MEMORANDUM

To: United Power and La Plata Association vs. Tri-State File
From: Linda D. Phillips, Esq., and Jason Wiener, Esq.
Re: Expert Consultant Opinion – Tri-State’s Purported Admission of Three Non-Utility Companies
Date: March 13, 2020

A. Facts and Background

We have been asked to review and analyze certain documents and information relating to certain actions of Tri-State Generation and Transmission Association, Inc., a Colorado Article 55 cooperative ("Tri-State") purporting to admit three non-utility, non-cooperative entities as members of Tri-State. We have received copies of the following documents that were reviewed as part of our analysis:

- Un-stamped Amended and Restated Articles of Incorporation, effective as of June 30, 2000 ("Articles").
- Amended and Restated Bylaws of Tri-State, with an April 3, 2019 date ("Bylaws"). While the first page of the Bylaws indicates the members adopted the Bylaws on April 3, 2019, there is no certification by a Tri-State officer to this effect.
- Membership Agreements between Tri-State and three Non-Utility Companies, MIECO, Inc., dated August 15, 2019 ("MIECO"),1 Ellgen Ranch Company, dated November 14, 2019 ("Ellgen"),2 and Olson’s Greenhouses of Colorado, LLC, dated November 14, 2019 ("Olson’s") (collectively "Non-Utility Companies").3
- Indemnity Agreement between Tri-State and Olson’s, dated October 1, 2019.4
- Deposition transcripts and a selection of discovery materials.

The MIECO, Ellgen and Olson’s Membership Agreements purport that Tri-State’s Board of Directors ("Board") established the "non-utility membership class" at a July 2019 meeting of the Board. In an executive session during a July 2019 Tri-State Board meeting, the Board considered potential new membership by Olson’s,5 Ellgen,6 and Thompson Farms, LLC

1 See TS-19-0146.
2 See TS-19-0151.
3 See TS-00170846-00170855.
4 See TS-00156426-00156427.
5 See TS-00081700-00081717.
6 See TS-00081728-00081736.
We understand that Tri-State did not consummate a membership agreement with Thompson.

Tri-State purports to admit MIECO to membership primarily to buy natural gas and obtain access to MIECO’s natural gas pipeline. Tri-State’s purpose to admit Ellgen is to lease it Tri-State owned land for ranching, even though Tri-State already had an existing relationship and lease with Ellgen as of the date of the purported membership agreement. Tri-State’s purpose to admit Olson’s as a member is to sell it thermal energy for its greenhouse operations, even though Tri-State already has an agreement with Olson’s to sell thermal energy and is now giving Olson’s a discount for that thermal energy. One of Tri-State’s 30(b)(6) witnesses, Brad Nebergall, confirms in deposition testimony that Tri-State’s significant, if not primary, purpose in admitting MIECO, Olson’s, and Ellgen was to lose Tri-State’s FERC exemption and default to FERC regulation, thereby seeking to exempting itself from Colorado PUC regulation. Tri-State’s Board Chairman, Mr. Rick Gordon, testified similarly. Tri-State's General Counsel, Kenneth Reif, testifying as a corporate designee, confirmed this.

B. Question Presented:

Is Tri-State’s purported admission of the three Non-Utility Companies, MIECO, Olson’s, and Ellgen, proper and lawful, pursuant to CRS Title 7, Article 55, Tri-State’s Articles, its Bylaws, and its membership agreements between Tri-State and the three Non-Utility Companies?

C. Summary of Conclusion:

Tri-State’s actions purporting to admit MIECO, Olson’s, and Ellgen are improper, and unlawful, and void because each was acted upon without authority under, and in contravention of, C.R.S. Title 7, Article 55, Tri-State’s Articles, and Bylaws.

D. Summary of applicable law:

1. **Colorado Revised Statutes, Title 7, Article 55.**

Tri-State is incorporated under Title 7, Article 55 of the Colorado Revised Statutes (“Article 55”). Article 55 was enacted in 1973 to replace many of the substantive provisions formerly contained in C.R.S 1963, Article 1 of Chapter 30. In part due to the adoption of the

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7 See TS-00081718-00081727.
8 TS-19-0146, at 1, RECITALS.
9 See supra FN 6, at 00081730-00081735; see also Tri-State’s Responses to LPEA’s Third Set of Discovery Requests, Interrogatory No. 3-3.
10 See supra FN 5, at 00081701-00081709; see also Tri-State’s Responses to LPEA’s Third Set of Discovery Requests, Interrogatory, No. 3-4.
13 Dep. of K. Reif, 72:24-73:3 (March 3, 2020) (“Question: And what is the benefit to Tri-State of making MIECO a nonutility member? Answer: Well, the primary benefit, from my perceptive, is that it allows Tri-State to become FERC jurisdictional.”).
Colorado Cooperative Act (C.R.S. Title 7, Article 56), and the more recent Colorado Uniform Limited Cooperative Association Act (C.R.S. Title 7, Article 58) most cooperative entities existing today are not formed under Article 55, and very few new cooperatives choose to incorporate under Article 55. There is very little case law in Colorado arising under Article 55. Most of the case law, norms and practices that have developed amongst Colorado cooperatives have done so under Articles 56 and 58 of C.R.S. Title 7.

