

# **Capital Credits Policy**

## **PEDERNALES ELECTRIC COOPERATIVE, INC.**

### **1. Purpose:**

**1.1.** The Capital Credits Policy (“Policy”) establishes the general Policy of and manner in which Pedernales Electric Cooperative, Inc. (“Cooperative” or “PEC”) allocates and retires Patronage Capital.

### **2. Scope:**

**2.1.** This Policy applies to all members and former members who have Allocated Capital Credits, the Board of Directors (“Board”), and employees of the Cooperative.

**2.2.** The Cooperative will allocate and retire capital credits in a manner that permits the Cooperative to comply with all applicable laws, all restrictions imposed by its debt financing covenants, the Cooperative Articles of Incorporation and Bylaws, is fair to the Cooperative’s members and former members, and is reasonable to maintain a healthy financial state.

### **3. Definitions:**

**3.1.** Allocated Capital Credits – means the amount of Capital Credits received by members appearing as an entry on the permanent financial records of the Cooperative that reflects a member’s equity. Allocated Capital Credits are distributed with an established retirement date. Margins are allocated to members yearly based on the amount billed to the member for electric purchases and the associated gross margin during that year.

**3.2.** Capital Credits – are a representation of each member’s share of the Cooperative’s margins as allocated during membership.

**3.3.** Discounted Retirement – is a Capital Credits retirement made before the established retirement date of an Allocated Capital Credit. A Discounted Retirement is the current net present value of a Capital Credits retirement that would otherwise have been made at a later date. The discounted amount received, if invested until the established retirement date, is equal to the established retirement amount.

**3.4.** Equity Management Plan – The Cooperative’s plan for future equity stabilization as outlined in the Equity Management Plan Policy.

**3.5.** General Retirements – Allocated Capital Credits retained by the Cooperative until an established retirement date. The Board declares a payment of General Retirements after a determination of the Cooperative’s financial health.

**3.6.** Inactive Accounts – An account under the membership of a person, business, corporation, or entity that is no longer receiving electric service, and whose membership fee has been applied to the final bill or refunded to the account holder.

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- 3.7.** Net Margins – means the percentage of revenue remaining after all operating expenses, interest, and taxes have been deducted from the Cooperative’s total revenue.
- 3.8.** Net Loss – means the bottom line of the Cooperative’s income statement when revenues and gains are less than the aggregate amount of cost of goods sold, operating expenses, losses, and income taxes.
- 3.9.** Non-Natural Member – means a membership in PEC held by a business entity or group other than a natural person that has dissolved or otherwise ceased existence and the account is inactive.
- 3.10.** Retired Capital Credits – means the payment distributed to member from Allocated Capital Credits when the Board declares a retirement after determination of the Cooperative’s financial health.
- 3.11.** Special Capital Credits Retirements – occurs when the Cooperative retires Capital Credits outside the established schedule for retirements. The Board declares a Special Capital Credits Retirement after determination of the Cooperative’s financial health.
- 3.12.** Unclaimed Capital Credits – a member’s financial interest in Capital Credits that is presumed abandoned after one or more years that is or may become Unclaimed Property.

#### **4. Policy Statement and Implementation:**

- 4.1.** Board approval. The Cooperative will allocate and retire Capital Credits in the manner, method, time, and amount as described in this Policy and as approved by the Board.
- 4.2.** Net margin allocations. Each member purchasing electricity from the Cooperative will receive an allocation of the net margins as adjusted for the net change in accrued unbilled revenue, made by the Cooperative during the fiscal year. Such allocation shall be made pro rata based upon the dollar amount of electricity purchased by the member during the year over the total amount of electricity purchased by the members. Prior to the allocation, the billing records shall be adjusted for each member and in total for negative total of purchases during the fiscal year so that members do not receive a negative allocation of the net margins.
- 4.3.** Net loss allocations. If the Cooperative has a loss in a given year, that loss will not be allocated to members. Instead, that loss will be rolled forward and combined with the positive net margins in the succeeding year(s) and any remaining net margins will then be allocated to the members.
- 4.4.** General Capital Credits Retirements. General retirements will be correlated to the assumptions and limitations contained in an Equity Management Plan to be

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approved annually. This correlation serves as the basis for a Board affirmative determination as to whether or not a retirement may result in an adverse impact to the Cooperative. The Board shall make this affirmative determination prior to any retirement. All retirements must comply with restrictions placed on PEC by its lenders, its Articles of Incorporation, Bylaws and state and federal law.

