

# **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 who have Allocated Capital Credits (as defined herein), the Board of Directors (“Board”), and employees of the Cooperative.
- 2.2. The Cooperative will allocate Capital Credits and retire Allocated Capital Credits in a method that permits the Cooperative to comply with all applicable laws, all restrictions imposed by its debt financing covenants, the Cooperative’s Articles of Incorporation and Bylaws, in a method that is just and reasonable, not unreasonably preferential, prejudicial, or discriminatory to the Cooperative’s Members, and in a way that maintains a healthy financial state for the Cooperative.

### **3. Definitions:**

- 3.1. Active Account – An account of a Member that is receiving electric service or energy.
- 3.2. Allocated Capital Credits – The amount of Capital Credits allocated to each Member appearing as an entry on the permanent financial records of the Cooperative that reflects a Member’s equity in the Cooperative.
- 3.3. Capital Credits – A representation of each Member’s share of the Cooperative’s Net Operating Margins based upon each Member’s purchases of electric service or energy, or as such Net Operating Margins may otherwise be allocated within a Member Class to a Member.
- 3.4. Capital Credit Retirements (or Retired Capital Credits) – The payment retired to a Member from Allocated Capital Credits when the Board declares a retirement after determination of the Cooperative’s financial health.
- 3.5. Discount Factor – The Discount Factor will be based upon the Cooperative’s cost of equity capital rate and the Retirement Schedule and calculated in accordance with Section 4.9.
- 3.6. Equity Management Plan – The Cooperative’s plan for equity stabilization as outlined in the Equity Management Plan Policy.
- 3.7. General Capital Credit Retirements – The Allocated Capital Credits retained by the Cooperative and retired in accordance with Section 4.7.
- 3.8. Inactive Accounts – An account under the membership of a natural person or Non-Natural Member that is no longer receiving electric service or energy, and whose membership fee has been applied to the final bill or refunded.
- 3.9. Member – Any individual or entity with capacity to enter into legally binding contracts that seeks electric service or energy within the Cooperative’s service area and fulfills requirements specified in the Bylaws and Tariff and Business

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Rules. A Member may include a former member. A Member may be a natural person or a Non-Natural Member.

- 3.10.** Member Class – A group of Members with similar electric use service characteristics (e.g. residential, commercial, industrial) taking service under one or more rate schedules.
- 3.11.** Net Operating Margins – The excess revenue remaining after all operating expenses, including but not limited to, cost of power, depreciation, interest, and taxes have been deducted from the Cooperative’s total operating revenue.
- 3.12.** Net Operating Loss – The lack of revenue remaining when revenues are less than the aggregate amount of all operating expenses, including but not limited to, cost of power, depreciation, interest, and taxes.
- 3.13.** Non-Natural Member – A membership in PEC held by a business entity, trust, or group or entity other than a natural person.
- 3.14.** Non-Operating Margins – The margins generated from activities that are not related to providing electric service or energy to Members including, without limitation, interest income, gain or loss on disposal of assets, monetary settlements, and any other activities that would not be considered related to providing electric services or energy.
- 3.15.** Patronage Capital – The capital component a Member furnishes the Cooperative through payment of amounts billed for electric services or energy.
- 3.16.** Retirement Schedule – An approximate thirty-year schedule for retirement of Capital Credits as determined by the Board.
- 3.17.** Special Capital Credits Retirements – The Allocated Capital Credits retained by the Cooperative and retired in accordance with Section 4.8.
- 3.18.** Unclaimed Capital Credits – A Member’s financial interest in Allocated Capital Credits that is presumed abandoned after one or more years and that is or may become “Unclaimed Property” under Texas law.

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

- 4.1.** Board Approval. The Cooperative will allocate Capital Credits and retire Allocated Capital Credits in the manner, method, time, and amount as described in this Policy and as approved by the Board.
- 4.2.** Net Operating Margin Allocations.
  - 4.2.1. Each Member purchasing electricity or being billed for electric services or energy from the Cooperative will receive an allocation of the Net Operating Margins.
  - 4.2.2. Non-Operating Margins will not be included in the allocation of Net Operating Margins.
  - 4.2.3. If the Board approves, the Cooperative may allocate Capital Credits or retire Allocated Capital Credits to the various Member Classes under different manners, methods, timing, and amounts, as long as the Cooperative, based on distinctions that are just and reasonable, not

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unreasonably preferential, prejudicial, or discriminatory, allocates Capital Credits and retires Allocated Capital Credits to Members within the same class using the same manner, method, timing, and amount. Furthermore, the Cooperative may discount Allocated Capital Credits when retiring prior to the Retirement Schedule.