Article 55 defines a “cooperative association” as “any cooperative organization, association, company, or corporation formed under this article and may be further defined as follows:

(a) The distribution of its earnings is made wholly or in part on the basis of, or in proportion to, the amount of property bought from or sold to members, or to members and other patrons, or of labor performed or other service rendered by the association, but such association shall not deal in products, handle supplies, or provide services for nonmembers in an amount greater in value than as are handled by it for members.
(b) Dividends on stock or interest on equity capital shall be limited, as prescribed in the bylaws of the association.
(c) Voting rights shall be limited to members of the association.
(d) Such association and its business shall not be carried on for profit but for the mutual benefit of all the members. Any person, firm, or corporation of any other cooperative association may become a member of such association upon meeting uniform terms and conditions stated in its bylaws. The association shall issue a certificate of membership to all who become members, which shall not be assignable or transferable except upon consent of the board of directors. The association shall have the right by the bylaws to limit transfer or assignment of membership and the terms and conditions upon which transfer shall be allowed.
(e) Any association formed pursuant to this article may admit to membership any other association so formed or formed under the law of any other jurisdiction upon such terms and conditions as may be provided by the bylaws. Any association formed under the provisions of this article may acquire membership in any other association likewise formed under the provisions of this article when, in the judgment of the directors, such membership shall promote the interest and purpose for which such association is formed.¹⁴ (emphasis added)

Cooperatives deal in a form of member capital called “patronage capital”, which generally includes the dollar amount of any fee to join the cooperative and the value of goods or services transacted between a member and the cooperative, either in a productive or consumptive capacity. A member “patronizes” the cooperative when the person or entity utilizes the services of the cooperative and the dollar value of the member patronizing the cooperative is called “patronage” or “member patronage”. Particularly relating to Tri-State as a cooperative electric

¹⁴ C.R.S. 7-55-101.
association, Article 55 defines “patronage capital” as “any capital credit, patronage dividend, or patronage refund allocated by a cooperative electric association...to a member or patron thereof.” Patent on capital is thus contributed to the cooperative by a member through the value of the electric service the member purchases. Under both Colorado statute and Federal regulations patronage capital must be calculated and defined consistently and uniformly among members. As this relates to Tri-State and its members, the cooperative must provide uniform policies on how patronage is calculated and how patronage dividends are allocated to all members and members of a particular class.

Similar to incorporated entities, Article 55 cooperatives are required to deliver to the Secretary of State for filing, pursuant to Part 3 of Article 90 (Title 7), articles of incorporation. Articles shall contain such information, including but not limited to: “the number of memberships authorized, the capital subscription of each, and the method of determining property rights and interests of each member without capital stock”. Likewise, Article 55 provides that cooperatives shall “adopt bylaws for the government and management of its affairs that are not inconsistent with this article” (emphasis added).

Article 55 contains many provisions recognizably similar to those contained in the Colorado Business Corporation Act (C.R.S. Title 7, Section 90), as well as other cooperative corporation laws. Among the relevant provisions of Article 55 is Section 113, which provides in part:

> every cooperative association...shall be conclusively presumed to have accepted and adopted the provisions of this article and shall be governed by the provisions of this article, unless such corporation or association or agricultural or livestock association has delivered to the secretary of state, for filing pursuant to part 3 of article 90 of this title, a copy of a resolution adopted by its board of directors, its members, or its stockholders stating that it has elected not to become subject to the provisions of this article (emphasis added)

Tri-State has not, as far as we can identify, delivered to the secretary of state any resolution stating that it has elected not to become subject to the provisions of Article 55.

Finally, Article 55 relies on C.R.S. Title 7, Articles 30-52, 101-117, and 121-137 of Title 7 to fill in the gaps when not inconsistent with an express provision of Article 55. Importantly, this Section evidences the legislature’s intent to govern Article 55 cooperatives like other incorporated entities.

15 C.R.S. 7-55-101.5.
16 C.R.S. 7-55-101(d); see also Rev. Rul. 72-36, 1972-1 C.B. 151.
17 C.R.S. 7-55-102.
18 C.R.S. 7-55-102(g). Note that for Article 55 cooperatives formed with capital stock, the Articles shall set forth “the authorized capital stock, the number of shares into which said stock is divided, and the par value of each” (C.R.S. 7-55-102(f)).
19 C.R.S. 7-55-103(1).
20 See, e.g., C.R.S. Title 7, Article 56.
21 C.R.S. 7-55-113.
22 C.R.S. 7-55-116.
2. **I.R.C. Title 26, Section 1381-1388 (Subchapter T).**

Tri-State appears to be taxed under Subchapter T of the Internal Revenue Code ("IRC"), which allows a company to utilize this section of the IRC if it is operating on a cooperative basis.\(^{23}\) As discussed above, Tri-State is governed by Article 55, Title 7 C.R.S. which defines operating on a cooperative basis, including allocation of patronage dividends to members.

Subchapter T of the IRC\(^{24}\) establishes a single-layer tax system for cooperatives. If the requirements of Subchapter T are met, a cooperative’s taxable income will not take into account amounts paid out to patrons before the 15th day of the ninth month following the close of the cooperative’s year end\(^{25}\) when the amounts are paid:

- As patronage dividends allocated to members;
- To redeem nonqualified notices of allocation;
- As per-unit retain allocations;\(^{26}\) or
- To redeem nonqualified per-unit retain certificates.\(^{27}\)

In essence, these payments will constitute a deduction in arriving at the cooperative’s taxable income, meaning there is no tax due at the cooperative level on the amounts paid out to patrons. If there is tax due at the cooperative level due to non-member generated income, that tax is generally calculated in the same manner as a corporation taxable under Subchapter C of the IRC.