Each year, subject to the Board's determination, the Cooperative will implement its general retirement strategy with the following principles in mind:

- 4.4.1. Retire total allocation of capital credits to the estates of deceased members that have come to the attention of the Cooperative. (See description below for Special Capital Credits Retirements).
- 4.4.2. Consider other special retirements for members that are corporate entities no longer in existence, inactive and delinquent accounts.
- 4.4.3. Approximately one-half of the general capital credits retirement will be from the oldest outstanding year(s) in which allocations have been made that have not yet been retired.
- 4.4.4. The remainder of the general retirement of capital credits shall be made available from the most recent year(s) for which allocations have been made, and may be made at a discounted rate. (See description below for Discounted Retirements).

**4.5. Special Capital Credits Retirements.** The Cooperative may retire capital credits outside the normal schedule for retirements under the following circumstances. For each of the following, the Board may annually set limits, either individually by member or in the aggregate, for the cash amounts that may be paid in the fiscal year:

- 4.5.1. Estates - The Cooperative may specially retire capital credits when the Cooperative receives proper notification that a member or former member who is a natural person has died. Upon request by the appropriate representative of the member and upon receipt of appropriate documentation, the Cooperative will pay the estate at a discounted rate as a Discounted Retirement as described below.
- 4.5.2. Non-Natural Members - The Cooperative may specially retire capital credits when the Cooperative receives proper notification of the dissolution, liquidation, or cessation of existence of an entity member or former member. Upon request of the appropriate representative of the entity and receipt of appropriate documentation, the Cooperative may pay the entity its remaining capital credits as a Discounted Retirement as described below. A non-natural entity that has dissolved or otherwise ceased existence for the

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purposes of reorganizing will not be eligible for a special distribution under this section.

- 4.5.3. **Inactive Accounts** - The Cooperative may specially retire capital credits of a former member when the member's account has been inactive for a period of no less than five years. Any special retirements under this provision shall be made as a Discounted Retirement as described below.
- 4.6. Discounted Retirement.** If the Board so directs, the Cooperative will pay the discounted, net present value of the capital credits. Any member or former member may refuse and elect to defer such discounted retirement until such date as the distribution at full value would otherwise occur. The amount of the discounted distribution will be calculated using a discount rate that equals the Cooperative's weighted cost of capital and taking into account the date that the distribution would have occurred based on an approximate thirty-year schedule of retirement. This method of calculation will apply to both general and special retirements made prior to the general retirement schedule which may be subject to a discounted rate. While the Cooperative will seek to maintain an approximate 30 retirement schedule, the actual discount period shall be the number of years of unretired patronage capital, including amounts assignable to the patrons, for the most recently ended fiscal year.
- 4.7. Recoupment.** If a member or former member has a balance due to the Cooperative, the Cooperative shall apply part or all of the capital credits being retired to the member's (or former member's) account, unless other arrangements for payment have been made by the member.
- 4.8. Forfeiture of Capital Credits.** The Cooperative shall not enter into any agreements under which a member or former member forfeits the right to the allocation or retirement of Capital Credits. The discounting of Capital Credits as provided for in this Policy shall not be deemed a forfeiture.
- 4.9. Member classes.** If the Board approves, the Cooperative may allocate or retire capital credits to similar classes of members or former members under different manners, methods, timing, and amounts, as long as the Cooperative, based on reasonable and fair distinctions, allocates and retires capital credits to similar classes, members and former members using the same manner, method, timing, and amount; provided that the Cooperative may discount capital credits as described above.
- 4.10. Notice of Allocation.** The Cooperative shall notify each member in writing of the amount allocated to the member for the preceding fiscal year within eight and one-half months following the end of the fiscal year.