4.2.4. In most cases, the dollar amount of electricity or energy purchased by the Member during a year over the total amount of electricity or energy purchased by the Members within a Member Class is calculated to determine that Member's Patronage Capital and resulting contribution to Net Operating Margins.

4.2.5. Other methods of allocating Net Operating Margins may be utilized that are deemed to be just and reasonable, not unreasonably preferential, prejudicial, or discriminatory.

### **4.3. Adjustments.**

4.3.1. Net Operating Margins may be adjusted for the net change in accrued unbilled revenue, made by the Cooperative during the fiscal year.

4.3.2. Prior to any allocation, billing records shall be reviewed for each Member to ensure that any Members with a net negative billing have been adjusted so that these Members do not receive a negative allocation of the Net Operating Margins.

4.4. **Net Operating Loss Allocation.** If the Cooperative has a Net Operating 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 Operating Margins in the succeeding year(s) and any remaining Net Operating Margins will then be allocated to the Members.

4.5. **Notice of Allocation.** The Cooperative will notify each Member in writing of the amount allocated to the Member for the preceding fiscal year within approximately eight and one-half months following the end of the fiscal year.

### **4.6. Capital Credit Retirements.**

4.6.1. Capital Credit Retirements will be made consistent with the assumptions and limitations contained in the approved Equity Management Plan. This analysis serves as the basis for a Board determination as to whether a retirement may result in an adverse impact to the Cooperative. The Board shall make a determination prior to any Capital Credit Retirements.

4.6.2. All Capital Credit Retirements must comply with restrictions placed on PEC by its lenders, its Articles of Incorporation, its Bylaws, and state and federal law.

4.6.3. Each year, subject to the Board's determination as to the impact to the Cooperative, the Cooperative will implement its Capital Credits Retirement strategy on a systematic basis for that year which includes General Capital Credits Retirement and/or Special Capital Credit Retirements as described in Sections 4.7 and 4.8.

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4.6.4. When retiring Allocated Capital Credits, either through General Capital Credit Retirements or Special Capital Credit Retirements, prior to the anticipated Retirement Schedule, the Cooperative will pay the discounted, net present value of the Capital Credits with the presumption that any Capital Credit retired prior to the Retirement Schedule will be paid after application of the Discount Factor. The actual amount of the discount will be recorded in the systems and records of the Cooperative in the name of the Member.

4.6.4.1. Only those members with an Active Account may refuse and elect to defer a discounting of its Allocated Capital Credits until such date as the payment at full value would otherwise occur. Acceptance of the discounted retirement of Capital Credits shall be considered acceptance of the Discount Factor.

### **4.7. General Capital Credits Retirements.**

4.7.1. In general, Allocated Capital Credits are retired based upon the Retirement Schedule as permitted by the financial health of the Cooperative and in accordance with Cooperative policies, but other time frames may be appropriate as determined by the Board. Unless otherwise directed by the Board, Capital Credits are generally retired as follows:

4.7.1.1. A portion of the General Capital Credit Retirements will be from the oldest outstanding year(s) for which allocations have been made that have not yet been retired. To the extent the oldest outstanding year(s) being retired have been retained less than the Retirement Schedule, the amounts being retired will be made after application of the Discount Factor.

4.7.1.2. A portion of the General Capital Credit Retirements will be made from the most recent year(s) for which allocations have been made that have not yet been retired. To the extent the most recent year(s) being retired have been retained less than the Retirement Schedule, the amounts being retired will be made after application of the Discount Factor.

4.7.1.3. A portion of the General Capital Credit Retirements may be made from such other year(s) for those members with Active Accounts for which allocations have been made that have not yet been retired. To the extent the most recent year(s) being retired have been retained less than the Retirement Schedule, the amounts being retired will be made after application of the Discount Factor.

**4.8. Special Capital Credits Retirements.** The Cooperative may retire Capital Credits outside the Retirement Schedule after considering the determination of the Cooperative's financial health.