Section 1388(a) of Subchapter T defines "patronage dividend" and includes the following relevant exclusion:

"Such term does not include any amount paid to a patron to the extent that (A) such amount is out of earnings other than from business done with or for patrons, or (B) such amount is out of earnings from business done with or for other patrons to whom no amounts are paid, or to whom smaller amounts are paid, with respect to substantially identical transactions." (emphasis added)

E. **Analysis:**

Tri-State’s actions purporting to admit three Non-Utility Companies are improper, and deficient, and void under Article 55, IRC Subchapter T, and Tri-State’s own Articles and Bylaws for the following reasons.

1. **Tri-State’s Bylaws, and the three Membership Agreements admitting three Non-Utility Companies, MIECO, Olson’s and Ellgen, violate non-waivable provisions of Article 55.**

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\(^{23}\) See Tri-State’s Responses to LPEA’s Third Set of Discovery Requests, Interrogatory No. 3-7.
\(^{24}\) 26 U.S.C. §§ 1381 through 1388.
\(^{25}\) 26 U.S.C. § 1382(d).
\(^{26}\) 26 U.S.C. § 1382(b).
\(^{27}\) 26 U.S.C. § 1382.
a. Tri-State is required by Article 55 to admit members who meet uniform terms and conditions of membership as set forth in its Bylaws. Uniformity is an elemental part of the definition of cooperative association; if the uniformity requirements are not met, the entity will not qualify as an Article 55 cooperative association. This provision of Article 55 is non-waivable.

Nevertheless, the recently amended Section 2 of Tri-State’s Bylaws states “Such rights and preferences and limitations on the rights and preferences may differ between membership classes and may be different for individual members within an additional class of membership.”

Relying on this amended bylaw, Tri-State entered into membership agreements with MIECO, Olson’s and Ellgen, which all improperly purport to have each non-utility member as specified in CRS Section 7-55-101(d).”

This attempted waiver is void. According to CRS § 7-102-106(2), “The bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or with the articles of incorporation.” “Because Colorado law and the bylaw amendment are inconsistent, the bylaw amendment is void.” Harding v. Heritage Health Products Co., 98 P.3d 945, 948 (2004).

CRS Section 7-55-101 provides the statutory definition of a “cooperative association” under Article 55. Subsection (d) provides several elements of this definition including that “[a] cooperative association “shall not be carried on for profit.” Bontrager v. La Plata Elec. Ass’n Inc., 68 P.3d 555, 561 (2003) (quoting Section 7–55–101(1)(d)). If the association operated for profit, or if failed to enforce uniform terms and conditions, the association would cease to qualify as an Article 55 cooperative association.

As a general matter, statutory requirements may be waived or modified only when the statute expressly provides for waiver or modification. For example, subsection (d) allows “The association shall have the right by the bylaws to limit transfer or assignment of membership and the terms and conditions upon which transfer shall be allowed.” No such language applies to the requirement of “uniform treatment.”

28 C.R.S. 7-55-101(d).
29 See Section 3.6 of MIECO Membership Agreement, supra FN 1, at 4; Section 3.6 of Ellgen Membership Agreement, supra FN 2, at TS-00142287; Section 3.5 of Olson’s Membership Agreement, supra FN 3, at 00170852.
30 This section is expressly incorporated by Article 55. See, CRS 7-55-116.
Uniform terms and conditions have not been created between Section 1 and Section 2 members and have not even been created between members in the same membership class, the non-utility member class, as required by Article 55. It is common for some cooperatives to create multiple classes of members, but these classes have distinct terms and conditions within the class, so that members of one class can be looked upon as a coherent group. However, if a cooperative is governed by Article 55, the cooperative must utilize uniform terms and conditions, especially within a class of members.\(^{31}\) Tri-State’s purported action of adding MIECO, Olson’s, and Ellgen violates this requirement.\(^{32}\) Since it violates, Article 55, the action is void.

b. Tri-State’s Bylaws fail to set forth uniform terms and conditions of membership, as required by Article 55.

Terms and conditions of membership are set forth in Article 1 of Tri-State’s Bylaws. Section 1 sets forth the membership eligibility criteria. Section 1 notably requires all members to “purchase from this Cooperative electric power and energy as hereinafter specified in Section 3 of this Article 1.” Section 1 only refers to “member” in the singular and does not reference multiple membership classes or make any distinction between individual members. Section 1 appears to govern all members.

The recently amended Section 2 purports to carve out exceptions to Section 1 and all other provisions of the Bylaws by setting forth the terms of additional membership classes, and by delegating much of the substantive terms and conditions to the Board to establish and determine. Section 2 improperly and fatally attempts to waive a non-waivable provision in Article 55 by permitting individual members to be governed by differential terms and conditions, not just in a separate class but also within the class between different members. Differential terms and conditions of membership are expressly prohibited by statute.\(^{33}\) The Bylaws fail to set forth the terms and conditions of membership for any members admitted pursuant to Section 2.

