MORGAN STANLEY & CO. INCORPORATED

NEW YORK COUNTY
NEW YORK, NEW YORK

AFFIDAVIT IN SUPPORT OF
ALABAMA POWER COMPANY

JOHN H. HUNEKE being duly sworn, deposes and states:

I am a Principal in the Public Utility Group of Morgan Stanley & Co. Incorporated ("Morgan Stanley"), a leading investment banking firm which is involved in the financing of public utilities throughout the United States. Since 1935, the year Morgan Stanley was founded, the firm has managed or co-managed a total of over $300 billion in public offerings and private placements of new issues of securities, of which over $35 billion has been for investor-owned electric and gas utilities. Morgan Stanley buys equity and fixed-income securities from, and sells such securities to, over 1500 major banks, insurance companies, pension and trust funds and other financial institutions in the United States and throughout the world.

As an investment banker, I am very familiar with the rights of lenders, the obligations of borrowers, and the need for appropriate conditions in financial transactions to assure these rights and obligations. With regard to the Farley transaction between APCO and Alabama Electric Cooperative (AEC), I firmly believe that AEC has the obligation to bear its full share of ownership including the cost of future capital improvements, decommissioning, and unforeseen contingent developments. As a result, I fully support APCO's request for AEC's member companies to provide their own guarantee that APCO will be paid for AEC's full share of Farley ownership costs.

Until recently, it was considered a near impossibility that public power entities would elect the alternative of bankruptcy proceedings in response to financial difficulties. With the bankruptcy filings of groups such as Wabash Valley Power Association, Washington-St. Tammany, and numerous other cooperative association near bankruptcies, it is clear that this is a real likelihood.

In the case of AEC, this cooperative has a very leveraged position with less than $7 million or 2% of its December 31, 1987 total capitalization provided by equity from its member companies. As a result, AEC's members would have little financial interest in the continued viability of AEC if the alternative were a significant financial commitment by them to meet unforeseen capital requirements which do not directly increase their revenue-producing assets. In such event, there is a substantial possibility that AEC would be dissolved.

Given this possibility, it appears that APCO is requesting in this proceeding what any prudent investor would require -- reasonable protection and assurance that ownership obligations will be met by the provision of a guarantee by the member companies of AEC. Through sale of ownership in the Farley unit, APCO is giving up the benefits of this economic generating station. It is inequitable that APCO should assume the risks associated with AEC's ownership in this plant in the event of unforeseen future financial requirements.

In this proceeding, AEC has argued that provision of such a guarantee by its member companies would harm their future capital raising capacity. I would maintain that these members already have a "potential" liability, whether explicit or implicit, by virtue of their participation in AEC. Astute lenders, in considering the creditworthiness of these companies, would take this into account as they make decisions about future financial commitments to them. The fact that there is a formal guarantee to APCO in the event of currently unforeseen financial requirements should not affect the ability of these companies to finance in the future.

Even if such a guarantee were to impact the financial position of the member companies, this would not change my view on the appropriateness of APCO being granted such a guarantee. It seems only equitable that APCO be in a position to protect itself from having to pay costs for which AEC is, in fact, obligated. APCO should be given reasonable assurance that AEC, by way of its members, will fully share in the ownership risks relating to the Farley unit. AEC's member companies have considerably more equity support than AEC itself, totaling over

$95 million at December 31, 1987, which represents 30-50% of each of their total capitalizations. It makes financial sense for those members to put their equity behind their obligations, just as APCO does.

STATE OF NEW YORK
NEW YORK COUNTY

John H. Huneke, being first duly sworn, deposes and says that he has read the Affidavit of John H. Huneke and that the matters and things set forth therein are true and correct to the best of his knowledge, information and belief.

John H. Huneke
John H. Huneke

Subscribed and sworn to before me this the 17th day of May, 1988.

Lenore Bell
Notary Public

My Commission expires: LENORE BELL
Notary Public, State of New York
No. 41-4790907
Qualified in Queens County
Commission Expires 12/31/89

COPY

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF INDIANA
INDIANAPOLIS DIVISION

In Re: WABASH VALLEY)
POWER ASSOCIATION, INC,) Case No. IP85-2238RA S
Debtor.)

TRANSCRIPT OF PROCEEDINGS

taken in the above matter on March 20, 1987, before the Honorable Nicholas Sufana, at the U. S. Courthouse, 46 East Ohio Street, Indianapolis, Marion County, Indiana, before Notary Public Carol A. Karen, RPR/CP.