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- 4.8.1. Estates – The Cooperative may specially retire Capital Credits when the Cooperative receives proper notification that a 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 its remaining Allocated Capital Credits after application of the Discount Factor.
- 4.8.2. 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 any Non-Natural Member. Upon request of the appropriate representative of the entity and receipt of appropriate documentation, the Cooperative will pay the Non-Natural Member its remaining Allocated Capital Credits after application of the Discount Factor. A Non-Natural Member that has dissolved or otherwise ceased existence for the purposes of reorganizing will not be eligible for a Special Capital Credit Retirement under this section.
- 4.8.3 Inactive Accounts – The Cooperative may specially retire Capital Credits of a former member when the former member has been disconnected from electric service and is no longer continuing service with PEC. In addition to retiring the historically Allocated Capital Credits, the Cooperative may estimate and allocate the current period's capital credit amount for a Member disconnecting from service using the prior year's allocation percentage. The Cooperative will pay the former member its Allocated Capital Credits after application of the Discount Factor.
- 4.9. Discounting of Allocated Capital Credits.**
- 4.9.1. The discounting of Allocated Capital Credits is computed by determining the current net present value of a retirement of Capital Credits that would otherwise have been made upon the anticipated Retirement Schedule. The discounted amount would be equal to the full retirement amount if it had been invested until the Retirement Schedule.
- 4.9.2. The amount of the discounted payment will be calculated using the Discount Factor that equals the Cooperative's cost of equity capital and taking into account the date that the payment of Capital Credits would have occurred based on the Retirement Schedule. The Cooperative will seek to maintain the Retirement Schedule.
- 4.9.3. This discounting of Allocated Capital Credits will apply to both General Capital Credit Retirements and Special Capital Credit Retirements made prior to the Retirement Schedule.
- 4.10. Recoupment.** If a 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 account balance, unless other arrangements for payment have been made by the Member.

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- 4.11. Forfeiture of Capital Credits.** The Cooperative shall not enter into any agreements under which a 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.
- 4.12. Method of payment.** The Cooperative will retire Capital Credits to Members either by cash, check, or bill credits, whichever the Board determines will be most effective and in the Cooperative's best interest.
- 4.13. Minimum Amount.** The Cooperative shall not retire and pay Allocated 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. The Cooperative may notify a former member that the former member has Allocated Capital Credits in an amount less than ten dollars (\$10.00).
- 4.14. Records.** The Cooperative will keep complete records of the amount of unretired Capital Credits that have been allocated to each 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. The Cooperative requires each Member with Allocated Capital Credits to keep the Cooperative informed of such Member's current mailing address in order that the Cooperative may retire Allocated Capital Credits efficiently.
- 4.15. Unclaimed Retired Capital Credits.**
- 4.15.1. Each year the Cooperative will send Retired Capital Credits to the most current address listed on the Cooperative's records for those Members with Allocated Capital Credits being retired. The Cooperative may receive returned Retired Capital Credits that Members have failed to claim or may receive notifications as a result of Members' failure to cash Retired Capital Credits. In each instance, the Cooperative will void any unclaimed or uncashed Retired Capital Credits within 120 days of issuance.
  - 4.15.2. For a period of three years the Cooperative will continue to send Retired Capital Credits to the most current address listed on the Cooperative's records of a Member with Allocated Capital Credits being retired that year even if in prior years the address for the Member has been determined as non-deliverable.
  - 4.15.3. The Cooperative may post on its website the names of Members with Retired Capital Credits that have been unclaimed or uncashed.
  - 4.15.4. When Retired Capital Credits remain unclaimed after three years, those amounts may be delivered in accordance with PEC's Unclaimed Property Policy and with Section 74.3013 of the Texas Property Code. Otherwise, the Cooperative will notify the Member regarding any unclaimed Retired Capital Credits in accordance with the current State of Texas unclaimed property laws and following such notice to those

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Members, such Retired Capital Credits will be reported and remitted to the State Comptroller's Office as required by law.

### **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 Capital Credits and retire Allocated 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 Capital Credits and retiring Allocated Capital Credits; and (2) when changes are believed to be in the best interest of the Cooperative and its 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 of Capital Credits and retirements of Allocated 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; and
  - 5.4.5. Approving and directing revisions to this Policy.

### **6. Enforcement:**

- 6.1. The Board 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. Texas Utilities Code Section 161.059
- 8.2. Articles of Incorporation
- 8.3. Bylaws
- 8.4. Texas Utilities Code Section 41.055
- 8.5. Equity Management Plan Policy
- 8.6. Unclaimed Property Policy

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**8.7. Capital Credits Handbook**

**8.8. Tariff and Business Rules**

Policy Title:	Capital Credits Policy
Review Frequency:	Every three years
Last Reviewed:	November 22, 2019
Date Adopted:	December 20, 2010
Effective Date:	November 22, 2019
Amendment Dates:	December 20, 2010; September 19, 2011; September 15, 2014; November 14, 2016; September 17, 2018; November 22, 2019
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.