

SUPERIOR COURT OF THE STATE OF GEORGIA

COUNTY OF COBB

EDGAR "BO" POUNDS, individually and on ) Case No. 07-1-9408-48  
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. )  
 )

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A F F I D A V I T

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

1.

I am KENNETH R. NEIL. 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 have been retained by Carr and Palmer to provide accounting advice and counsel regarding accounting and financial issues relating to this case. My resume is attached as Exhibit A. I am a CPA and have years of experience providing accounting services to electric membership corporations.

3.

I have reviewed the audited financial statements for Cobb Electric Membership Corporation (Cobb EMC) for the years ended April 30, 1993 through 2007. Exhibit B. In addition, I have reviewed the board minutes for Cobb EMC for the periods of January 1998 through September 2007. Exhibit C. I also reviewed the Complaint in this case. I have the following observations and opinions to a reasonable degree of accounting certainty:

4.

As of January 1, 1998 Cobb EMC began paying Cobb Energy a 2% add-on to the payroll. The Cobb EMC employees became employees of Cobb Energy. This resulted in Cobb EMC paying 2% more for payroll expense than before. This certainly raises a serious question as to how this benefits the EMC or its members. This add-on apparently changed to a 6% add-on effective April 1, 2000. Again this raises a very serious question

as to what benefit flowed to the EMC and its members as a result of this charge. Without the Cobb Energy contract, the EMC was paying the actual cost, and after the Contract it paid the costs plus a 2% to 6% premium. Prior to this increase Cobb Energy operated at a loss. After this increase Cobb Energy apparently operated at a profit. This suggests that the profitability of Cobb energy is closely tied to the contract with Cobb EMC which is manipulated to cause Cobb Energy to be profitable. The actual effect of the change in the add-on percentage cannot be determined without copies of the operating agreements and addendums between Cobb EMC and Cobb Energy Management.

5.

In the 1999 Cobb EMC audited financial statements, the EMC records the sale of meters to Cobb Energy Management at a book value of \$9,696,967. There should have been an independent evaluation of the meters to make sure that book value was a fair price for the equipment. That does not appear to have been done. There is a reference in the minutes to a valuation by Arthur Anderson but it does not appear that the study was performed. If the valuation was completed, the result was not reported. According to the minutes this transaction had to be completed to facilitate the purchase of 200,000 shares of Cobb Energy preferred stock by the National Cooperative Service Corporation. It appears that management and the directors of the two companies were using the assets of Cobb EMC to facilitate a securities transaction for Cobb Energy with no apparent benefit to the EMC. In order for the board members to meet their fiduciary duties to approve this transaction, they would have had to have had the value of the meters to assure the fairness of the transaction. In the event no valuation was obtained, by the board that

would be a failure of the board to meet their fiduciary obligations from an accounting standpoint.

6.

The 1999 financial statements also indicate the purchase of additional stock of Cobb Energy Management by Cobb EMC totaling \$5,020,574. The January 26, 1999 board minutes indicate that Cobb Energy Management declared and paid a \$5,000,000 dividend to Cobb EMC to fund the purchase. This transaction raises several questions: (1) How does a company which has yet to operate at a profit, declare and pay a \$5,000,000 dividend? (2) What benefit would it be to Cobb Energy Management? (3) Where is the dividend on Cobb EMC's financial statements? I cannot determine that the dividend ever occurred. An audit of all aspects of this transaction should be accomplished to determine the legitimacy of the transaction which is highly questionable from an accounting standpoint.

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According to the National Rural Utilities Finance Corporation 2006 Key Ratio Trend Analysis of the 42 electric cooperatives in Georgia, 35 (83%) report refunding of capital credits. From a cumulative standpoint, the median percentage of capital credits refunded by EMCs operating in Georgia since inception for the State of Georgia was 20.14%. Cobb EMC's percentage as of April 30, 2007 was .452%, which means that the Cobb EMC cumulative capital credits refunds are 97% lower than the median for the state of Georgia. Some explanation of this extremely low return to members is called for.

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8.

The complaint alleges that certain officers and directors of Cobb EMC serve as officers and directors of Cobb Energy and have an ownership interest in Cobb Energy. This is also reflected in certain of the minutes, but the identity of the officers and directors serving both companies is not clearly stated.

9.

The Financial Accounting Standards Board Statement No. 57 on related party disclosures states:

Related party transactions include transactions between (a) a parent company and its subsidiaries; (b) subsidiaries of a common parent; (c) an enterprise and trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of the enterprise's management; (d) an enterprise and its principal owners, management, or members of their immediate families; and (e) affiliates.

Transactions between related parties commonly occur in the normal course of business. Some examples of common types of transactions with related parties are: sales, purchases, and transfers of realty and personal property; services received or furnished, for example, accounting management, engineering, and legal services; use of property and equipment by lease or otherwise; borrowings and lendings; guarantees; maintenance of bank balances as compensating balances for the benefit of another; intercompany billings based on allocations of common costs; and filling of consolidated tax returns. Transactions between related parties are considered to be related party transactions even though they may not be given accounting recognition. For example, an enterprise may receive services from a related party without charge and not record receipt of the services.