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\(^{31}\) See supra FN 28. The phrase “uniform terms and conditions” is also used in Title 7, with respect to preemptive rights.

The shareholders have a preemptive right, subject to any uniform terms and conditions prescribed by the board of directors to provide a fair and reasonable opportunity to exercise the right, to acquire proportional amounts of the unissued shares upon the decision of the board of directors to issue them. § 7-106-301(1)(a)

The term performs a similar function in each section. With respect to pre-emptive rights, “uniform terms and conditions” prevent some shareholders from having an advantage over others in maintaining their proportional ownership interest. With respect to cooperative associations, “uniform terms and conditions” prevent some members of the cooperative from having an advantage over other in maintaining their proportional patronage interests. Indeed, CRS 7-106-301(1)(a) is among the many provisions of Title 7 which are expressly incorporated by Article 55. See, CRS 7-55-116.

\(^{32}\) Dep. of R. Gordon, 74:24-78:25.

\(^{33}\) C.R.S. 7-55-101(d).
Tri-State embeds terms and conditions of the three Non-Utility Companies’ memberships in the respective MIECO, Olson’s and Ellgen Membership Agreements. The totality of Section 3 in each MIECO, Olson’s and Ellgen Membership Agreement attempts to set forth the [redacted] of each admitted non-utility member. Section 3 of each agreement governs [redacted].

Not only do these provisions in the membership agreements of MIECO, Olson’s and Ellgen fail to establish uniform terms as required by Article 55, they expressly conflict with other provisions in Tri-State’s Bylaws. For example, the [redacted] provision in each agreement conflicts with Section 6 of Article II of the Bylaws, which provides that “the member will independently operate and maintain a separate electricity distribution system.” (emphasis added) The terms in the membership agreements of MIECO, Olson’s and Ellgen that conflict with the Bylaws are void.

The Section 3 [redacted] provision in each MIECO, Olson’s and Ellgen Membership Agreements expressly conflict with Section 3 of Article VII of the Bylaws, which generally defines patronage in connection with furnishing or purchasing electric energy. Section 3 of Article VII of the Bylaws makes absolutely no mention of, or distinction between, electric service members and Non-Utility Companies. Tri-State, through its agent Brad Nebergall, admits to this differential patronage allocation approach.

Tri-State’s attempt to admit Non-Utility Companies by defining differential terms and conditions in contract is improper, unauthorized and violates non-waivable provisions of Article 55, as well as Subchapter T requirements for equitable treatment of patronage allocations among members and among members of a particular class.

Tri-State further violates the uniformity requirement by admitting that prior to April 2019 it admitted new members by a vote of the existing members, but after April 2019 it purports to have authority to admit members by action of the Board.

34 See supra FNs 1-3.
35 See Tri-State’s Responses to LPEA’s Third Set of Discovery Requests, Interrogatory No. 3-6.
36 See Tri-State’s Responses to LPEA’s Third Set of Discovery Requests, Interrogatory No. 3-5; see also supra FNs 1-3.
Article 55, Section 110 requires that the voting rights of members must be set forth in the bylaws of the cooperative. It is problematic that the uniform voting rights set forth in Tri-State’s Bylaws do not extend consistently into the membership agreements of the three Non-Utility Company purportedly admitted as members. The membership agreements set forth membership voting rights, however, unlike the utility members, these Non-Utility Companies were stripped of the power to elect directors to the Board. These differential terms relative to voting rights should have been set forth in the Bylaws. The voting rights defined and set forth in the membership agreements for three Non-Utility Companies are invalid, as non-compliant with Article 55, Section 110.

2. Tri-State’s admission of three Non-Utility Companies is ultra vires because it is inconsistent with Tri-State’s chartered purpose and is therefore unauthorized.

Article II of Tri-State’s Articles define its corporate purpose as:

(a) Generating, manufacturing, purchasing, acquiring and accumulating electric power and energy for its members and transmitting, distributing, furnishing, selling and disposing of such electric power and energy primarily to its members, provided that this Corporation may dispose of its electric power and energy to other than members insofar as it may have excess power and energy which can be disposed of on an interchange or sales basis for the ultimate benefit of its members; and

(b) Any other lawful purpose. (emphasis added)

Tri-State has expressed in its own words that “The primary purpose of generation and transmission cooperatives is to provide wholesale electric power to their member distribution cooperatives.” Selling thermal energy, purchasing natural gas, or leasing ranch land does not fit within Tri-State’s own statement of its purpose.

Tri-State has not made any material changes to its stated purpose since incorporation in 1952. Even though the Articles contain the catch-all phrase “any other lawful purpose”, and the cooperative has made other changes to its Articles over the years, it

37 C.R.S. 7-55-110.
39 But see, Bontrager v. La Plata Elec. Ass’n Inc., 68 P.3d 555 (2003):

"Here, § 7–55–102(1) unambiguously grants to cooperative associations the right to engage in “any lawful business, except banking.” Plaintiff does not explain, and we cannot discern, how the phrase “any lawful business” could be narrowly construed. See Obert v. Colo. Dept. of Social Services, 766 P.2d 1186 (Colo. 1988) (interpreting “any” as meaning without restriction)."
has not changed its primary business purpose. For the past 68 years, the cooperative has not deviated from the primary purpose set forth in the Articles.

