

SUPERIOR COURT OF THE STATE OF GEORGIA

COUNTY OF COBB

EDGAR "BO" POUNDS, ET AL.)

Plaintiffs,)

vs.)

DWIGHT BROWN, ET AL.)

Defendants,)

-and-)

COBB ELECTRIC MEMBERSHIP CORPORATION, a Georgia Corporation,)

Nominal Defendant.)

Civil Action File No. 07-1-9408-48

)C

STATE OF MISSOURI

COUNTY OF JACKSON

AFFIDAVIT OF WAYNE MIDDLEBROOKS

Personally appeared before the undersigned, an officer duly authorized by law to administer oaths, WAYNE MIDDLEBROOKS who after being duly sworn, did depose and state under oath as follows:

1.

I am WAYNE MIDDLEBROOKS. The matters set forth herein are based on my own personal knowledge and I am over the age of 18 and legally competent to give this Affidavit.

2.

I graduated from the University of Missouri at Kansas City in 1977 with a Business Administration degree with a concentration in accounting. After graduation I

went to work for the accounting firm of Schmidt & Company (S & Co.) in Kansas City. S & Co.'s audit practice was concentrated in performing independent financial audits of electric membership cooperatives (EMCs) and other energy related companies affiliated with electric cooperatives. I became a junior partner with the firm in 1980 and a full partner in 1984. I retired from the firm in 2004. I became a Certified Public Accountant (CPA) in 1980. For most of my career I have been a member of the American Institute of Certified Public Accountants and the Missouri Society of Certified Public Accountants. My work as a CPA was primarily performing audits of electric cooperatives.

3.

I am presently licensed to practice accountancy in the state of Missouri. During my career I performed and/or reviewed approximately one thousand three hundred audits of electric cooperatives, and Public Power Districts. I have conducted these audits in the states of Missouri, Kansas, Oklahoma, Colorado, Wyoming, Arkansas, Iowa, Nebraska, Louisiana, and North Carolina. At the time of the audits in the states other than Missouri either I or my firm were licensed in those states. S & Co. was required to undergo peer reviews every three years by the Rural Utilities Service. A peer review is a procedure in which auditors outside your firm review your work independently to determine compliance with applicable audit standards. S & Co. passed all peer reviews conducted during my career. Each of the audits was accepted by the Board of Directors of the audited cooperative.

4.

As a result of my training and experience as described above I have developed a comprehensive knowledge of the financial operations of EMCs including applicable accounting standards and procedures.

5.

Electric Membership Cooperatives (EMC's) were established starting in the mid-1930s as an effort by the federal government to encourage the development of electric service into the rural areas and smaller cities throughout the United States where electrical service had not historically been provided due to low population density. The electric membership cooperative program was administered initially by the Rural Electric Administration, which provided low interest loans to EMCs and also provided technical and managerial assistance. The Rural Electric Administration "REA" later became the Rural Utilities Service "RUS." The core concept of an EMC from the beginning that continues to the present is that the EMC, owned by its members, will be operated on a not-for-profit basis to provide reliable electric service to its members at the lowest possible cost. Further, an EMC is governed by a Board of Directors that is elected periodically by a vote of the members. The Board of Directors typically hires the President or Chief Executive Officer of the EMC. In some states the entity may be a political subdivision of the state.

6.

One of the features of an EMC is "Patronage Capital" which consists of the earnings over time attributed to members. While each member gets only one vote, Patronage Capital is allocated on the basis of the members' purchases compared to the purchases of other members. After the fiscal year is over, a cooperative computes its earnings on business conducted on a cooperative basis. Those earnings are returned to the patrons--as cash and/or equity allocations--on the basis of how much business each patron did with the cooperative during the year. These distributions are called patronage refunds. For example, if a cooperative has earnings from business conducted on a

cooperative basis of \$20,000 for the year, and Ms. Jones does 2 percent of the business with the cooperative, she receives a patronage refund of \$400 ($\$20,000 \times .02$). This allows the cooperative to return margins to members on an annual basis, consistent with standard accounting conventions and without regard to how much was earned on each transaction. Patronage Capital may be refunded from time to time if the Board of Directors determines that by doing so the financial condition of the EMC will not be impaired.

7.

