SUPERIOR COURT OF THE STATE OF GEORGIA
COUNTY OF COBB

EDGAR "BO" POUNDS, individually and on behalf of the estate of Mary Jean Pounds, JOSEPH THOMPSON, FRANKLIN SMITH, EAGLE EYE FORENSICS, LLC, DIANNE BRACKIN, and WILLIAM SHARP, Derivatively On Behalf of COBB ELECTRIC MEMBERSHIP CORPORATION. **Plaintiffs,** **vs.** **DWIGHT BROWN, DON BARNETT, DAVID MCGINNIS, KAY ANDERSON, AL FORTNEY, JR., FRANK BOONE, SARAH BROWN, LARRY CHADWICK, HENRY BALKCOM III, COBB ENERGY MANAGEMENT CORPORATION and DOES 1-15, inclusive,** **Defendants,** **-and-** **COBB ELECTRIC MEMBERSHIP CORPORATION, a Georgia Corporation,** **Nominal Defendant.**	)	**Civil Action File No. 07-1-9408-48**

PLAINTIFFS' MEMORANDUM OF LAW IN
OPPOSITION TO DEFENDANT COBB EMC'S MOTION TO STAY

A shareholder derivative suit is a uniquely equitable remedy in which a shareholder asserts on behalf of a corporation a claim not belonging to the shareholder, but to the corporation. Levine v Smith *591 A.2d 194, 200 (Del. May 8, 1991).*

INTRODUCTION

In this derivative proceeding this Court will investigate on behalf of over 200,000 members of the Cobb Electric Membership Corporation one of the most shocking thefts of corporate assets in the history of the State of Georgia.

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The Court will be guided by at least the following universal rules of corporate governance throughout this entire matter:

1. *It is an actionable wrong for an officer or director to compete with her corporation or divert to personal use assets or opportunities belonging to her corporation;*

2. *The core of this fiduciary duty is the requirement that a director favor the corporation's interests over her own whenever those interests conflict. As with the duty of care, there is a duty of candor aspect to the duty of loyalty;*

3. *Corporate officers and directors bear a duty of loyalty to the corporations they serve. As Justice Cardozo explained the fiduciary duty in Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (1928):*

   > *A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.*

4. *A transaction constitutes a "waste of corporate assets" if it involves an expenditure of corporate funds or a disposition of corporate assets for which no consideration is received in exchange and for which there is no rational business purpose, or, if consideration is received in exchange, the consideration the corporation receives is so inadequate in value that no person of ordinary sound business judgment would deem it worth that which the corporation has paid;*

5. *If there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, is, from its nature, in the line of the corporation's business and is of practical advantage to it, is one in which the corporation has an interest or a reasonable expectancy, and, by embracing the opportunity, the self-interest of the officer or director will be brought into conflict with that of the corporation, the law will not permit him to seize the opportunity for himself; and*

6. *It is among the rudiments of the law that the same person cannot act for himself and at the same time, with respect to the same matter, as the agent of another whose interest are conflicting.*

O'Kelley and Thompson, Corporations and Other Business Association, §4 (5th ed. 2006).

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SUMMARY OF ARGUMENT

Defendants Motion for Stay should be denied for the following four core reasons.

1. The Georgia Electric Membership Corporation Act does not now, and has never, contained a stay provision. *There is not a single reported derivative case throughout the country involving an EMC where a stay has been issued.*

2. Even if a stay were available, the process Defendants' used to form their committee resulted in a committee that is completely interested and not independent, in violation of well-established law and "[f]ails to past muster under every standard." See, Affidavit of Professor Charles O'Kelley (Nov. 28, 2007)(Ex. 1 hereto).

3. Defendants failed to respond to Plaintiffs' demand within 30 days and thus, the Plaintiffs are entitled to proceed as a matter of law.

4. There is no justifiable reason for a stay. The stay is simply a delay tactic that will drag out this matter unnecessarily and prevent the Court and Plaintiffs from obtaining information necessary to reach a resolution of this matter.

BACKGROUND[1]

Cobb EMC is an income tax exempt electric distribution cooperative headquartered in Marietta, Georgia serving approximately 190,000 consumers in the Georgia counties of Cobb, Cherokee, Bartow, Fulton, Paulding, Randolph, Clay, Quitman and Calhoun. The EMC's principal customers are residential and commercial members of the cooperative. Formed in 1938, Cobb EMC started as an electric utility with 489 members and 14 commercial accounts. With approximately 200,000 members, Cobb EMC ranks among the largest EMCs in the nation. In 2006, Cobb EMC sold over 3.9 billion kilowatt hours of electricity. Cobb EMC's mission is

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[1] The factual issues here are taken from the Complaint, which are deemed true for purposes of this motion, or from documents which are specifically referenced.