In 2019, the members were asked to amend the Bylaws with the supposed intention of creating a new class of members that would still fall under the same purpose as set forth in the Articles (providing or purchasing electricity). The admission of three Non-Utility Companies do not, however, comply with the Articles. At the time the Bylaws were amended, Tri-State had the opportunity to also amend the Articles, so the two documents could become consistent, but it neglected to do so.

In slides of an executive session of the Board, Tri-State summarized as among the benefits of admitting Olson’s and Ellgen that admitting Olson’s and Ellgen into membership is not tantamount to an admission of intent. It appears that Tri-State's motive was not only to opt into FERC regulation but to evade Colorado PUC regulation. Further, Tri-State’s 30(b)(6) witness admits that Tri-State’s significant, if not primary, purpose in admitting MIECO, Olson’s, and Ellgen was to lose its FERC exemption. This is tantamount to an admission of intent. It appears that Tri-State's motive was not only to opt into FERC regulation but to evade Colorado PUC regulation. For this reason, Tri-State’s actions to admit MIECO, Olson’s and Ellgen do not comport with Tri-State’s purpose to operate for “any other lawful purpose”. Evasion of regulation cannot be a lawful purpose.

Additionally, Tri-State’s actions to admit MIECO, Olson’s, and Ellgen fail to comport with Tri-State’s primary and particularized corporate purpose because Tri-State’s relationship to and purpose in admitting MIECO, Olson’s, and Ellgen is not one of or to “generate, manufacture, purchase, acquire, and accumulate electric power for its members”, or “transmit, distribute, furnish, sell and dispose of such electric power and energy primarily to its members”. Tri-State purports to admit MIECO to membership primarily to buy natural gas and access to MIECO’s natural gas pipeline. Tri-State’s purpose to admit Ellgen Ranch is to lease it Tri-State owned land for ranching that it was already leasing to Ellgen. Tri-State’s purpose to admit Olson’s is to sell it thermal energy for its greenhouse operations that it was already selling to Olson’s, only discounted by 25 percent.

Generally, the articles of incorporation of a cooperative trump the provisions in the cooperative’s bylaws, unless specifically provided in the articles that the bylaws will govern. For example, in Tri-State’s Articles, Article VI provides that the cooperative

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40 See supra FN 5, at 00081709; supra FN 6, at 00081734.
41 See supra FN 11.
43 C.R.S. 40-6-108; C.R.S. 40-3-102.
44 TS-19-0146, at 1, RECITALS.
45 See supra FN 6, at 00081730-00081735.
46 See supra FN 5, at 00081701-00081709.
shall be obligated to account on a patronage basis to all its members as provided in the Bylaws. There are no provisions in the Bylaws concerning the type of patronage accrued by either of the three purported Non-Utility Companies and the Membership Agreements cannot then provide for such patronage. The Articles have not been superseded and must govern.

3. **Tri-State’s admission of MIECO, Olson’s, and Ellgen as members is improper because the Non-Utility Companies cannot contribute patronage capital as defined by Article 55, the Articles or Bylaws, and Tri-State’s requirement to allocate patronage dividends on an equitable basis as required by IRC Subchapter T.**

   Tri-State’s Articles state “[t]his Corporation shall be obligated to account on a patronage basis to all its members as provided in the Bylaws” (emphasis added),\(^{47}\) not in a separate membership agreement.

   **Tri-State’s Bylaws provide in Article VII, Section 3, in relevant part:**

   In the furnishing of electric energy the Corporation's operations shall be so conducted that all members will through their patronage furnish capital for the Corporation. In order to induce patronage and to assure that the Corporation will operate on a non-profit basis, the Corporation is obligated to account on a patronage basis to all its members for all amounts received and receivable from the furnishing of electric power and energy in excess of the sum of (a) operating costs and expenses properly chargeable against the furnishing of electric power and energy, (b) amounts required to offset any losses incurred during the current or any prior fiscal year, and (c) adjustments to reserves or deferred credit accounts for the purpose of stabilizing margins and rate increases from year to year. The sum of subparagraphs (a), (b) and (c) shall be identified as “operating costs and expenses” for purposes of this Article. All amounts in excess of operating costs and expenses at the moment of receipt by the Corporation are received with the understanding that they are furnished by the members as capital and are not profit to or from the Corporation or its operations. The Corporation is obligated to allocate by credits, to a capital account for each member, all such amounts in excess of operating costs and expenses. The books and records of the Corporation shall be set up and kept in such a manner that at the end of each fiscal year the amount of capital, if any, so furnished by each member is clearly reflected and credited in an appropriate record to the capital account of each member, and the Corporation shall, within a reasonable time after the close of the fiscal year, notify each member of the amount of capital so credited to such member's account. All such amounts credited to the capital account of any member shall have the same status as though they had been paid to such member in cash in pursuance of a legal obligation to do so and such member had then furnished the Corporation corresponding amounts for capital.

   All other amounts received by the Corporation from its operations in excess of costs and expenses shall, insofar as permitted by law, be used to offset any losses incurred during the current or any prior fiscal year; and to the extent not needed for that purpose, allocated to its members on a patronage basis, and any amount so allocated shall be included as a part of the capital credited to the accounts of members, as herein provided.