I have been asked by counsel to assume a number of facts that are stated here and elsewhere in this document for purposes of opinions I offer. I have been asked to assume that Mr. Dwight Brown served as President of Cobb EMC. I have been asked to assume that Mr. Brown and others own or have owned interests in Cobb Energy. I have been asked to assume that Mr. Brown also served as a President and Chairman of the Board of Cobb Energy and that certain members of the Board of Cobb EMC have served as members of the Board of Cobb Energy. I have been asked to assume that Cobb Energy is a for-profit entity originally set up by and owned 100% by Cobb EMC. I have been asked to assume that Mr. Brown, certain directors of Cobb EMC, and others purchased stock of Cobb Energy. These initial stock transactions had the effect over time of reducing the ownership interest and voting rights of the EMC. I have been asked to assume that Mr. Brown, with the approval of the Board of Directors of Cobb EMC, caused Cobb EMC to engage in substantial business transactions with Cobb Energy by which Cobb Energy has received 10's of millions of dollars as a result of business done with Cobb EMC. Included among the transactions between the two companies was the transfer of the meters and personnel of Cobb EMC to Cobb Energy. Also, Mr. Brown

recommended the Board of Directors of Cobb EMC sign a forty year contract (“Contract”) with Cobb Energy by which Cobb Energy performs virtually all of the functions of the EMC. The Board complied with this request without dissent. This included the work force, meter services, billing, marketing, human resources, and other functions. Prior to the Contract Cobb Energy performed all of these functions at cost. Under the Contract, the cost of base Service Labor & Benefits, Marketing Services, and Meter Services are charged back to Cobb EMC plus an “adder” that has been 2%, later 6%, and since 2005, 11%. Assuming these facts to be true, I have been asked to offer my opinion of these transactions and others from an auditing/accounting standpoint.

I have also reviewed at least the following documents:

- EMC Minutes, Exhibits 1 through 148
- Arthur Anderson Valuation Report, Exhibit 156
- Operating Agreement and amendments thereto, Exhibit 162
- EMC Bylaws, Exhibit 349
- EMC Audit Reports, Exhibit 227
- EMC Tax Returns, Exhibit 228
- Cobb Energy Fee Schedules, Exhibit 230, 231
- Cobb EMC Policy Manual, Exhibit 214
- Cobb Energy Financial Reports, Exhibit 233
- Cobb Energy Tax Returns, Exhibit 235
- Cobb EMC Investment Manual, Exhibit 243
- NRECA Directors Guidelines, Exhibit 250
- Adder Fee Schedule, Exhibit 254

- Flint EMC v. Barrow
- Deposition Excerpts, Hale, Schoonover, Polucci, Steele
- Form 7's, Exhibit 350
- Other Documents as referenced hereinafter

To the extent further investigation shows these assumed facts to be incorrect or incomplete, I reserve the right to modify the opinions expressed herein consistent with such additional facts as are brought to my attention.

8

From an auditor's standpoint, if an auditor learned of the existence of the types of transactions and joint management of affiliated companies, as described herein, the procedure would be to develop a complete understanding of the nature of all transactions between the two entities and the flow of funds as a result of the transactions between the two entities. This would include gaining a complete understanding of the relationship of the shared officers and directors of both entities. Statements on Auditing Standards, SAS's, published by the American Institute of Certified Public Accountants.

The National Rural Electric Cooperative Association (NRECA) is an organization that provides a wide range of services to the cooperative industry including the publication of guidelines for cooperatives. These guidelines are universally followed by the EMC industry, particularly as they relate to corporate governance. The Directors' duties and liabilities are set forth in 2600.1 of the NRECA Guide (Exhibit 250). It is noted that the Directors' duties are primarily three "loyalty-obedience-due care," page 61. It is further noted that the Director should "refrain from engaging in personal activity that could be construed as a conflict of interest." The Guidelines provide "The Director's duty of loyalty requires that in any self-interested transaction, the Director has the duty to

fully disclose any potential conflicts of interest. When dealing in your own interest, the transaction must be approved by a majority of disinterested Directors, in some instances approved by a majority of the shareholders, and inherently fair to the corporation . . . whenever a director personally benefits from his or her office, there may be a presumption of fraud. Self-dealing is usually considered a breach of duties. A Director cannot engage in a competing business at the detriment of the corporation. Directors may not usurp the corporate opportunity.” NRECA Guidelines, page 64.

The directives and guidelines issued by NRECA are universally respected in the cooperative industry and are reflected in the By-laws of Cobb EMC. For instance, Section III (2)(c) of the By-laws provides as follows: A Director may “[N]ot in any way be employed by or financially interested in a competing business or enterprise selling electric energy or selling supplies to Cobb EMC, or engaged in a business primarily engaged in selling electrical or plumbing appliances, fixtures or supplies to Cobb EMC members; . . . 2(g) [Must] Be loyal to the cooperative, acting at all times in good faith for its best interest; . . . 2(h) [Must] Be unaffected by any continuing and substantial personal interest that is in conflict with the best interest of the cooperative.” Indeed any Director disqualified pursuant to the provisions of Section 2 is required to be removed from the Board.