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to provide its member/consumers with the best service *at the lowest possible price*. Aff. of former Flint Electric Cooperative CEO, Harold Smith (Nov. 14, 2007)(Ex. 2 hereto)("Smith Affidavit"); *Memorandum in Support of Motion to Dismiss*, Maddox et al. v. Brown, et al., Civil Action File No. 07-1-7977-48. It has no "shareholders." Instead, as a non-profit cooperative, Cobb EMC is a member-owned organization. Each consumer who receives electric service from Cobb EMC is a member. Cobb EMC is governed by a board of ten directors, who are supposed to be elected from and by the membership at meetings held annually. O.C.G.A. §46-3-170 et seq.

Pursuant to the Cobb EMC Articles of Incorporation, Section II (May 20, 1937), the EMC was formed to engage in rural electrification by any one or more of the following methods:

> (1) furnishing of electric energy to persons in rural areas who are not receiving electric services from any corporation subject to the jurisdiction of the Georgia Public Services Commission, or from any municipal corporation;
> (2) assisting in wiring of the premises of its members or in the installation therein, or the acquisition or supplying, of electrical or plumbing equipment; and
> (3) furnishing of electric energy, wiring facilities, electrical or plumbing equipment or services to any member corporation organized under the Electric Membership Corporation Act.

Cobb EMC, as an electric membership corporation, is statutorily governed by the Georgia Electric Membership Corporation Act, O.C.G.A. § 46-3-170 et seq. The statutory authorization for Cobb EMC, O.C.G.A. §46-3-200, *strictly limits* the non-profit purposes for which an EMC may serve to the following:

> An electric membership corporation may serve any one or more of the following purposes:
> (4) To furnish electrical energy and services;
> (5) To assist its members in the efficient and economical use of energy;
> (6) To engage in research and to promote and develop energy conservation and sources and methods of conserving, producing, converting, and developing energy; and

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> (7) To engage in any lawful act or activity necessary or convenient to effect the foregoing purposes.

Additionally, O.C.G.A. §46-3-340(a) expressly provides that "Each electric membership corporation shall be operated **without profit to its members**." (emphasis added). As a result of its non-profit status and Internal Revenue Code § 501(c)(12), Cobb EMC is not subject to standard taxation. Consequently, and also pursuant to the cited limitations above of O.C.G.A. §46-3-200 and §46-3-340, an EMC may not directly or indirectly operate a for-profit company.

Indeed, every state Supreme Court that has analyzed this precise issue of whether a non-profit electric cooperative can own and operate a for-profit subsidiary has unanimously ruled against the EMCs. More specifically, in Flint Elec. Mem. Corp. v. Barrow, 271 Ga. 636-38 (1999) the Supreme Court of Georgia ruled:

> [N]othing in the Georgia Electric Membership Corporation Act, § 46-3-170 et seq., authorizes an EMC to furnish or sell another form of energy. **In fact, § 46-3-201 makes it clear that, while an EMC is empowered to assist its members in the efficient and economical use of energy, § 46-3-201(b)(8), it can only furnish or sell electricity…More importantly, Flint Energy was incorporated by Flint [EMC] just to enable Flint [EMC] to do indirectly what it could not do directly….Flint [EMC] created Flint Energy as a shell solely for its own convenience and benefit.**

(emphasis added).

Likewise, in Lewis v. Jackson Energy Coop. Corp., 189 S.W.3d 87 (Ky. 2005), the Supreme Court of Kentucky explained:

> The principal issue in this utility case is whether Jackson Energy, a rural electric cooperative, is in violation of *KRS Chapter 279* [Kentucky Electric Cooperative Act] for providing propane gas and other non-electric services to its members and customers… It was plain error for both the circuit court and the Court of Appeals to construe *KRS 279.020* as permitting rural electric cooperatives to engage in non-electric ventures. If the rationale of the circuit court were followed to its logical conclusion, it would in effect destroy the distinction between a special purpose electrical cooperative and a general purpose corporation…**what the utility is forbidden to do**

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directly, it may not accomplish by indirection by way of resort to any device or subterfuge leading to the same result.

Similarly, in Hilco Elec. Coop. et al. v. Midlothian Butane Gas Co., Inc., 111 S.W.3d 75 (Tex. 2003), the Supreme Court of Texas concluded:

> We hold that the HILCO companies failed to establish conclusively that the creation and ownership of a for-profit propane business furthered a proper purpose for a cooperative created under the ECCA [Electric Cooperative Corporation Act]... The powers of electric cooperatives are solely derived from, and therefore measured by, the Act which created them.