The statement goes on to require the following disclosures:

1. The nature of the relationships involved
2. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each year 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.

3. 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 year.
4. 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.

The statement also states:

1. Transactions involving related parties cannot be presumed to be carried out on an arm's-length basis, as the requisite conditions of competitive, free market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions unless such representations can be substantiated.
2. If the reporting enterprise and one or more other enterprises are under common ownership or management control and the existence of that control could result in operating results or financial position of the reporting enterprise significantly different from those that would have been obtained if the enterprises were autonomous, the nature of the control relationship shall be disclosed even though there are no transactions between the parties.

In my opinion, based on generally accepted accounting principles, there should be an annual disclosure of the owners of Cobb Energy stock in the annual report showing the interest each officer and director of the EMC has in Cobb Energy. As there are material transactions between the two companies with overlapping leadership, all such transactions should receive special audit scrutiny to insure adequate disclosure. In my opinion the board of the EMC was in serious violation of its fiduciary obligations from an accounting standpoint in not requiring full and complete disclosure as to the ownership interest of Cobb EMC officers and directors in Cobb Energy on an annual basis. These material transactions involving related parties cannot be presumed to be carried out on an arm's length basis, as the requisite conditions of competitive, free market dealings most

likely did not exist. The existence of the common control could possibly result in operating results or financial position of Cobb EMC or Cobb Energy that would be significantly different from those that would have been obtained if the enterprises were autonomous. It is imperative that management adequately disclose the nature of the relationships between the companies to the readers of the financial statements.

10.

In my opinion there should be a full audit and disclosure of such audit results to the EMC members of all aspects of the material transactions between COBB EMC and Cobb Energy so to determine the fairness of the transactions to Cobb EMC, and to assure that assets of the EMC have not been misappropriated, particularly in light of the related party transactions. To do so would require the audit of at least the following documents:

Cobb Electric Membership Corporation

#### List of Requested Documents

1. Detailed trial balances as December 31, 1997 through 2006
2. Detailed trial balances as of April 30, 1997 through 2007
3. Audit adjustments for the 1998 through 2007 financial statements
4. IRS Form W-4 for 1998
5. All contracts or agreements (including addendums) between Cobb EMC and Cobb Energy Management Corporation
6. Results of any studies conducted regarding the value of assets transferred or sold to Cobb Energy Management Corporation
7. Schedule of payments of add-on fees for services rendered by Cobb Energy Management Corporation for the years ended April 30, 1998 through 2007
8. Results of any studies conducted on the value of Cobb Energy Management Corporation stock
9. Compensation agreements between Dwight Brown and Cobb EMC

10. Evidence of receipt of \$5,000,000 dividend from Cobb Energy Management Corporation received in 1998 or 1999 and the journal entry which recorded the transaction
11. Copies of any notes receivable or notes payable between Cobb EMC and Cobb Energy Management Corporation

Cobb Energy Management Corporation  
List of Requested Documents

1. Detailed trial balances as of the fiscal year end for 1998 through 2007
2. Audited financial statements for the years 1998 through 2007
3. Audit adjustments for the years 1998 through 2007
4. Results of any studies conducted on the value of Cobb Energy Management Corporation stock
5. Copy of Articles of Incorporation
6. Copy of By-Laws
7. Listing of stockholders of record as of September 30, 2007
8. Compensation agreements between Cobb Energy Management Corporation and Dwight Brown
9. Board minutes for 1998 through 2007
10. IRS Form W-4 for 1998 through 2006
11. Schedule of dividends paid since 1998

11.

The companies have common managers and common directors. Cobb EMC is operated on a non-profit basis. Cobb Energy is a for profit company. On the non-profit side, their roles are to provide reliable electric service at the lowest possible cost. On the profit side their roles are to maximize the profit for the benefit of the shareholders. There appear to be clear and severe conflicts of interests. In order to determine the scope and significance of these conflicts there needs to be full and complete review and disclosure to the members of all aspects of the material transactions between the companies and full disclosure as to the benefits flowing to the officers and directors as a result of the relationship.

From an accounting standpoint it is disturbing at best that certain officers and directors of the EMC caused portions of the stock of Cobb Energy, that was owned 100% by Cobb EMC, to be transferred to themselves. Such transactions solidify the conflict of interest as to those who own Cobb Energy stock and also have leadership positions in both companies. This constitutes not only the potential for compromise of objectivity, but almost assures it.

Further affiant sayeth not.

  
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Kenneth R. Neil, CPA, CFE

DATE: 11/29/07

Sworn to and subscribed  
before me this 29th day  
of November, 2007.

Brenda Joyce Kellan  
Notary Public

My Commission Expires:  
Notary Public, Monroe County, Georgia  
My Commission Expires February 21, 2009

