gresham, Barnett and Forney are each recent additions to the Board of Cobb EMC, having been elected in 2006, 1999, and 1999 respectively. As required by the Cobb EMC bylaws, each are residents of Cobb County and are themselves members of Cobb EMC.

The Committee has been charged by the Board with the responsibility of independently reviewing and investigating all of the allegations in the two lawsuits

¹ *See, e.g., Thompson v. Scientific Atlanta, Inc.*, 275 Ga. App. 680, 621 S.E.2d 796 (2005). *See infra* pp. 12-15 for additional authorities.

against Cobb EMC, for the purpose of reporting its findings and making recommendations to all of the disinterested members of the Board on the appropriate response to the allegations. (*Id.*) The Committee has the authority to engage the resources it needs to perform its investigation, and the Board has directed Cobb EMC officials and counsel to cooperate fully with the Board. (*Id.*) Understanding the need for the Committee to have the time to make a thorough investigation, the Board did not set a deadline for the completion of the Committee's tasks.

To date, Plaintiffs have, upon information and belief, served most, if not all, of the Defendants in this lawsuit. If a stay is not put in place, the following officers and directors of Cobb EMC, who have been individually named as Defendants in this lawsuit, will be required to answer Plaintiffs' Complaint:

- Don Barnett (Vice President, Wholesale Division of Lummus Supply Company, Atlanta)
- David McGinnis (President and CEO of Security Exchange Bank, Marietta)
- Kay Anderson (Director of Cobb County Department of Family and Children Services ("DFCS"); Regional Director of DFCS for Cherokee, Cobb and Douglas Counties)
- Al Fortney, Jr. (owner of Fortney Sales, Kennesaw)
- Frank Boone (owner and President of North Cobb Animal Clinic, Kennesaw)

- Sarah Brown (retired)
- Larry Chadwick (retired)
- Henry Balkcom III (engineer with American Buildings Company, Quitman County)
- Dwight Brown (CEO of Cobb EMC and Cobb Energy)

Despite the fact that Plaintiffs just filed their lawsuit and none of the Defendants have yet answered, on October 26, 2007, Plaintiffs sent to Cobb EMC a notice of Rule 30(b)(6) deposition to occur on November 30, 2007. (*See* Ex. 3.) The notice requested that Cobb EMC provide representatives to speak to 32 different topics, which cover roughly all of the allegations in Plaintiffs' Complaint.

(*Id.*) These topics include, among other things:

- The circumstances surrounding the creation of Cobb Energy
- The ownership history and structure of Cobb Energy
- The facts, circumstances and professional opinions related to a 40-year operating agreement between Cobb EMC and Cobb Energy
- The names and present whereabouts of officers and directors of Cobb EMC and Cobb Energy
- Payments and benefits to officers and directors of Cobb Energy and Cobb EMC
- The consideration paid by each individual or entity having an ownership interest in Cobb Energy since its inception date to present

- All loans to Cobb Energy from its inception to present
- All loans made by Cobb EMC and Cobb Energy to the officers and directors of these two entities
- The amount and description of all charges by Cobb Energy to Cobb EMC for goods or services since the inception date of the operating agreement between the two

(Id.) The notice also purports to require Cobb EMC to produce, on the day of the deposition, 30 different broad, unduly burdensome categories of documents. *(Id.)* Roughly mirroring the deposition topics, these categories of documents include, among other things, documents that “state or evidence”:

- The complete ownership history and structure of Cobb Energy from its inception to present
- All professional opinions, including attorney opinions, addressing the legality and propriety of the operating agreement between Cobb Energy and Cobb EMC
- Payments and benefits to officers and directors of Cobb Energy and Cobb EMC
- The consideration paid by each individual or entity having an ownership interest in Cobb Energy since its inception date to present
- All loans to Cobb Energy from its inception to present
- All loans made by Cobb EMC and Cobb Energy to the officers and directors of these two entities

- The amount and description of all charges by Cobb Energy to Cobb EMC for goods or services since the inception date of the operating agreement between the two
- All of the outstanding shares of Cobb Energy stock from its inception to present

(*Id.*)

III. ARGUMENT AND CITATION TO AUTHORITY

A. UNDER BOTH GEORGIA CASE LAW AND THE REASONING BEHIND THE DEMAND REQUIREMENT FROM GEORGIA'S EMC ACT, THE COURT HAS THE AUTHORITY TO STAY PLAINTIFFS' LAWSUIT.

Under Georgia case law, the Court has broad inherent power to stay the lawsuit to control the disposition of the case with economy of time and effort for itself, counsel and the parties. *See Bloomfield v. Liggett & Myers, Inc.*, 230 Ga. 484, 484, 198 S.E.2d 144, 145 (1973); *Commercial Union Ins. Co. v. Hoover Treated Wood Prod.*, 202 Ga. App. 35, 36, 413 S.E.2d 217, 219 (1991); *Fludd v. Tiller*, 184 Ga. App. 93, 93, 360 S.E.2d 647, 647 (1987).