Every state Supreme Court in the country that has addressed this issue has ruled that an EMC may not through an affiliated corporate entity engage in for-profit general business activities.[2] The Cobb Energy/Cobb EMC scheme violates this well-established Georgia Supreme Court law of Flint and creates serious conflicts of interest. Harold Smith Aff. ¶ 7, 9. Violation of this well-established principle of law and EMC governance also constitutes gross mismanagement of the company, self dealing, waste of assets and usurpation of corporate opportunity.

While Defendants steadfastly refuse to provide any information as to Cobb Energy, the information below is known from a review of the non-redacted board minutes of Cobb EMC. In an attempt to circumvent the strict limitations that the EMC operate solely as a non-profit, Defendant Dwight Brown, Defendant McGinnis, Defendant Boone and others caused the formation of Cobb Energy Management Corporation (hereinafter "Cobb Energy" or "CEMC"), a for-profit corporation, and appointed Defendants Dwight Brown, David McGinnis and Frank Boone, all officers or directors of Cobb EMC, as the sole directors of Cobb Energy. The

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[2] In 2002, the Georgia general assembly authorized one narrow exception to this strict limitation. In Georgia an EMC may now hold a permit through an affiliate to market natural gas. §46-4-153.1. This in no way affects the strict prohibition of an EMC engaging in non-electrical business activities provided by §46-3-200 and the Georgia Supreme Court's decision in Flint.

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remaining then in office Defendant EMC board members caused or acquiesced in the formation of Cobb Energy. Defendant Dwight Brown admits that the creation of Cobb Energy was "his brainchild" as stated at the Cobb EMC 2007 annual meeting. Cobb Energy was formed on or about September 3, 1997.

Defendant Dwight Brown also admits that Cobb Energy is an "affiliated" entity of Cobb EMC that "provides diversified, energy-related and non-energy related products and services."[3] In fact, at the time of formation, Cobb Energy was 100% owned by Cobb EMC. Cobb EMC Auditor's Report (1998)("Cobb Energy Management Corporation (CEMC) was organized during the year and began operation January 1, 1998, as a wholly owned subsidiary of Cobb EMC.").

At approximately the same time Cobb Energy was formed, Defendant Dwight Brown, Defendant McGinnis, Defendant Boone and the remaining then in office board members caused the EMC, by vote, acquiescence or otherwise, to transfer all of its employees, the majority of its business activities and substantially all of its revenue (totaling hundreds of millions of dollars as reflected, in part, by the EMC's 2006 annual report) to Cobb Energy. Since such time, these same directors and officers have caused by vote, acquiescence or otherwise the continuation of this unlawful transfer. Defendant Brown admits to these transactions and transfers. "Cobb Energy has an operating agreement with Cobb EMC to provide labor for most of Cobb EMC's functions." See, footnote 3, Brown Memo at pp. 2-3. Furthermore, the 2006 Cobb EMC Annual Report provides the following details in final footnote 19 for just two of the forty years:

> Cobb EMC employees became CEMC employees to furnish **all services** for Cobb [EMC] including marketing, meter reading and meter maintenance services. The charges for these services were approximately **58 million in 2006 and 48 million in 2005**.

[3] See, *Dwight T. Brown's Memorandum of Law in Support of Motion to Dismiss*, filed in Maddox et al. v. Cobb Electric Membership Corp. et al., Civil Action File No. 07-1-7977-48, Superior Court of Cobb County, Georgia (Oct. 11, 2007)("Brown Memo").

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(emphasis added). Astonishingly, not only is this contract and these transfers set to continue for a period of forty years, the contract charges the EMC and its members, a 6% premium for services that Defendants state *are the exact same services* that were provided when the employees performed the work as employees of the EMC. "Employees will be performing the same function for CEMC as they have done for Cobb EMC." Cobb EMC Board Minutes (Dec. 1997). The difference is that now, it costs the EMC 6% more for the exact same services, thus making the EMC the golden cash cow for Cobb Energy and its owners. At best, this 6% self-dealing arrangement is completely contrary to the EMC concept, applicable accounting principles and applicable law. Affidavit Kenneth Neil (Nov. 29, 2007)(Ex. 3 hereto); Harold Smith Aff. ¶¶ 7-8; O'Kelley Aff. ¶ 8-11.