VOLUME V

ACCURATE REPORTING OF INDIANA
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APPEARANCES:

For CFC

Mr. Wilbur Foster
Mr. Thomas Titsworth

For Government

Mr. George Kielman
Mr. Tim Brown
Mr. Frank Clover

For WVPA

Mr. David Kleiman
Mr. Mel Daniel
Mr. Don Morton

For Fruit Belt

Ms. Margaret Morris

For Members Committee

Mr. Steven Ancel

10:00 A.M., E.S.T.

March 20, 1987

THE COURT: This is a continued hearing in the matter of Wabash Valley Power Association, Inc. under cause number IP 85-2238RA S. We're now hearing the debtor's side of the valuation hearing. Are you ready with the first witness?

MR. KLEIMAN: Yes, your Honor. We would call Mr. Paul Kovich.

S. PAUL KOVICH, called upon to testify on behalf of WVPA, having been first duly sworn, testified as follows:

DIRECT EXAMINATION,

QUESTIONS BY MR. KLEIMAN:

Q. State your name, please.

A. S. Paul Kovich, K-O-V-I-C-H.

Q. And your address, Mr. Kovich?

A. 245 East 87th Street, New York City.

Q. And where are you currently employed, Mr. Kovich?

A. Senior vice-president with Shearson-Lehman Brothers.

Q. Beginning with your graduation from high school, would you tell the court your educational background?

A. I attended high school in New Jersey, I attended college in New Jersey, Drew University where I received a Bachelor's in economics, and I attended Columbia Graduate School of Business, where I received an M.B.A. with a specialization in accounting.

Q. Would you also tell the court what your professional experience has been since you graduated from Drew University?

A. After Drew University I worked for two years as an accountant with a company that makes air pollution control equipment, Research Control.

After Columbia Business School I worked for two years with Arthur Andersen and Company as a public accountant in the regulated industries division. Following that, I joined Bache, Allis, Drew & Shields (phonetic), an investment bank and brokerage firm where I worked in the public utilities group providing investment banking services to electric utilities, gas companies, telephone utilities.

Following three years with Bache, I joined Shearson-Lehman Brothers, at that time it was Lehman Brothers, where I have been employed now for about four and a half years, again doing work with the public utility industry, primarily electric companies, providing investment banking services to those companies.

Q. Mr. Kovich, the people in the back may have trouble hearing you, so you might want to speak up a little louder.

A. Okay, thank you.

Q. Will you tell the court what kind of a business Shearson-Lehman Brothers is?

A. Shearson-Lehman Brothers is an investment bank and brokerage firm. It's a wholly-owned subsidiary of American Express Company. It provides financial services to corporations, governments, municipal entities, private companies, public companies. It also provides investment services to retail and institutional investors. We provide sales and trading capabilities to those investors for their securities, and the area that I specialize in is the investment banking side, and that does involve providing financial services to corporations and governments, entities of that nature.

Q. Is Bache, the firm that you formerly worked for, also an investment banking firm?

A. Yes, they provide basically the same services that Shearson-Lehman does.

Q. Will you tell us briefly the kind of work that you performed at Bache?

A. There I was -- at that time I was a more junior member of the investment banking department. I worked with senior bankers providing financial services to public utilities. We helped arrange financings. We provided advisory services on things like dividend policy, credit ratings, capital structure; but primarily, the main focus of the business there was raising money through debt offerings and equity offerings.

Q. Can you tell the court some of the representative clients in the electric utilities industries that are served by Shearson-Lehman Brothers?

A. Yes. We work with Long Island Lighting

Company, Central Maine Power, New York State Electric & Gas, Baltimore Gas & Electric, Cleveland Electric Illuminating, Union Electric Company, Indianapolis Power & Light, Toledo Edison, in the past we have also done work with So. Cal. Edison, Duke Power, quite a few more utilities we can keep going through, if you want.

Q. That's adequate.

A. Okay. We also do work with rural electric co-ops and also with municipal power systems, too.

Q. Can you tell the court some of the rural electric co-ops and other companies in that industry for which Shearson-Lehman Brothers performs services?

A. Certainly. We are the lead banker to National Rural Utilities Cooperative Finance Company.

Q. CFC?

A. CFC. We provide extensive advisory services to CFC. We are the lead banker for most of their public debt offerings. We advise them when they are providing financing services to their members, such as leverage pollution control financings.

We also work directly with many of the large generation and transmission cooperatives, for instance, Wabash Valley, we provided financial services to them in the past, Arkansas Electric, Buckeye Power, Cajun, Deseret, most of the major G&T's, Seminole. We have extensive experience with these companies.