“Cobb EMC Policy Manual, Exhibit 214 addresses the same concepts. For instance Bulletin 2, Item B2 provides in part, “Each board member should evaluate his/her ability to sift ideas and make independent judgments for the good of the whole cooperative; thereby enhancing his/her value to the entire board.”

Policy Bulletin No. 42 provides, “The board of Directors discourages and will not permit any of its employees to engage in outside business, which will in any way be in conflict with the interest of the corporation and other interests in the community.”

Policy Bulletin No. 64 I-C provides, each board member must “be loyal to the cooperative, acting at all times in good faith and for its best interest.” II-B provides that members of the Board of Directors shall “not be employed by, or financially interested, in a competing enterprise or a business selling electrical energy or supplies to the cooperative...”

In my opinion, there is no question that the Officers and Directors of the EMC that are, or have been, financially involved with Cobb Energy would be in violation of both the letter and spirit of Cobb EMCs own by-laws, the NRECA guidelines, and the EMC’s Policy Manual. It is particularly noteworthy that the meeting minutes of Cobb EMC’s Board of Directors reflect that by and large, but not always, Directors Boone and McGinnis excused themselves from votes on the EMC Board addressing issues relating to Cobb Energy. But so far as I can tell Mr. Brown, the CEO and Chairman of the Board of Cobb Energy and Mr. Chadwick, Chairman of the Board of EMC, both with substantial stock in Cobb Energy never excused themselves at least as reflected in the minutes from such discussions. When deciding any substantive issues dealing with Cobb Energy, the Cobb EMC Board was conflicted by the participation of Mr. Brown and Mr. Chadwick who have, or had, substantial financial interests in Cobb Energy and stood to economically benefit from the Energy/Cobb EMC transactions. The same is true for

Director Hames prior to his death. See for example Exhibit 15, the minutes dealing with the transfer of the meters.

Cobb EMC was organized as an Electric Membership Cooperative (EMC). As discussed above, the function of an EMC is to provide reliable electrical service to its members at the lowest possible cost. Mr. Brown, while serving in the capacity as President of the EMC, as well as the Board of the EMC, has a duty to assure that the business activities of the EMC are conducted with the highest level of ethics with an eye always toward meeting the mission of the EMC as a not-for-profit entity. On the other hand, Mr. Brown's role as President of Cobb Energy and Chairman of the Board, and the role of the Directors of Cobb EMC also serving as Directors of Cobb Energy, is to assure that Cobb Energy is operated in a fashion to maximize profits and shareholder value. In my opinion, Mr. Brown's service as President of both Cobb EMC and Cobb Energy and Chairman of the Board of Cobb Energy creates an irreconcilable conflict of interest as the goal of the two entities is in conflict. Under certain circumstances directors may serve on boards of the non-profit and affiliated for profit organization. However, in the event directors common to both boards receive financial benefit as a result of serving on the board of the affiliated for-profit entity, which benefit arises from economic transactions between the for-profit and not-for-profit, then in such event there would clearly be a conflict of interest.

In my 27 years of EMC audit work I have never seen a structure like this and I am unaware of any Board of an EMC ever approving these types of conflict of interest transactions. In my opinion this would constitute a lack of ethics and a departure from the letter and spirit of the entire EMC movement.

I have read the audit reports for the years 1996 through 2007 (Exhibit 227) for Cobb EMC as well as the minutes of the board of directors meetings for the calendar years 1997 through September of 2007 (Exhibits 1 through 148). I have the following observations:

1. The 1998 audit report was issued as a consolidated audit report. The financial statements of Cobb EMC and Cobb Energy were appropriately combined as if they were one company. The unconsolidated financial statements indicated that Cobb EMC owned \$11,000 or 100% of the capital stock issued and outstanding of Cobb Energy. This agreed with information obtained from the board minutes of August 26, 1997. It is required that consolidated financial statements be issued when a company owns more than 50% of another company (SFAS 94).
2. The April 30, 1999 audit report indicated that Cobb EMC no longer had a controlling interest in Cobb Energy and consolidated financial statements were not issued. The ownership of Cobb Energy was 49.665%, down from 100% from the prior period, which removes the requirement to consolidate the financial statements. An accounting requirement exists that requires a company owning more than 20% but less than 50% of an affiliated company to recognize its investment on the equity basis. The cash flow statement properly indicated that a loss on equity investment of \$626K was recognized. However as reflected in the minutes of the January 26, 1999 meeting, in connection with the sale of meters from Cobb EMC to Cobb Energy, Larry Chadwick accepted 200,000 additional Class A Common shares of Cobb Energy which would have increased the EMC's Class A shares to 400,000.
3. At the February 24, 1998 board meeting there was a resolution authorizing moving Cobb EMC's meters to Cobb Energy. The value of the meters was left blank on the resolution although Arthur Anderson had reported the fair market