Not only do these transaction violate the EMC bylaws and articles of incorporation, they are illegal under O.C.G.A. § 46-3-170 et seq. and IRC § 501(c)(12). The EMC cannot circumvent the strict limitations to operate solely as a non-profit under Georgia law, IRC code § 501(c)(12), its bylaws and articles of incorporation by creating an "affiliated entity," by transferring and converting substantially all of the EMC's non-profit business to the newly-created for-profit affiliate and generating hundreds of millions of dollars in revenue under the for-profit entity during the Relevant Period. As discussed above on pages 5 and 6, every state Supreme Court that has addressed this specific issue has ruled that an EMC may not engage in business activities not specifically authorized by the applicable electric cooperative act.

Shockingly, Defendant Dwight Brown stubbornly continues to refuse to disclose the identification of the owners of Cobb Energy stock, or their ownership interest, including his own, and continues to refuse to provide any other details as to the financial and business affairs of that corporation, even to Cobb EMC members who own the EMC. In addition to the fact that Cobb

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Energy was 100% owned by Cobb EMC during its early period, it is known that on or about February 4, 2004, Defendants Dwight Brown, Frank Boone, David McGinnis (all board members of Cobb EMC and Cobb Energy), along with the other board members of Cobb Energy, caused $7,000,000 worth of Cobb Energy preferred stock to be transferred to themselves, Defendant Dwight Brown's wife Mary Ellen Brown and a few others, pursuant to Form D private placement filing with the Securities and Exchange Commission. To accomplish this, these Defendants engaged the Houston, Texas law firm of Vinson & Elkins, LLP, former counsel to the Enron Energy Corporation. (Ex. 4 hereto).

Consequently, these Defendants, and certain of their family members have the ability to cash out and sell these shares, assets that are rightfully the EMC's. Some have admittedly already done so. "Cobb EMC further states that no Cobb EMC board members own stock of Cobb Energy *at this time*." Cobb EMC Answer, Maddox et al. v. Brown et al., Civil Action File No. 07-1-7977-48 (Oct. 24, 2007)(emphasis added).

As shown by the 2004 Regulation D filing, Defendants Dwight Brown, McGinnis and Boone transferred so much stock to themselves and Defendant Brown's wife, that all of them became beneficial owners of Cobb Energy corporation (exceeding 10% of the outstanding shares of Cobb Energy), which ownership interests are dramatically impacted in a positive direction by the previously discussed transfer of all Cobb EMC employees, the majority of Cobb EMC business and substantially all Cobb EMC revenue to Cobb Energy. In causing these latter transfers for forty years, the value of Cobb Energy as a corporate entity was dramatically enhanced by tens of millions of dollars. As a direct result therefrom, the value of the shares Defendants Dwight Brown, Frank Boone and David McGinnis gave themselves, and certain of their family members, were commensurately enhanced.

According to tax returns filed with the Internal Revenue Service, Defendant Dwight Brown and the Director Defendants, some of whom may be named thus far in this action as John Doe Defendants, have by vote, acquiescence or otherwise caused loans of approximately $1,500,000 to be made to “officers and directors.” These loans are nowhere disclosed in the financial documents provided to the EMC members.

Defendant Dwight Brown also admitted at the 2007 EMC annual meeting that the EMC’s auditors are “concerned” about the appropriateness and legality of the Cobb EMC/Cobb Energy scheme.

In addition to directly and indirectly causing or allowing the EMC to transfer and convert the majority of its business to Cobb Energy for the next forty years, Defendant Brown and the then in office board members, some of whom may be John Doe Defendants herein, by vote, acquiescence or otherwise caused the EMC to inappropriately transfer and/or continue the loan of assets to Cobb Energy, including $5,000,000 worth of Cobb EMC property and a $5,000,000 *interest free* loan. The $5,000,000 interest free loan, at a minimum, violates Defendants’ fiduciary duties to serve the best interests of the EMC and protect and preserve its assets. These loans and transfers are grossly in violation of the EMC Act. Defendant Dwight Brown publicly acknowledged these transfers totaling $10,000,000 at the 2007 Annual meeting on September 6, 2007.

On September 6, 2007 at the EMC annual meeting, Defendant Brown also admitted that Cobb Energy entered into a contract to pay $20,000,000.00 for the naming rights for a new performing arts center. On information and belief, the present value of that amount, or approximately $13,000,000.00, was funded in advance.

According to tax returns filed with the Internal Revenue Service on March 8, 2001, and Defendant Cobb EMC's *Answer* in Civil Action File No. 07-1-7977-48, Cobb EMC purchased property that was later sold to Cobb Energy for approximately $6.9 million. On information and belief, through these transactions Cobb EMC built an office for Cobb Energy subsidiary ProCore Solutions and Cobb EMC then loaned the money to Cobb Energy to purchase the property from the EMC.