Q. Do you have clients for which you are personally responsible?

A. Yes.

Q. Would you tell the court some of those that are your personal clients?

A. Long Island Lighting Company, on the investor-owned utility side, Long Island Lighting Company.

Q. Does Long Island Lighting Company have a nuclear plant?

A. Yes. Currently involved in the Shoreham Nuclear Power Station. That plant is complete but LILCO, which is the acronym for Long Island Lighting Company, is having considerable difficulty in getting a final operating license for that plant. They have been having that difficulty now for approximately two years over a disagreement with the State of New York about the adequacy of evacuation plans.

Q. You're consulting with them about these types of interests?

A. We have been financial advisor to LILCO since 1983. We have been a banker to them for much longer than that, but financial advisor during this period advising them on their financial condition relative to the problems created by not getting this plant in service.

When you have that much of your assets tied up with a non-productive entity, it can wreak havoc on your financial condition.

Q. What are some of the other clients you personally worked with?

A. New York State Electric & Gas, it's also involved in a large nuclear project, Nine Mile Pt. 2 project in northern New York. It's a co-tenant with other utilities in that project. It owns 18%. They are currently experiencing difficulties with that plant, too.

I work with Baltimore Gas & Electric, Pennsylvania Power & Light, Rochester Gas & Electric.

In the past I have done -- been intimately involved with Central Maine. Over the past year I have done less work with them, but that was a primary relationship at one point.

On the rural electric cooperative -- with the cooperatives I'm one of the two people that spend an awful lot of time with CFC. I do work with a managing director at Shearson-Lehman Brothers on that account, but we function equally and almost independently at times because the demands of that client relationship are so great and, of course, doing the work here at Wabash in this case.

Q. That's the valuation work?

A. The valuation work here.

Q. Generally, what types of services do you provide to your clients?

A. We help them raise money. That's a very important function. We help them raise money in the debt and equity markets, but we also provide advice to them, financial advice, advice on mergers and acquisitions, whether they are planning on buying a company or they are afraid they may be bought by another company.

We provide guidance on setting dividend policy, advice often establishing a credit policy, their own credit, trying to maybe take a weaker credit and help them turn it into a better credit over time. We provide advice on capital structure. Just general financial strategic planning is a major area we provide a lot of advice to.

Q. Do you provide any services on take-over defense?

A. Yes, take-over defense is part of the valuation. Work we do in mergers and acquisitions, take-over defense is a portion of that business.

Q. What is take-over defense?

A. Take-over defense is -- in the utility industry the prospects for hostile takeovers where a company tries to come in and take over another company really against the

wishes of management is a fairly recent
phenomenon. It's much more common to
corporate America in general. It's
something that's been around now for 10 or
20 years, but for utilities it's a fairly
new threat, and we provide advice to
corporations to position themselves so they
are not such an easy target for takeovers.
That involves some valuation work, and it
also involves advice on restructuring
3 charters, Articles of Incorporation, putting
in various take-over defense methods.

Q. The various types of work that you
identified, do any of these involve
valuations?

A. Most of them involve valuations in one form
or another.

Q. Can you just generally describe how that
occurs?

A. Sure. Whenever you're raising money for a
company it implies valuation. For instance,
if you're doing a bond offering, the debt of
a company has a value just like the equity
of a company, and that debt is a function of
those credit ratings in the capital markets

at the time, so in a real sense you're providing valuation for the senior securities of that company. Certainly the same is true in equity offerings, also when you're providing work in relation to mergers and acquisitions in take-over defense.

The large part of that job involves establishing values for company, either the companies you're trying to buy or establishing a value for yourself in your defense of your company if someone is trying to take you over.

We also take on valuation assignments. This is certainly one. Another one we're involved in right now is providing advice to the government of New Zealand to restructure and provide a valuation for the generation and transmission power supply system for that country, and that is first and foremost a valuation, and after we establish a value, it will be up to us to propose an appropriate capital structure, rate setting methodology, things of that nature.

Q. Who is your client in that situation?

A. It is the government of New Zealand. We're working with the treasury department.

Q. Is that at this time a not-for-profit entity?

A. It's a not-for-profit, and very often a loss entity, as many government-owned organizations can be. We are trying to structure it as really as a quasi-public company. Where you have a government-owned entity, very often there are other objectives you're trying to meet besides just making a profit or satisfying your debt servicing. We are restructuring it as a quasi-public agency, and we would expect that sometime in the future it will, indeed, go public.

Q. Are there other people involved in that valuation process and restructuring process?

A. Sure. In a valuation many times there is the need to hire experts on particular areas. We happen to be using R. W. Beck. We hired Beck to provide engineering expertise on this particular assignment, and we selected Beck because they have a very good reputation in the industry for this type of work, engineering and consulting work, and we have done business with them numerous times in the past on the municipal finance side.