   Allocation units may be established by the Board of Directors on a reasonable and equitable basis. If allocation units are established, the Board of Directors shall adopt such reasonable and equitable accounting procedures as will, in the Board's judgment, equitably allocate...\(^{47}\) Articles, Article VI.
among such allocation units this Corporation’s items of income, gain, expense and loss. The Board of Directors may establish procedures under which a net loss incurred within an allocation unit may be offset against the net margins earned by another allocation unit or units and the right, if any,

The members of the Corporation, by dealing with the Corporation, acknowledge that the terms and provisions of the Articles of Incorporation and Bylaws shall constitute and be a contract between the Corporation and each member and both the Corporation and the member are bound by such contract, as fully as though each member had individually signed a separate instrument containing such terms and provisions. The provisions of this article of the Bylaws shall be called to the attention of each member of the Corporation by keeping a copy of such Bylaws available for inspection by any member in the Corporation’s office.

Tri-State’s Bylaws describe patronage only in terms of electric service provided and describe in detail the process by which Tri-State’s operating costs and expenses are computed. No provision is made here whatsoever for the type of patronage Tri-State purports to establish and recognize in the MIECO, Olson’s, and Ellgen Membership Agreements, in the form of natural gas purchased, thermal steam energy sold, or land leased. Consequently, the MIECO, Olson’s, and Ellgen patronage must be properly deemed “non-member” income and not accorded patronage credit under the Articles or the Bylaws.

Tri-State’s public SEC filings similarly describe patronage exclusively in terms of member *purchase* of electricity.

A cooperative is a business entity owned by its members, which are also its retail or wholesale customers. Cooperatives are designed to give their members the opportunity to satisfy their collective needs in a particular area of business more effectively than if the members acted independently. As organizations acting on a not-for-profit basis, cooperatives provide services to their members on a cost effective basis, in part by eliminating the need to produce profits or a return on equity in excess of required margins. Cooperatives generally establish rates to recover their cost-of-service and to collect a portion of revenues in excess of expenses, which constitute margins. Margins not yet distributed to members in each constitute patronage capital, a cooperative’s principal source of equity. Patronage capital is held for the account of the members without interest and returned when the board of directors deems it appropriate to do so. The timing and amount of any actual return of capital to the members depends on the financial goals of the cooperative, current and projected capital expenditures, and the cooperative’s loan and security agreements.

Electric cooperatives generally include distribution cooperatives, such as thirty-nine of our Members, and generation and transmission cooperatives, such as us. The primary purpose of electric distribution cooperatives is to supply the requirements of their retail consumers through bulk purchases of capacity and energy and to maintain a distribution system to deliver the electricity necessary to satisfy their consumers’ requirements. The primary purpose of generation and transmission cooperatives is to provide wholesale electric power to their member distribution cooperatives.  

Further, the patronage contributed by MIECO, Olson’s, and Ellgen fails to meet Subchapter T’s equitable allocation of patronage provisions because the three Non-Utility

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48 See *supra* FN 38, at Part I, Item I.
Companies exist in one membership class but receive different allocations of patronage dividends based upon different formulas.

- None of the patron-members of electric service are also patrons of the other service (land lease, thermal energy sales, or natural gas purchases).
- None of Tri-State’s Articles, Bylaws or written policies specifically detail the composition of the non-utility member allocation units. These are set forth in private written agreements between Tri-State and each of the three Non-Utility Companies. The patronage provisions are not part of the Bylaws as required by the Articles of Tri-State.
- There is no evidence that Tri-State informed the electric service members of the revised allocation methodology by which they would share in risk and benefits of combining their electric service patronage with the patronage of three Non-Utility Companies.
- There is no evidence that a majority of Tri-State’s members agreed as a group to any revised patronage methodology. Rather in fact, each of the three Non-Utility Companies were purportedly admitted only by the Board authorizing a resolution to admit new members, generally, as opposed to a vote by the Board to authorize each individual member.
- There is no evidence that members have ever voted to affirm the agreements recognizing the form of patronage contributed by MIECO, Olson’s, or Ellgen.

The courts and the Internal Revenue Service’s Tax Court have construed Subchapter T to require equitable treatment of patronage calculations and allocations among members especially with respect to cooperatives with more than one membership class. In *Pomeroy Cooperative Grain Co. v. Commissioner*, 288 F.2d 326 (8th Cir. 1961) rev’d in part, aff’d in part, 31 T.C. 674 (1958), the Court looked at whether different treatment of patronage allocations was equitable in a cooperative that offered different services to its members. Pomeroy Cooperative offered both grain storage and grain marketing services to its members and to nonmembers. The Tax Court found the two services were separate and patronage calculations must be separate. The trial court, however, found that the two services were intertwined and therefore the cooperative rightfully combined the income from the two services as part of its calculations for patronage dividends. This was a cooperative whose services were integrated as a bundle of services for its farmer members.

At Tri-State, the cooperative has created a separate class or category of members and within that class are three different types of supposed patronage income. Based on the foregoing, it is doubtful that the Internal Revenue Service would conclude the patronage allocations to the three Non-Utility Companies, which are all members of the same class of membership, would be excludable income to the cooperative, because of the inequity in determining patronage in the same class of membership.
4. Consequently, Tri-State's attempt to incorporate non-electric service patronage into Tri-State's patronage calculation methodology violates the Articles, the Bylaws and Subchapter T of the IRC. Tri-State improperly attempts to subvert its own Bylaws by using contracts with MIECO, Olson's, and Ellgen to admit them as Non-Utility Companies.