These multiple and serious particularized examples of self-dealing constitute violations of, among other things, the officers' and directors' fiduciaries duties of loyalty, good faith, honesty, care, obedience. Harold Smith Aff. ¶¶ 7,8,9,11; O'Kelley Aff. ¶¶ 10-13,18.

ARGUMENT AND CITATION TO AUTHORITY

Defendants Motion for Stay should be denied for the following four primary reasons discussed below.

1. The Georgia Electric Membership Corporation Act Has Never, and Does Not Now, Contain a Stay Provision.

The Georgia Electric Membership Corporation Act, O.C.G.A. §46-3-170 et seq. ("EMC Act") solely governs Cobb EMC rather than the Georgia Business Corporation Code, O.C.G.A. §14-2-101 et seq. or the Georgia Non-Profit Corporation Code, O.C.G.A. §14-3-101 et seq. The EMC Act contains detailed provisions controlling derivative proceedings for an electric membership corporation. There is absolutely no provision in the EMC Act derivative provisions providing for a stay and thus, a stay of a derivative proceeding involving an EMC is not authorized. O'Kelley Aff. ¶ 15.

Indeed, NO REPORTED EMC DERIVATIVE CASE IN THE UNITED STATES HAS EVER BEEN STAYED.

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All of the authorities relied upon by Defendants in support of their motion to stay address the stay provisions of the general corporation code or the non-profit code, and are completely inapplicable to this case. Indeed, at the same time Defendants direct the Court to the general corporate code and the non-profit business code, **they elsewhere expressly agree and admit that these specific codes do not apply in this case and that the EMC Act solely governs this action**. Dwight Brown and Cobb Energy admit this in their *Memorandum in Support of Motion to Dismiss* and *Answer* filed in the now dismissed action Maddox et al. v. Brown, et al., Civil Action File No. 07-1-7977-48, respectively. Specifically, in Defendant Brown's *Memorandum of Law in Support of its Motion to Dismiss*, in the section titled "Plaintiffs Overlook the Relevant Statutory Law" Brown correctly admits:

> Plaintiffs' Complaint erroneously assumes that Cobb EMC is a generic corporation. Georgia statutes respecting corporations, generally, do not provide the relevant body of statutory law governing these Defendants. The relevant statutory law is found in Title 46 and contains a list of statutes governing electric membership corporations, specifically. For instance, O.C.G.A. §46-3-303.1 provides standards of care and conduct for the discharge of duties by directors and officers.

Dwight Brown's Memorandum of Law in Support of Motion to Dismiss (Oct. 11, 2007)(Civil Action File No. 07-1-7977-48) at pg. 17.

Additionally, as a matter of statutory construction, where a specific statute addressing a subject matter (here, the EMC Act), and another statute addressing a more general act (here, the Georgia Business Corporation Code), the specific trumps the general. Dixon v. State, 278 Ga. 4 (2004); Goldberg v. State, 2007 Lexis 577 (2007); O'Kelley Aff. ¶ 15; Alexander Properties Group, Inc. v. Doe et al., 280 Ga. 306 (2006).

The fact that the EMC Act derivative code sections do not include a stay provision, like those found in the general business code and non-profit code, is critical. Individual members of

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Cobb EMC are captive members of a monopoly that cannot choose their electricity provider or sell their shares and invest elsewhere upon learning of massive corporate wrongdoing, as would be the case with a garden variety for-profit corporation. Smith Aff. ¶ 9. Thus, much more restrictive statutory provisions are applicable to electric cooperatives than generic for-profit corporations. *A stay based on the appointment of a special committee is simply not a procedural mechanism available* to Defendant Cobb EMC under the precise statutes governing it.

To suggest that the EMC Act authorizes a stay or that the general business code and nonprofit code should apply is flatly wrong.

2. The Process Used to Form The Special Committee Has Resulted In A Committee that "Fails to Pass Muster Under Every Standard."

In the event the Court were to even consider the Defendants' position that the appointment of an independent committee entitles the Defendants to a stay, the procedure in forming the committee here, and the membership of this committee, is totally flawed.

One of the leading Delaware cases addressing the appointment of a special committee pursuant to the Delaware statue for general corporate law is Zapata Corp. v. Maldonado, 430 A.2d. 779 (1981).[4] Of course, no such statute exists for EMCs or is involved here. In addressing the bona fides of a special committee the Court indicated:

> The court should inquire into the independence and good faith of the committee … the corporation should have the burden of proving independence, good faith and a reasonable investigation, rather than presuming independence, good faith and reasonableness. If the court determines either that the committee is not independent or has not shown reasonable basis for its conclusions, or is the court is not satisfied for other reasons relating to the process, including but not limited to the good faith of the committee, the court shall deny the corporation's motion.