We also hired an economic consulting firm from Putman & Hayes to provide consulting work on a variety of regulation and economic matters. It's common to hire extra consultants in a situation like that.

Q. So it would be common to work with a consulting engineer in a valuation project?

A. Very much so, especially in a valuation project that depends upon a real understanding of technical engineering matters.

Q. The valuation that you did for Wabash Valley, was that done in the manner that you would normally do in these other valuations that you have generally referred to in your prior testimony?

A. Yes.

Q. Would you tell the court generally the methodology that you employed in doing the valuation for Wabash Valley?

A. Certainly. The method we used is a method that's common to most valuation exercises done by people from Wall Street. We tend to rely on the market very heavily to guide us in determining what value should be placed upon enterprises. That's the area of expertise that we have. We trust the market. We believe it works efficiently and we believe it helps to resolve a lot of the subjective points involving valuation.

Q. What is the market?

A. The market, the market is public capital markets for debt and equity securities. It's a huge auction process that goes on every day where individual investors, institutional investors, buy and sell securities, debt and equity securities.

In the process of doing that, they are continually revaluing the valuations of publicly owned companies. Values are being set every day by that market. There are enough people doing it that we have a lot of faith in that auction process. It gives a very good estimate of value.

The process that we undertake, which we will call the market valuation approach, really begins with getting a real understanding of the business you're trying to value. Any approach is going to require that. You have to feel certain that you understand the risks of that business, that you understand the history of that business, where it is today, where it's going in the future, what the projections of its financial condition are and why they are that way; but primarily, making sure you really have a good understanding of the risks associated with that future stream of earnings, those future streams of cash flow that you hope to value.

Q. In the case of Wabash Valley, did you examine into the risks associated with this company?

A. Yes.

Q. Would you explain that to the court?

A. Certainly. During the past year and a half we have had considerable opportunity to get familiar with the business of Wabash Valley and understanding the risks with Wabash Valley. At one level it's complicated, every business faces a number of risks, but it's also at another level fairly simple. Wabash Valley is a generation and transmission utility that supplies bulk power. Bulk power supply is one of the most competitive aspects to the public utility business. Wabash Valley happens to operate in a very competitive bulk power supply market. There are a lot of utilities, investor-owned utilities and otherwise around here that have excess capacity, and will have excess capacity for quite a long time.

Wabash Valley then is faced with a competitive threat to its market. It has real pricing considerations, just as in many instances almost like an industrial company would have. To the degree that its rates are subject to regulation differentiates it a little from an industrial company, but the ultimate determiner in my opinion, after this year and a half of study, is going to be the market. This is a competitive power supply market and that is a major risk.

Q. Before going on, why are risks so important to the investment banker?

A. Well, risks are important to the investment banker because they are important to the investor. You can't determine what return you require on an investment unless you really have a good understanding of what the risks are. You can go out and buy a long-term government security at 7 1/2% yield and feel that that might be a very low yield but, on the other hand, there is a very low risk inherent in that investment.

The other side of the extreme, staying with the debt as an example, would be what's commonly referred to as junk bonds, bonds that have less than investment grade credit ratings, bonds that have an inordinate amount of risk attached to investing. Today, as I said, long-term government securities have yields of about 7 1/2%, junk bonds easily have yields of 13 1/2 to 14%. Those are significant risk premiums associated with making investments in significantly riskier investment alternatives so, until you have a good understanding of what that risk is, you can't really know what the return should be.

Q. Does the risk issue have an importance as it relates to disclosure?
A. Very much so.
Q. Would you explain what disclosure is and how risk relates to that?
A. Certainly. In an initial public offering, or in any public offering of securities, an initial public offering is particularly important in this case because that was one of the major subjects we made in approaching this valuation process.

We have assumed that we would be taking Wabash Valley public in an initial offering. The disclosure requirements established by the Securities and Exchange Commission are demanding, and they are particularly demanding for initial offerings for companies that haven't been publicly owned in the past that are being offered for the first time to the public.

There are a whole host of disclosure requirements. By "disclosure," I mean information must be presented in the prospectus that's used to sell these securities, a prospectus that's delivered to the public at the termination of their sale, and the requirements for disclosure for those prospectuses require that you provide a very detailed outline of what the business is, what the historical financial condition of the company has been, what the business risks that company faces are, and particularly in an initial public offering a business risk section is considered to be so important it always comes first, and to the extent that you have particular business risks that may present extreme risks to an investor, you very often put them on the front of the prospectus.