value of the meters to the company on January 12, 1998 showing the value of the meters to be approximately \$15.7M (Exhibit 156). The meters are one of, if not the most important assets of a utility as they are the only resource for capturing usage data. It is unlikely from an accounting standpoint that the meters would be transferred to another entity at less than market value. Cobb EMC was supposedly paid for the meters by a \$5M wire transfer plus 200K shares of Class A Common Stock in Cobb Energy (EMC answer to Interrogatory No. 10). This would give the EMC a total of 401K shares of Cobb Energy, This additional 200K shares is not reflected on any of the financial statements that I have reviewed. This suggests that the EMC only received \$5M for meters independently valued at \$15.7M. The Board rescinded the sale of meters to Cobb Energy at the March 24, 1998 meeting, page 8. The July 28, 1998 board minutes “Approved moving the meters to CEMC for the book value of \$9,696,967.30. The motion was amended with no dollar value to approve the meters being transferred as contribution to capital.” According to the minutes this transaction had to be completed to facilitate the following transaction.

The Board minutes January 26, 1999 page 8 & 9 stated “Bonnie Wilson presided over the signing of the paperwork for the CEMC closing. Approvals had been obtained from the Cobb EMC Board of Directors and CEMC Board of Directors. Funds will be wire transferred from CFC to CEMC. As part of the prior approvals obtained from the CEMC Board, a dividend has been declared and \$5M transferred to Cobb EMC.” It appears that Cobb Energy was operating at a substantial loss. It is difficult to understand how a company operating at a loss could declare and pay a \$5M dividend. The 1999 financial statements do not appear to show receipt of this \$5M dividend by Cobb EMC. A dividend would have been recognized as income to Cobb EMC and would be shown on both the Income Statement and Statement of Changes in Financial Position. No such entry appears to have been made. Stock certificates were presented to Lee McKinstry (4,000 shares/Class A Preferred Stock), Sheldon Petersen (200,000 shares/Class A preferred stock) for NCSC and Larry Chadwick (200,000 shares/Class A Common Stock) for Cobb EMC. (Board minutes January 26, 1999 page 9) Based

on the limited information available it would appear that the following sequence of events occurred.

- a. Cobb Energy was created by board action on August 26, 1997 and Cobb EMC was issued 200K shares of Class A Stock and 1K shares of Class B Stock for \$11K. The stock transfer was effective September 6, 1997 (See attachments to August 26, 1997 Board Minutes). At 4/30/1998 the unconsolidated financial statements appear to support the total investment in Cobb Energy as \$11,000.
 - b. According to the minutes of January 26, 1999 Cobb Energy issued an additional 200,000 shares of common stock to Cobb EMC in payment for approximately ½ of the purchase price of the meters. This would have increased the number of shares to 401,000. NCSC received 200,000 shares of Class A Preferred Stock for its financial contribution of \$5M (Exhibit 160). There was also an issuance of stock to Lee McKinstry of 4K shares of Class A Preferred Stock.
 - c. This reduced the ownership interest of the EMC in Cobb Energy down to 49.665%. This is questionable as the second 200,000 shares to the EMC are not otherwise reflected in the records. Since NCSC received preferred stock which carries only dividend and voting rights, the ownership of the EMC would have been unaffected although the voting rights would have gone down. These transactions are confusing and should be adequately documented and explained. Any auditor looking at these transactions would have requested a full explanation. The minutes do not reflect any concern by the Board.
4. The April 30, 2000 audit report indicated that the ownership interest in Cobb Energy was now 49.63%, Page 6, second paragraph. I find no explanation for the decrease in ownership interest during the year. The cash flow statement indicates that Cobb EMC recognized a loss on its equity investment in Cobb Energy in the amount of \$955K. That tells us that Cobb Energy sustained an approximate book loss of \$1.9M for the year ended April 30, 2000. Further this tells us that patronage capital was reduced by \$955K. Cobb Energy billed Cobb EMC approximately \$34.175M. This billing included approximately \$670K of added cost under the 2% add-on provision of the contract between the two entities.