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- 4.11. Method of payment.** The Cooperative will retire Capital Credits to members either by cash, check or by bill credits, whichever the Board of Directors determines will be most effective and in the Cooperative's best interest. Former members may be notified in writing of the retirement of their Capital Credits prior to issuance of a check to confirm the location of the former member.
- 4.12. Minimum Amount.** The Cooperative shall not retire and pay capital credits in an amount less than ten dollars (\$10.00), unless the retirement and payment is for all remaining Capital Credits allocated to a former member. This section shall not apply to discounted distributions for the most recent years retired as part of the general distribution strategy.
- 4.13. Records.** The Cooperative will keep complete records of the amount of unretired capital credits that have been allocated to each member and former member, along with a record of the retirements to that member representing the five years preceding the oldest outstanding unretired year. This information will be available upon request to each member.
- 4.14. Unclaimed Capital Credits.** When a member/former member fails to cash or claim a Retired Capital Credits check, the Cooperative shall send a notice to the member's or former member's most current address listed on the Cooperative's records calling this failure to the member's attention. If the member or former member has not contacted the Cooperative after 45 days from the date of the first notice, a second notice will be sent; provided, however, the first notice was not returned to the Cooperative as non-deliverable without a forwarding address.
- 4.14.1. Former members may be notified of a retirement prior to the issuance of a check in order to confirm the new location of the former member. If there is no response from the former member, the failure to respond to the notice of retirement will be treated the same as the failure to cash or claim a check for the purposes of the Cooperative's Unclaimed Property responsibilities. If the notice is returned to the Cooperative as non-deliverable without a forwarding address, the second notice is not required and no further action is necessary.
- 4.14.2. When Retired Capital Credits remain unclaimed after three years, the retirement distribution may be delivered in accordance with PEC's Unclaimed Property Policy and with Section 74.3013 of the Property Code. Otherwise, such amounts will be reported and remitted to the State Comptroller's Office in accordance with current State of Texas unclaimed property laws.

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### **5. Procedure Responsibilities**

- 5.1. Implementation of Policy.** The Cooperative's Chief Executive Officer ("CEO") is responsible for implementing this Policy and for developing the practices and procedures necessary to allocate and retire capital credits according to this Policy.
- 5.2. Recommendations to the Board.** The Cooperative's CEO is responsible for: (1) recommending to the Board the manner, method, timing, and amount for allocating and retiring capital credits; and (2) when changes are believed to be in the best interest of the Cooperative and its members and former members, recommending to the Board revisions to this Policy.
- 5.3. Education and Communication.** The Cooperative's CEO is responsible for developing and implementing a program to (1) educate employees and members about the role of Capital Credits in the cooperative business model and (2) effectively inform employees and members about annual allocations and retirements.
- 5.4. Review and Approval by Board.** The Board is responsible for:
- 5.4.1. Reviewing, discussing, and evaluating the CEO's recommendations regarding the allocation and retirement of Capital Credits;
  - 5.4.2. Approving Allocations and Retirements of Capital Credits
  - 5.4.3. Reviewing, discussing, and evaluating this Policy regularly;
  - 5.4.4. Reviewing, discussing, and evaluating the CEO's recommendations for revisions of this Policy;
  - 5.4.5. Approving and directing revisions to this Policy.

### **6. Enforcement**

- 6.1.** The Board of Directors oversees and enforces this Policy. The CEO shall implement and comply with this Policy. Violations of this Policy may result in disciplinary action, up to and including, termination.

### **7. Superseding Effect**

- 7.1.** This Policy supersedes all previous policies and memoranda concerning the subject matter. Only the Approver may authorize exceptions to this Policy.

### **8. References and Related Documents:**

- 8.1.** Articles of Incorporation
- 8.2.** Bylaws
- 8.3.** Equity Management Plan Policy
- 8.4.** Unclaimed Property Policy

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### PEDERNALES ELECTRIC COOPERATIVE, INC.

Policy Title:	Capital Credits Policy
Review Frequency:	Every three years
Last Reviewed:	September 17, 2018
Date Adopted:	December 20, 2010
Effective Date:	January 1, 2011
Amendment Dates:	December 20, 2010; September 19, 2011; September 15, 2014, November 14, 2016, September 17, 2018
Approver:	Board of Directors
Applies to:	All PEC Members, former Members, Board of Directors and employees
Administrator:	Chief Financial Officer
Superseding Effect	This Policy supersedes all previous policies and memoranda concerning the subject matter. Only the Approver may authorize exceptions to this Policy.