The investor needs to know what these risks are before he can agree to buy at those prices that you set or not buy at those prices that you have set, and force you in your offering of those securities to even lower the prices. So he has to know what those risks are, and you face considerable legal liability as an underwriter if you haven't adequately disclosed those risks because you haven't told the whole story.

We're required to diligently examine the underlying business that creates those numbers that we are disclosing.

Q. The investigation you have described, is that what's known as due diligence?

A. That's what's referred to as due diligence, yes.

Q. Your investigation of the business of Wabash, was that in the nature of a due diligence exercise?

A. Most certainly, most certainly. In this case it might be called something different, but we went through the same things we would do if we were performing a due diligence review of a company for initial public offering.

Q. Is regulation an item that has to be discussed in the disclosure document?

A. Certainly, when you're dealing with a utility regulation must be discussed. Competition is discussed, even for utilities that are integrated, may face less competition than the wholesale bulk power supplier does. But competition, regulation, those things that are fundamental to a business are always disclosed and discussed at length.

Q. Would you be required in the prospectus to set forth the current regulatory regulations as they relate to the company that was going public?

A. Certainly. We would describe state regulation, and to the extent there was any federal regulation, we would discuss to what degree the federal regulation affects those revenues, what percentages regulated at the FERC level. Yes, two or three pages might be on regulation.

Q. And would the same be true for competition?

A. That certainly would be true. Competition disclosure requirements are directly dealt with in disclosure regulations for prospectuses. You have to talk about major suppliers, major customers. Those are requirements.

But in addition, you have to deal with the competition in the market that you're selling your products into, who your competitors might be, what competitive pressures your business might face. If you didn't discuss those you would run a real risk of facing considerable legal liability if the valuation you place on those securities at the time of the offering turned out not to be the valuation that they really could withstand given those competitive pressures.

Q. Are you aware of the wholesale power supply contracts between Wabash Valley and its principal customers, being its members?

A. Certainly. It's very similar to the contracts throughout the rural electric industry.

Q. You have seen these types of contracts in other situations?

A. Sure, yes.

Q. Would there need to be disclosures regarding these contracts in a prospectus or an offering memorandum?

A. Yes, most certainly. The whole business of Wabash Valley depends on contracts, it particularly depends on these contracts. Before entering into an initial public offering where the valuation of the business depends on a series of contracts, and given some of the experiences currently in this industry with the enforcement of contracts, just the experience in business in general, in particular over the past ten years or so over the enforcement of contracts or the non-enforceability of contracts in many instances, these contracts would be a major disclosure point and they would also -- being an investment banker and trying to bring this company public, and taking it more from a hypothetical to an actual, if I were structuring this deal I would want more than just disclose the nature of the contracts.

I would ask Wabash, request Wabash strenuously to go back and try to have those contracts either reaffirmed or guaranteed by its members, to do something to bind those distribution members even more tightly to Wabash than is currently evidenced by the contracts that exist.

Q. You testified and mentioned a problem throughout the industry. Can you describe that for the court?

A. It's a fairly recent phenomenon, but it appears to be a serious one. There are a number of instances in the rural electric industry where these contracts are being challenged. The situation exists in Alabama right now that's referred to as the Cousa Valley case where a distribution member is trying to challenge the validity of a contract.

There is another case in the Pacific referred to as the Shashone case where the Shashone distribution cooperative sold its business out to an investor-owned utility and took the position that that voided the contract, and that there were no more liabilities attached under the all-requirements contracts once that business was dissolved and sold away.

There are numerous instances concerning the Seabrook Nuclear Power Plant involving cooperatives and municipal power suppliers.

Q. What is the Seabrook?

A. The Seabrook Nuclear Power Project is one of the many nuclear power projects that the electric utility is facing considerable difficulty with. There were two units. The first one is basically finished, the second one has been cancelled. Numerous partners have gotten out of those contracts.

Q. Were there wholesale power supply contracts going out of the Seabrook situation?

A. To the extent that there were some G&T's that are the partners of Seabrook, New Hampshire Distribution Co-Op involved, Massachusetts and Maine, I believe there is a cooperative in Maine involved in the Seabrook project. There has been considerable pressure on those cooperatives to get out of those contracts, break the contracts and extricate themselves from the Seabrook mess.

Q. Were there also investor-owned utilities who had all-requirements contracts with or had requirement contracts in the Seabrook project?

A. Well, there are two utilities in Maine that had contracts with Public Service of New Hampshire to buy power from that project.

Q. Were one of those utilities a client of Shearson-Lehman Brothers?