At the April 25, 2000 board meeting it was reported that the CEMC board asked the Cobb EMC board to consider increasing the fee paid for services

between the companies from 2% to 6%. The request was approved. At April 30, 2000 the accumulated book losses of Cobb Energy were approximately \$3.22M.

Schedule 1

Year Ended		Recognized Income (Loss)	Cobb EMC % Ownership of CEMC	Income (Loss) of CEMC	Accumulated Earnings (Loss) of CEMC
4/31/98	98 loss	(35,524)	100.00%	(35,524)	(35,524)
4/30/99	99 loss	(626,276)	49.67%	(1,260,874)	(1,296,398)
4/30/00	00 loss	(955,000)	49.63%	(1,924,239)	(3,220,637)

The Notes to the Audit Report for 1999 disclosed that Cobb EMC was paying Cobb Energy a 2% add-on to the cost contract. Note 1, page 6 of the 1999 Audit. The percentage add-on increased from 2% to 6%, during the year but was not mentioned in the 2000 or any subsequent Audit Report. It increased to 11% February of 2005 which was nowhere reported in the financial statements. This was a material change that normally should have been reported in the financial statements of Cobb EMC.

- The April 30, 2001 audit report reported the ownership interest was 44.4%. I find no explanation for the decrease in ownership interest during the year. The cash flow statement indicates that a gain on equity investment of \$961K was recognized. Cobb Energy billed Cobb EMC approximately \$40.752M. This billing included approximately \$2.3M of added cost under the 6% add-on provision of the contract between the two entities. This suggests that Cobb Energy earned approximately \$2.165M for the year ended April 30, 2001. (44.4% of \$2.165M equals \$961K, the equity earnings.) We also can determine that the increase of the add-on from 2% to 6% increased the positive performance of Cobb Energy approximately \$1.5M. (A 2% add-on of a \$40.752M billing would amount to approximately \$800K. \$2.3M minus \$800K equals \$1.5M.) This

shows that the dramatic improvement of the performance of Cobb Energy was based largely on incremental charges to the EMC resulting in the members shoring up the financial condition of Cobb Energy.

At the Board Meeting of September 26, 2000, the board caused Cobb EMC to purchase \$500K worth of CBV stock. Apparently CBV had experienced revenue difficulties. This raises at least two questions, first, why was the EMC subsidizing a company operated by Cobb Energy, second there did not appear to be a valuation made of the investment in CBV stock prior to purchase which would be a normal procedure followed to ensure that the board's fiduciary duties had been fulfilled. On February 27, 2001 the EMC Board minutes indicate that the EMC sold nine shares of CBV stock valued at \$450K to Cobb Energy to help Cobb Energy save on taxes. Again there was no valuation provided as to the value of the CBV stock. Further no explanation was provided as to why the EMC was helping Cobb Energy "save on taxes", page 3 of the Board Minutes. These issues raise serious questions as to the board's exercise of their fiduciary duties.

6. The April 30, 2002 audit report indicates the ownership interest was 32.99%. I find no explanation for the decrease in ownership interest during the year. The cash flow statement indicates that a loss on equity investment of \$457K was recognized. This suggests that Cobb Energy lost approximately \$1.38M for the year ended April 30, 2002. This tells us that increase of the add-on from 2% to 6% increased the performance of Cobb Energy approximately \$1.6M. Cobb Energy billed Cobb EMC approximately \$43M. This billing included approximately \$2.58M of added cost under the 6% add-on provision of the contract between the two entities.
7. The April 30, 2003 audit report reflected the ownership interest was 41.28%. The cash flow statement indicates that a gain on equity investment of \$658K was recognized. The gain on equity investment was corrected to \$177K in the 2004 audit report. This suggests that Cobb Energy earned approximately \$427K for the year ended April 30, 2003. This tells us that increase of the add-on from 2% to