Since its creation in 1952, Tri-State has recognized only one form of patronage capital from its members, the purchasing of electricity. There is indeed an appropriate and proper way to establish new membership classes for Non-Utility Companies; Tri-State simply failed in its efforts.

It is a fundamental tenet of corporate law that conflicts between corporate documents will be resolved (1) first by reference to applicable statute, (2) next by applicable regulation, (3) next by the corporate Articles of Incorporation, (4) next by the corporate Bylaws, and then, and only then, (5) by contract. Agents for Tri-State misunderstood and misrepresented this hierarchy of authority and purport to have a mere contract trump Tri-State's Bylaws.

In all three Non-Utility Company contracts, Tri-State purports to invert this well recognized order of operations and have the contract supersede the Articles and Bylaws. Section 1.2 of each the MIECO, Olson's, and Ellgen Membership Agreements reads in part:

Tri-State purported to have MIECO, Olson's, and Ellgen customarily and in fact set forth in the Bylaws (as required by the Articles) through its membership agreements with MIECO, Olson's, and Ellgen.

The contractual provisions that do indeed conflict with the Articles and Bylaws are null and void because they conflict with the Articles and Bylaws.

It is worth noting that Section 5.1 of each MIECO, Olson's, and Ellgen membership agreement

49 See supra FN 19.
50 See, CRS § 7-102-106(2) ("The bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or with the articles of incorporation."); Harding v. Heritage Health Products Co., 98 P.3d 945, (2004).
51 See, e.g., Email from Brad Nebereazl to Gary Ellgen, Sept. 25, 2019, at 19F-0620E TS-00161912
52 See supra.
53 See supra.
Article VII, Section 1 of the Bylaws defines the “sole relationship between [Tri-State] and each member” as that of “a cooperative corporation and member as provided by Colorado statutory law.” Tri-State would have its contracts with MIECO, Olson’s, and Ellgen subvert both the Bylaws and Colorado statutory law. This is patentlly improper.

5. Tri-State fails to comply with Article 55 by having its membership qualifications codified in the Bylaws and contract, instead of in its Articles.

Article 55 requires that the Articles state “the number of memberships authorized, the capital subscription of each, and the method of determining property rights and interests of each member without capital stock (emphasis added).” While some of this information is set forth in the Bylaws, it is not stated in the Articles, as is required by Article 55. Tri-State is obligated to adhere to Article 55.

Tri-State’s Articles fail to state with respect to either its electric service membership or its Non-Utility Companies (i) the number of memberships authorized, (ii) the capital subscription of each, and (iii) the method of determining the property rights and interests of each member. While Tri-State’s Articles provide for patronage capital, they neither provide for nor waive any requirement for subscribed capital. Consequently, Tri-State’s Articles are deficient.

Describing some of this information in the Bylaws does not obviate Tri-State’s obligation to meet the Article 55 statutory requirements and the Bylaws certainly cannot trump the Articles.

6. Neither MIECO, Olson’s, nor Ellgen meet Tri-State’s membership qualifications, and therefore may not properly be admitted as members.

MIECO, Olson’s, and Ellgen do not meet Tri-State’s duly adopted definition of membership. Considering the primacy of Articles over Bylaws, which both supersede any membership contracts, the membership requirements, terms and conditions agreed to in the membership agreement are void to the extent they are inconsistent with the Articles or Bylaws.

Tri-State’s duly amended and restated Articles state: “Membership in this Corporation shall be limited to any cooperatively-owned power supplier, public power district or other entity accepted for membership by the Board of Directors of this Corporation in accordance with the Bylaws of this Corporation” (emphasis added). The phrase “other entity” follows two types of electric-service entities and therefore implies another entity within the electric service industry. There is no language in this clause

54 See supra FN 18.
55 See supra FN 19.
56 See supra FN 21.
57 See supra FN 19.
58 Articles, Article V, Section 1.
suggesting an expansive interpretation to include a land lessee, a thermal energy buyer, or a natural gas transport supplier.

Tri-State’s own public SEC filings characterize its members as purchasers of wholesale electric power:

Tri-State Generation and Transmission Association, Inc. is a taxable wholesale electric power generation and transmission cooperative operating on a not-for-profit basis serving large portions of Colorado, Nebraska, New Mexico and Wyoming. We were incorporated under the laws of the State of Colorado in 1952 as a cooperative corporation. We supply wholesale electric power to our forty-three Members, which, in turn, supply retail electric power to residential, commercial, industrial and agricultural customers.

We are owned entirely by our Members. Thirty-nine of our Members are not-for-profit, electric distribution cooperative associations. The remaining four Members are public power districts, which are political subdivisions of the State of Nebraska. The retail service territories of our Members cover approximately 200,000 square miles and their customers include suburban and rural residences, farms and ranches, and large and small businesses and industries. Our Members serve approximately 615,000 retail electric meters. Our Members are the sole state certified providers of electric service to retail (residential and business) customers within their designated service territories.59

(emphasis added)

Neither MIECO, Olson’s, nor Ellgen are (a) cooperatively owned, (b) are power supplies or public power districts, or (c) other power-related entities properly accepted for membership by the Board in accordance with the Bylaws.