[4] Where Georgia law is sparse or silent on corporate law issues Georgia Courts routinely look to Delaware law. Grace Bros. v. Farley Indus., 264 Ga. 817, 819 (1994); Millsap v. American Family Corp., 208 Ga. App. 230, 234 (1993); Phoenix Airline Services, Inc. v. Metro Airlines, Inc., 260 Ga. 584 (1990).

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More specifically, in the seminal case of Biondi v. Scrushy, 820 A.2d 1148, 1150 (Del. Cha. 2003) the Delaware Chancery court held, in a case with circumstances remarkably near exact to the relevant circumstances here:

> Nor do I believe that these actions should be stayed to give the SLC time to finish its investigation. Although the sensible general rule is that such a stay should ordinarily issue, these cases present a very unusual situation. Here, the undisputed facts make it clear that this court will never be able to defer to a decision by the HealthSouth SLC [Special Litigation Committee] to terminate these actions. When combined with certain other circumstances, the SLC's strange conduct and troubling composition are -- as described herein -- too confidence-undermining for the SLC to meet the independence requirement of the Zapata standard. Therefore, it is evident that a stay would serve no rational purpose and should be denied…. It would be futile and wasteful to issue a stay when the undisputed facts will make it impossible for the court later to accept a decision of the special litigation committee to terminate the derivative litigation because the committee will not be able to satisfy its burden under *Zapata* to show that it exercised an independent business judgment.

The Scrushy Court went on to explain in more detail:

> One of the obvious purposes for forming a special litigation committee is to promote confidence in the integrity of corporate decision making by vesting the company's power to respond to accusations of serious misconduct by high officials in an impartial group of independent directors. By forming a committee whose fairness and objectivity cannot be reasonably questioned, giving them the resources to retain advisors, and granting them the freedom to do a thorough investigation and to pursue claims against wrongdoers, the company can assuage concern among its stockholders and retain, through the SLC, control over any claims belonging to the company itself. Critical to the accomplishment of these objectives, however, is the proper composition and empowerment of the committee. If a special litigation committee is comprised of directors with compromising ties to the key officials who are suspected of malfeasance, if the committee is not fully empowered to act for the company without approval by the full board, or if the committee behaves in a manner inconsistent with the duty to carefully and open-mindedly investigate the alleged wrongdoing, its ability to instill confidence is, at best, compromised and, at worst, inutile.

Id. at 1155-56.

It is important to point out that in reaching the conclusion that a stay was completely inappropriate, the Scrushy court analyzed a pattern of facts that are virtually identical to the situation here:

> Regrettably, the HealthSouth SLC's early days involved several confidence-shaking events. They begin with the composition of the SLC itself. When first formed, the SLC was to be comprised of an **existing** HealthSouth director, Larry D. Striplin, Jr., and a **newly appointed director**, Jon Hanson. Of course, one of the key reasons for the formation of a special litigation committee is to insulate the company's decision making process from the influence of those under suspicion. In this matter, Scrushy is the key target of all the lawsuits alleging improper trading in advance of the company's disclosure of the impact of the Group Rate Policy.

(emphasis added). Even more so than in Scrushy, here, the SLC consists of *three* "existing" directors. Two of these directors, directors Barnett and Fortney, have been on the board since 1999, are accused of wronging in the Complaint and are now charged with investigation themselves by virtue of their appointment on the SLC. The third director is Johnny Gresham. Just as in Scrushy, he is a "newly appointed director," having been appointed in 2006.

Next, the Scrushy court indicates:

> Just six days later, HealthSouth put out a press release, which quotes company director and Scrushy's new successor as CEO, William Owens, to the following effect: "I want to make it clear that Richard M. Scrushy had absolutely no knowledge about any change in Medicare reimbursement rules until August 6, 2002, and none of us had any knowledge whatsoever that a possible rule change would have a material, financial impact on our company until August 15, 2002." This statement was rather unusual, coming from the CEO of a company that had just chosen to form the SLC to investigate, among other things, the very question of whether Scrushy and other HealthSouth insiders had traded improperly while recognizing the adverse effect the Group Rate Policy would have on the company.