- 6% increased the positive performance approximately \$1.7M. Cobb Energy billed Cobb EMC approximately \$46M. This billing included approximately \$2.6M of added cost under the 6% add-on provision of the contract between the two entities. Note that Cobb EMC purchased and extensively renovated a commercial building with the intention of either selling or leasing to one of its affiliated companies. This sale was reported in 2004 which resulted in a gain of \$225K.
8. The April 30, 2004 audit report reflected the ownership interest was 36.95%. The cash flow statement indicates that a gain on equity investment of \$472K was recognized. This suggests that Cobb Energy earned approximately \$1.278M for the year ended April 30, 2004. This tells us that the increase of the add-on from 2% to 6% increased the positive performance approximately \$1.7M Cobb Energy billed Cobb EMC approximately \$46M. This billing included approximately \$2.76M of added cost under the 6% add-on provision of the contract between the two entities.
 9. The April 30, 2005 audit report reflected the ownership interest was 29.43%. The cash flow statement indicates that a gain on equity investment of \$231K was recognized. This suggests that Cobb Energy earned approximately \$785K for the year ended April 30, 2005
 10. The April 30, 2006 audit report did not state the ownership interest. The cash flow statement indicates that a gain on equity investment of \$163K was recognized. Cobb Energy billed Cobb EMC approximately \$58M. This billing included approximately \$5.75M of added cost under the 11% add-on provision of the contract between the two entities. Nothing was said about the 11% add-on in the minutes or financial statements.
 11. The April 30, 2007 audit report did not reflect the ownership interest percentage. The cash flow statement indicates that a gain on equity investment of \$200K was

recognized. Cobb Energy billed Cobb EMC approximately \$58M. This billing included approximately \$5.75M of added cost under the 11% add-on provision of the contract between the two entities. Nothing was said about the percentage add-on.

10.

The transactions between Cobb Energy and its affiliates and Cobb EMC are related party transactions under FASB (Financial Accounting Standards Board) No. 57.

An excerpt from FASB 57 follows:

Financial statements shall include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business.

The disclosures shall include:

- a. The nature of the relationship(s) involved*
- b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements*
- c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period*
- d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement*

Virtually none of the required related party disclosures have been made in any meaningful way to the members of Cobb EMC. In my opinion the disclosure of related party transactions should conform to the requirements of FAS 57. Management should provide a complete Related Party Disclosure in a restated audit report for the period ending April 30, 2007 including full disclosure of:

- The relationship between the entities:

- The dollar amount of all transactions between the companies and affiliates:
- Common executive control and ownership interest of management and directors:
- Loans between entities:
- Loans to members of management and directors;
- Intercompany rent:
- Intercompany guarantees:
- Intercompany transfers of assets:

11.

Independent of the legality of the corporate structure, the arrangement by which Cobb Energy charges back the various costs plus an adder fee has the effect of increasing those costs to the EMC by the amount of the adder fee. No readily apparent benefit flows to the EMC as a result of these transactions. Mr. Brown has presented a cost-savings analysis (Exhibit 149), showing according to him that Cobb Energy has been of great benefit to the EMC. This stems from charts that have power costs, kilowatt hour cost, and total cost of service. It is not clear to me how this justifies the contention that the Cobb Energy relationship has been beneficial to Cobb EMC. Comparables for the EMC industry are not included. Claims of cost savings are undocumented by the financial statements.

Data from Cobb EMC's Form 7's do not appear to support this contention when compared to other cooperatives of similar size and geographical location. I have calculated the ratio of Distribution Expense Operations, Distribution Expense

Maintenance, Consumer Accounts Expense, Customer Information and Assistance, and Administration and General expense combined divided by customers per month for Cobb EMC (Cobb EMC Form 7's), Jackson EMC, and Sawnee EMC for various years that information is obtainable. The results are illustrated in the table below:

	Cost per month per consumer of the sum of lines 5 through 10 of the Statement of Operations		
	Cobb EMC	Jackson EMC	Sawnee EMC
2003	24.0113		17.7507
2005	24.7354		
2006	27.4921	20.9448	18.4415
2007	28.6404	20.7273	

It appears that Cobb EMC's costs per consumer per month for the selected expenses are substantially greater than the same expenses for Jackson EMC and Sawnee EMC.

12.

Particularly disturbing is the fact that Cobb EMC contracted directly with Bermex, a meter reading and services company, at least through February 28, 2004, but Cobb Energy, not a party to the contract charged the EMC its applicable adder fee (Exhibit 191). Apparently Cobb Energy contracted with Bermex after February 28, 2004 for these services and continued to charge the adder (Deposition of Schoonover, pages 22-24). This arrangement does not appear to provide any benefit to the EMC. Also disturbing is the fact that Cobb Energy charges the adder fee on depreciation of the meters according to the Schoonover Deposition page 24. Charges for depreciation are unauthorized by the Operating Agreement or Amendments.