Tri-State’s duly adopted Bylaws, Article II, Section 6 requires that “the member will independently operate and maintain a separate electricity distribution system (emphasis added)”. Note that this provision is compulsory, not permissive. Neither MIECO, Olson’s, nor Ellgen operate and maintain separate electricity distribution systems, and therefore do not meet this membership requirement.

Tri-State amended its Bylaws to insert what is now Section 2, which purports to create a categorical exception to all other bylaws (including, by inference, Article II, Section 6) if the Board establishes one or more classes of membership, including “one or more partial requirements membership classes whereby a member who chooses to be a member of that class shall assume a responsibility for meeting a portion of its load requirements”. Again, neither MIECO, Olson’s, nor Ellgen desire to procure even part of their electric demand requirements from Tri-State; their purpose for being admitted as members does not include electric service.60

As authority for the position that MIECO, Olson’s, and Ellgen meet the definition of, and are qualified to be admitted as, members of Tri-State, Tri-State will likely rely

59 See supra FN 38, at Part I, Item I.
60 See supra FN 8-10.
upon two drafting constructions in its Bylaws. First, Article I, Section 2 applies
"[n]otwithstanding any other provision of these Bylaws to the contrary..." Tri-State
drafted this proviso as a categorical carve out, to not only supersede all other conflicting
Bylaws provisions, but also to be interpreted broadly into all other provisions that, while
not conflicting, do not contemplate membership other than electric service membership.
For example, since neither MIECO, Olson’s, nor Ellgen are power providers or power
districts, Tri-State has attempted by this Section 2 to authorize the Board to determine
that parties with no association with the electric service sector meet the definition of
member, thereby giving the Board the power to interpret and determine the scope of its
own Articles. Such an interpretation of the Bylaws would render the Board omnipotent
and with unlimited authority. This position is also problematic because throughout the
Bylaws the various provisions describing membership and electric service patronage
would need to be read consistently with the Board’s authority to define new membership
classes, however, the bylaws provide no such guidance.61 This position is also difficult
because Tri-State purports for the Board to define the terms of MIECO, Olson’s and
Ellgen’s membership not under its authority in the Bylaws (so that the definition could be
read consistently with the other Bylaws provisions), but rather in contracts, which Tri-
State attempts to have supersede the bylaws62. Such a broad and sweeping Board powers
position stands in stark contrast to Tri-State’s own longstanding history prior to April
2019 to admit new members by member approval.63

The second way Tri-State has contrived a loophole by which to admit MIECO,
Olson’s, and Ellgen is by defining the Board’s authority to establish one or more classes
of additional memberships to include, but not be limited to the example of a “partial
requirements membership class”.64 By providing the Board with unlimited scope to
establish new types of membership classes, the Board could establish just about any type
of membership class, whether related to electric service or not. Yet, no language
anywhere else in the Bylaws even hints at Olson’s thermal energy purchases, Ellgen’s
ranching land lease, or MIECO’s natural gas sales as the type of activity for which
membership is compatible or even conceived.

F. Conclusion:

Tri-State’s purported admission of three “Non-Utility Companies” is improper because
each was acted upon without authority under and in contravention of C.R.S. Title 7, Article 55,
IRC Subchapter T, Tri-State’s Articles of Incorporation, and Bylaws, as each may be amended or
restated.

Tri-State’s attempt to admit MIECO, Olson’s and Ellgen to membership in the
cooperative is void. The admission of these three entities depends on an amendment to Section 2
of the cooperative’s Bylaws. That amendment, however, is inconsistent with Colorado statute, in

61 See supra.
62 See supra Section 4 hereof.
63 See supra FN 36.
64 See Bylaws, Article 1, Section 2.
the form of Article 55. The amendment to the Bylaws is void since it conflicts with statute, therefore the attempt to admit new members pursuant to the void amendment is also void.

Tri-State’s attempt to admit MIECO, Olson’s and Ellgen also fails because Article 55 requires that uniform terms and conditions of membership be set forth in the Bylaws. Instead, Tri-State attempted to establish terms and conditions in separate contracts with each entity.

In attempting to admit these entities to membership, Tri-State violated its chartered purpose and acted beyond the scope of its legitimate powers. Attempting to admit these entities was an unlawful act motivated by the explicit intent to evade regulation by the Colorado PUC. For this reason alone, the attempt is voidable.

Admitting these entities to the cooperative would also violate the requirement of the taxation regime under which Tri-State operates. If these entities became members, Tri-State would not comply with the requirement to equitably allocate patronage. This failure would violate Subchapter T of the IRC.

In addition to being void for the reasons given above, the contracts between Tri-State and the three entities are void because they conflict with Tri-State’s own Bylaws. Tri-State’s Articles are also deficient. According to statute, membership qualifications must be stated in a cooperative’s Articles. Tri-State’s Articles fail to do this. Indeed, the membership qualifications which Tri-State have set forth exclude all three entities from membership.

Tri-State’s actions to admit MIECO, Olson’s, and Ellgen are improper and unlawful because each was acted upon without authority under, and in contravention of, C.R.S. Title 7, Article 55, Tri-State’s Articles, and Bylaws.