Cobb EMC is governed by the Georgia Electric Membership Corporation Act (the "EMC Act"), O.C.G.A. §§ 46-3-170 - 46-3-541. As discussed below, the EMC Act contains a demand requirement to allow a defendant EMC to evaluate derivative claims made by the EMC's members to determine if a lawsuit is in the EMC's best interests. *See* O.C.G.A. §§ 46-3-272(a). In addition to the authority granted to the Court under relevant case law, the reasoning behind this demand requirement also specifically allows the Court to stay Plaintiffs' derivative lawsuit

while the Committee, formed by Cobb EMC's Board, investigates the allegations made in the Complaint. If an EMC did not have the ability and time to investigate the claims made in a derivative suit (and did not have a mechanism to create time for that investigation through staying the suit), the demand requirement would be superfluous.²

B. BECAUSE COBB EMC WOULD BE THE ULTIMATE BENEFICIARY OF ANY RECOVERY BY PLAINTIFFS, THE LAW ALLOWS COBB EMC'S BOARD TO DETERMINE, THROUGH A SPECIAL LITIGATION COMMITTEE, IF A LAWSUIT WOULD BE IN THE EMC'S BEST INTERESTS.

Because they have brought a derivative suit, Plaintiffs are asserting claims on behalf of Cobb EMC. (*See* Compl. at ¶ 1.) This is shown by the "Derivative Actions by members" section of the EMC Act, which provides:

A derivative action may be brought by a member in the right of the electric membership corporation to procure a judgment in its favor against directors, officers, or other representatives of the electric membership corporation or members or third parties, or any combination thereof, whenever the electric membership corporation has a claim or cause of action which the representatives of the electric membership corporation, in violation of their duties, have failed to enforce, including a claim or cause of action against such representatives for their failure in this respect.

² For similar reasons, the Georgia Nonprofit Corporation Code (the "Nonprofit Code") provides: "If the corporation commences an inquiry into the allegations made in the demand or complaint, the court may stay any derivative proceeding for such period as the court deems appropriate." O.C.G.A. § 14-3-743. The Georgia Business Corporation Code and the Model Business Corporation Act both contain an identical provision. *See* O.C.G.A. § 14-2-743; Model Act § 7.43.

O.C.G.A. § 46-3-272(a) (emphasis added). Similarly, the Georgia Court of Appeals has explained:

In a nonprofit derivative suit, a member asserts for the corporation's benefit rights or remedies belonging to the corporation, not to the member. See 12B Fletcher, *Cyclopedia of the Law of Private Corporations*, § 5908 (rev. ed. 1995). The wrong which the action seeks to redress is one which the corporation, not the individual, has sustained. *Id.* The member is a mere nominal party, having no right, title or interest in the claim itself. *Id.*

Dunn v. Ceccarelli, 227 Ga. App. 505, 507, 489 S.E.2d 563, 566 (1997).

To enable Cobb EMC to determine if pursuing Plaintiffs' claims is in the best interest of the corporation, the EMC Act required that Plaintiffs deliver, 30 days before filing their derivative suit, a written demand to Cobb EMC setting forth Plaintiffs' claims and the basis for these claims. See O.C.G.A. § 46-3-272(a). In a derivative action, the demand requirement is an important feature of corporate law and it is not a "mere formality." 19 Am. Jur. 2d *Corporations* § 1961 (2007).

The demand requirement serves at least two vital purposes:

[F]irst, it provides corporate managers with the opportunity to address a shareholder's claims, so that if the board determines that the allegations are meritorious, it may choose to remedy the situation internally or embrace the litigation; and second, if the managers disagree with the shareholder's concerns, the demand requirement provides the board with an opportunity to reject the demand and, if necessary, seek early dismissal of the suit.

Id.

To help a corporation's board evaluate the claims in a member demand, Georgia courts have both explicitly and implicitly recognized the authority for special litigation committees. *See Millsaps v. Am. Family Corp.*, 208 Ga. App. 230, 231-32, 430 S.E.2d 385, 387 (1993) (finding that special litigation committee had properly delegated authority, under Georgia law, to act for board); *Thompson v. Scientific Atlanta, Inc.*, 275 Ga. App. 680, 683-84, 621 S.E.2d 796, 798-99 (2005) (holding that trial court did not abuse its discretion in dismissing derivative action after special litigation committee found action not in corporation's best interests).

Based on Georgia case law and the Georgia Code, Cobb EMC may — depending on what the Committee decides — undertake the claims on its own or move to dismiss Plaintiffs' derivative action. If Cobb EMC decides to assume control of the litigation, Plaintiffs' right to control the proceeding ends unless it can be shown that Cobb EMC will not adequately pursue the matter. *See McKoon v. Jones*, 214 Ga. App. 40, 41, 447 S.E.2d 50, 51 (1994) (citing Comment 4 to O.C.G.A. § 14-2-742).³ If the Committee conducts a reasonable investigation into the allegations in Plaintiffs' Complaint and, in good faith, determines that it is not in the best interests of Cobb EMC for the litigation to proceed, Cobb EMC should

³ While a comment to the Code is not controlling authority, it may serve as persuasive authority. *McKoon*, 214 Ga. App. at 41, 447 S.E.2d at 51.