Exactly like the press releases issued by HealthSouth that were found to conclusively demonstrate the inadequacy of the formation and composition of the SLC in that case, here, on October 19, 2007, *the very next day after the formation of the Cobb EMC SLC*, Defendant

Dwight Brown caused the EMC to send a letter to all EMC members in which, among other things, he stated the EMC wanted to "set the record straight." In this same letter he divulged the EMC's true intentions to *never seriously investigate or prosecute* the Plaintiffs' demand:

> **I am confident the claims will be found baseless… I say to you the <u>defense</u> of this legal action will honor the history of prudence, integrity and resolve that has always been represented in the governance of your cooperative.**

That wasn't the end of it. Far more outrageous than in <u>Scrushy</u>, here, the EMC Board Chairman, Larry Chadwick and the rest of the EMC directors and management (which unquestionably includes the director SLC members) then unashamedly undertook *an entire press campaign* that included numerous full-page ads in the Marietta Daily Journal beginning on October 26, 2007. The ads were issued solely to continue the attempt to vindicate the EMC and the individual Defendants, and claimed the allegations in the lawsuit were false and "gross distortions." On November 5, 2007, the EMC Management issued the next of its full-page ads again revealing the EMC's true intentions, "**We intend to vigorously defend the relationship between Cobb EMC and Cobb Energy.**"

The numerous additional full-page ads that followed were similarly issued denying wrongdoing and in defense of the EMC. Ex. 5 hereto. All of these ads were issued and signed on behalf of the entire Management of the EMC, which fully includes the SLC directors.

One such press release alone, as the <u>Scrushy</u> court exhaustively points out, requires denial of a stay:

> **Because there is one fact alone that would warrant denying a stay** and that, in combination with these other factors, makes the denial of a stay an easy call: the public announcement by the SLC's Chairman, director May, of his opinion that the Fulbright & Jaworksi report vindicated Scrushy. This extraordinary announcement came at a time when the SLC's own investigation was just getting underway…

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> Zapata presents an opportunity for a board that cannot act impartially as a whole to vest control of derivative litigation in a trustworthy committee of the board -- i.e., one that is not compromised in its ability to act impartially. The composition and conduct of a special litigation committee therefore must be such as to instill confidence in the judiciary and, as important, the stockholders of the company that the committee can act with integrity and objectivity.
>
> How can the court and the company's stockholders reasonably repose confidence in an SLC whose Chairman has publicly and prematurely issued statements exculpating one of the key company insiders whose conduct is supposed to be impartially investigated by the SLC? **The answer is that they cannot.**

Scrushy**,** 820 A.2d at 1166 (emphasis added).

It is also critical that directors appointed to the special committee not be defendants in the derivative suit. Demott, Shareholder's Derivative Actions, § 5:23; See also, Mills v. Esmark, Inc. 544 F. Supp. 1275, 1983 (N.D. Ill. 1982). Here, two of the three directors appointed to the SLC are defendants directly accused of wrongdoing in this action. Lomas & Nettleton Financial Corp., 625 F.2d 49 (5th Cir. 1980), cert. denied, 450 U.S. 1029 (1981)(court rejected use of special litigation committee when the defendant dominated the board and chose its members stating "The court should not cajole itself into believing that the members of the Board of Directors elected by the dominant and accused majority stockholder, after accusations of wrongdoing have been made, were selected for membership on the Board to protect the interest of the minority stockholders and to assure a vigorous prosecution of effective litigation against the offending majority."); Miller v. Register & Tribune Syndicate, Inc., 336 N.W. 2d 709 (Iowa 1983); Alford v. Shaw, 72 N.C.App. 537 (1985).

Additionally, "[T]he committee's independence may be called into question if it serves only in an advisory capacity to the full board rather than being vested with plenary power to bind the full board by its determinations about derivative litigation." Demott, § 5.23, citing Swenson

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v. Thibaut, 39 N.C. App. 77 (1978). Here, "the resolution creating the SLC makes clear that the SLC has not been fully empowered to act for the board. Rather, the SLC is charged with making recommendations…" O'Kelley Aff. ¶ 18. Furthermore, just as is the case here, where a majority of the independent committee face personal liability the committee may not be deemed independent. *Kloha v. Duda*, 226 F. Supp. 2d 1342 (M.D. Fla. 2002).

The proverbial fox guarding the henhouse situation Defendant Cobb EMC intentionally attempts to create here in untenable under any standard. Put simply, the process used by the EMC to select the SLC, and the SLC structure itself, is fatal and "[f]ails to past muster under every standard..." O'Kelley Aff. (Nov. 28, 2007).

3. The EMC's Defense of the Individual Defendants and Special Litigation Committee Is Also Fatal.

The EMC filed the motion requesting an extension and protective order on behalf of *both the EMC and all individual Defendants*. No other firm has made a formal appearance on behalf of the EMC director defendants and the EMC's counsel of record, as recently as November 29, 2007, informed Plaintiffs' counsel that the individual directors were still not represented by counsel separate from the EMC's counsel.