According to documents provided by the EMC, ProCore, a consolidated subsidiary of Cobb Energy, has been paid \$43,315,915 since 2000 (Exhibit 255) for call center operations which includes a 50% adder to cost. The EMC is billed for these services at labor cost plus approximately 50% (Steele Deposition, page 18). Apparently, there is no reason why Cobb EMC could not provide these services itself at its own cost (Schoonover Deposition page 38). There is a question as to why the EMC would incur such incremental costs as are charged by ProCore for activities it could perform itself at cost.

13.

The EMC investment in Cobb Energy amounted to approximately \$5,031,000 and according to the Cobb EMC financial statements the value of that investment at April 30, 2007 has increased to approximately \$5,097,000, an increase of approximately 0.1% per year. No dividends have been paid to Cobb EMC on the investment, however dividends have been paid to owners of Preferred Stock in the aggregate amount of \$5,130,000 (see schedule below). Cobb Energy's overall financial performance has been abysmal.

The following chart demonstrates that the affiliates of Cobb Energy with the exception of ProCore have been unprofitable. Cobb Energy is shown to have cumulative profits of \$9.76M. If the direct charge to retained earnings, the prior period adjustment, and the sum of accumulated Comprehensive Loss are subtracted from Cobb Energy's reported income, then net reported income for Cobb Energy would be a loss of \$66K. Further, dividends in the amount of \$5,130,000 have been paid to the Preferred Shareholders. The overall effect of this is that the Consolidated Retained Earnings of Cobb Energy and affiliates is \$-12.527M.

Analysis of Accumulated Net Income (Deficit) and Dividends
As of December 31, 2006

Source: Audited Financial Statements

Consolidated Income Statement - Book Basis

			Cobb							Cobb		Total	
	CI A Div	CI B Div	Energy	Procure	CBFS	CBV	AUN	AE	CEPC	Mort			
1/31/99			-1,261									-1,261	≠
1/31/00	-451		-1,924									-1,924	≠
1/31/01	-451		2,218	40	-93							2,165	≠
1/31/02	-488		1,821	282	74	-1,086						1,091	≠
1/31/03	-609		1,499	264	-11	-1,008	-316					428	≠
1/31/04	-522		2,013	416	-27	-445	-679	-261				1,017	≠ 1
1/31/05	-522	-155	2,266	555	-37	-619	-643	-737				785	≠
12/31/05	-389	-606	1,953	615	-56	-646	-123	-830	-96	-221		596	≠
12/31/06	-389	-548	1,180	463	-57	-403	-550	-271	-108	-117		137	≠
Totals	<u>-3,821</u>	<u>-1,309</u>	<u>9,765</u>	<u>2,635</u>	<u>-207</u>	<u>-4,207</u>	<u>-2,311</u>	<u>-2,099</u>	<u>-204</u>	<u>-338</u>		3,034	
												Less Dividends paid	-5,130
												Less 2002 direct charge to Retained Earning	-1,945
												Less 2003 prior period adjustment	-2,417
												Accumulated Deficit per Balance Sheet 12/31/06	<u>-6,458</u>
												Other Comprehensive Loss	<u>-6,069</u>
												The total Retained Earnings 12/31/06 is	<u>-12,527</u>

≠ = Agrees with Audits CEMC

1 = Restated 1/31/05 to include Allied Energy loss of \$261K

14.

The EMC has produced in discovery the Financial Policy and Investment Practices Manual which includes the investment practices effective March 18, 1999 (Exhibit 243). I understand Mr. Myers testified that the Manual only applies to the Financial Services Division (Myers Deposition, Page 22). That position is not supported by the plain language of the Manual. Provisions of the Manuals restrict Cobb EMC from investing in any investment that is not extremely conservative. The approved investments are described in detail beginning at page 4 of the Manual. Cobb Energy, at the time of its start-up would have been viewed as a risky enterprise given that one of its primary purposes was to establish new businesses in multiple different specialties. As

such it would not have been an authorized investment under the Investment Practices Manual. The policies were changed in 2005, however, I do not believe the changes alter this fact. The Board has violated its own investment policies by approving the investment in Cobb Energy. This would appear to be a breach of their fiduciary obligation to the company and to its members.

15.

The financials and tax returns show no rent expense to Cobb Energy or rent income to Cobb EMC even though Cobb Energy occupies substantially all of Cobb EMC's buildings. According to Mr. Paolucci, rent is handled by a complex sequence of cost offsetting between Cobb Energy, its affiliates, and Cobb EMC as described by Moore Colson (Exhibit 261). The buildings should have been rented on a fair market value basis rather than cost.

16.