It is axiomatic that when faced with derivative litigation, Cobb EMC cannot vigorously investigate and prosecute litigation against the individual Defendants while at the same time defend them (let alone represent the SLC charged with investigating them), just as it is clearly doing here with its press campaigns and directly through pleadings. A corporation in whose name a derivative action is brought may not seek to defend the action on behalf of the individual defendants, either by raising the defense that the defendants did not breach their duty to the corporation or by asserting other defenses that would defeat the corporate claim on the merits. H. Henn and J. Alexander, Laws of Corporations and Other Business Entities, §370 (3rd ed.

1983); Katub v. Optical Fashions, Inc., 158 F. Supp. 757 (S.D.N.Y. 1958); Meyers v. Smith, 190 Minn 157 (1933); Slutzker v. Rieber, 132 N.J. Eq. 412 (1942). The rationale underlying these cases has been that the corporation's real "interest is, and ought to be, having the truth of the charges determined and in recovering all funds of which it was deprived." Otis & Co. v. Pennsylvania Railroad Co., 57 F. Supp. 680 (E.D.Pa. 1944). This well-established principle is also highlighted by Professor O'Kelley.

> [U]nder corporate law norms, it is the SLC, acting for the corporation, that files a motion to stay. Thus, the fact that the Cobb EMC SLC did not act for the corporation in filing the motion to stay is a significant indication that the Cobb EMC board has not really empowered its SLC to carryout a meaningful role in evaluating the claims made in this case. Indeed, the record that I have reviewed does not indicate that the SLC has begun to function in any significant or appropriate way. For example, contrary to norms of corporate governance the SLC has acted to date without having separate counsel. In these circumstances, it is hard to view the SLC as anything other than an alter ego of the full board.

O'Kelley Aff. ¶ 18.

Because the actions taken by the EMC regarding the formation and composition of the EMC fail under every conceivable standard, it would be error to grant Defendants' motion to stay.

3. Defendants Failed to Respond to Plaintiffs' Demand Within the Required 30 Days.

The EMC Act provision on derivative proceedings also specifically shortens the 90-day time period for responding to a demand in the Georgia Business Corporation Code, O.C.G.A. §14-2-742, and the Georgia Nonprofit Corporation Code, §14-3-742, to 30 days. Defendants took no action in response to Plaintiffs' demand letter within the 30 day period as expressly required by O.C.G.A. §46-3-272. Additionally, although Defendant Cobb EMC appointed their so-called Special Litigation Committee, they acknowledge doing so only *several days after the*

expiration of the 30 day requirement through resolution on October 18, 2007. See, *Cobb EMC's Memorandum of Law in Support of Motion to Stay* (Nov. 9, 2007). Furthermore, as discussed in detail above, the appointment of the SLC and its composition are unlawful here and render it a nullity. Consequently, as of the date of this filing, no lawful response has been taken by the EMC to Plaintiffs' demand. Thus, Plaintiffs case is entitled to move forward. O.C.G.A. §46-3-272.

4. There is no justifiable reason for a stay.

There is absolutely no justifiable reason for a stay. If Defendants wish to conduct an investigation into these issues, even through their utterly flawed and interested committee, and then report to the Court the results of their investigation, absolutely nothing is stopping them from doing so. For certain, Plaintiffs moving forward with this matter and obtaining information to better inform the Court as to what has transpired will not prevent Defendants from carrying out any investigation they wish to undertake. In truth, the real reason Defendants' requested the stay is to prevent the Court from learning the truth and continue, what has to date been a largely successful scheme, to actively conceal and prevent the EMC members from learning about the massive theft that has occurred.

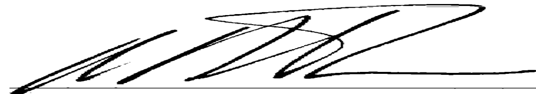
The minimal discovery and depositions that Plaintiffs will need at this point should certainly cost less to address than the continued highly-inappropriate actions, efforts and press campaigns that have been undertaken to continue to conceal the truth.

CONCLUSION

For all of the above reasons, Plaintiffs respectfully request this Court refrain from signing It's Honorable name to this massive scandal and deny Defendants' motion to stay. Because the statutory provision for a stay has been expressly eliminated, because the method of formation

and composition of the SLC is highly-inappropriate at best, because no action was timely taken in response to Plaintiffs' demand and because no justifiable reason for a stay exists, the stay should be denied.

Respectfully submitted this 29th day of November, 2007.



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CERTIFICATE OF SERVICE

This is to certify that I have this date served a copy of Plaintiffs' Memorandum of Law in Opposition to Defendants' Motion to Stay upon opposing counsel of record in this matter by hand delivery to:

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This 30th day of November, 2007.

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