Documentation provided by the EMC on Board Compensation shows that Board Members, Balkcom, Anderson, and Gresham received retirement contributions ranging from \$107,000 to \$130,000 upon assuming their directorships, and that the other directors have received substantial insurance and retirement benefits. Mr. Paolucci testified that if they left the Board, this retirement benefit would remain in place (Paolucci Deposition, page 42). The Bylaws of Cobb EMC, Article 3, Section 5 limit compensation to Directors to a per diem fee plus expenses. Per Diem means a reasonable fee paid for attending specific meetings and other functions. There is no authorization for the payment of retirement benefits and insurance to Directors. These sums should be reimbursed to Cobb EMC.

17.

[REDACTED]

18.

I am asked to assume that each of the Directors has testified that they have no question or concern about conflicts-of-interest relating to any aspect of the Cobb EMC/Cobb Energy contract and relationship, including Brown's service as CEO of both companies and Brown's stock ownership in Cobb Energy. In my opinion, this reflects an

appalling failure of the Board to meet its obligations under the EMC policy Manual and the recommendations of the NRECA guidelines and the Bylaws.

19.

The stated purpose for the creation of Cobb Energy was to "... lower Cobb EMC's cost" (July 22, 1977 Board Minutes). Based on information provided by the company, the adder fees have totaled \$27,506,101 (Exhibit 254) through December 31, 2007. It appears that, through April 2007 Cobb EMC has recognized the sum of \$166K of equity earnings of Cobb Energy. This calculation is as follows:

Schedule 3

<u>Date</u>	<u>Description</u>	<u>Direct Investment</u>	<u>Recognized Earnings</u>	<u>Investment in CEMC Accumulated</u>	<u>Per Audit Reports</u>
9/6/97	Purchase stock	\$11,000	\$ -	\$11,000	
4/31/98	Loss per F/S		(35,524)	(24,524)	
	Unrecognized		35,524	11,000	
1/26/99	Purchase stock	5,020,574		5,031,574	
4/30/99	Equity loss		(626,276)	4,405,298	4,405,297
4/30/00	Equity loss		(955,000)	3,450,298	3,449,297
4/30/01	Equity gain		961,260	4,411,558	4,410,557
4/30/02	Equity loss		(456,778)	3,954,780	3,954,779
4/30/03	Equity gain		658,063	4,612,843	4,612,842
4/30/03	Amended		(481,385)	4,131,458	
4/30/04	Equity gain		472,221	4,603,679	4,603,678
4/30/05	Equity gain		231,026	4,834,705	4,834,704
4/30/06	Equity gain		163,000	4,997,705	4,997,404
4/30/07	Equity gain		200,000	5,197,705	5,197,094
Total			<u>\$ 166,131</u>		

A payout of approximately \$27M versus a noncash return on investment of \$166K does not appear to satisfy the original reason for the creation of Cobb Energy. It

appears that Cobb EMC has been subsidizing Cobb Energy during Cobb Energy's existence. We can only assume that the shareholders of Cobb Energy have been the ultimate beneficiaries of this subsidy.

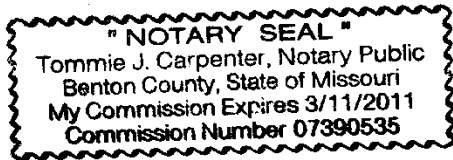
It appears that the relationship between Cobb EMC and Cobb Energy has not lowered Cobb EMC's costs but has increased Cobb EMC's costs substantially. Those costs have reduced the member's patronage allocation.

20.

I recommend the EMC be reimbursed at least the following:

1. The adder fees have totaled \$27,506,101 (Exhibit 254) through December 31, 2007. In the event it is determined, as would appear to be the case that the Cobb Energy scheme is unlawful then all such fees should be reimbursed to the EMC. In the event it is not determined to be unlawful then these adder fees should still be reimbursed to the EMC as there has been no demonstrated benefit to the EMC.
2. The EMC should be reimbursed by ProCore approximately \$14.3M in excess costs.
3. The EMC should be reimbursed for the full value of the meters in the amount of \$15.7M less what can be shown they have already received.
4. The EMC should be reimbursed the \$3M paid to Cobb Energy because of the termination of the SCANA contract.
5. The EMC should be compensated for intercompany rent at fair market value less the amounts already received.
6. The EMC should be compensated for the use of its customer base under the SCANA contract.

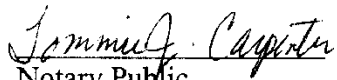
Further affiant sayeth not.




WAYNE MIDDLEBROOKS

DATE: 8/13/08

Sworn to and subscribed
before me this 13th day
of August, 2008.


Notary Public
My Commission Expires:
March 11, 2011