



CAPITAL CREDITS POLICY

Effective Date: ~~November 22, 2019~~TBD

POLICY AT A GLANCE

PEC is committed to upholding the Cooperative Principle of **Member Economic Participation** by reinvesting in our operations and returning margins to our Members in the form of Capital Credits.

SUBJECTS INCLUDED IN THIS POLICY

CEO Responsibilities	Board Responsibilities	Net Operating Margin Allocations	Adjustments
Net Operating Loss Allocation	Notice of Allocation	Capital Credit Retirements	Discounting of Allocated Capital Credits
Establishing a Capital Credits Beneficiary	Recoupment	Forfeiture of Capital Credits	Method of Payment
Minimum Amount	Records	Unclaimed Retired Capital Credits	



1. PURPOSE

The purpose of the Capital Credits Policy ("Policy") ~~establishes the general policy of and is to establish that the method~~ and manner in which Pedernales Electric Cooperative, Inc. ("Cooperative" or "PEC") allocates and retires Patronage Capital. ~~The Cooperative will allocate Capital Credits and retire Allocated Capital Credits in a method that is compliant permits the Cooperative to comply with all applicable laws, all restrictions imposed by its debt financing covenants, and the Cooperative's Articles of Incorporation and Bylaws. The allocation and retirement of Patronage Capital shall be in a method that is just and reasonable, reasonable, not unreasonably preferential, prejudicial, or discriminatory to the Cooperative's Members, and implemented in a way that maintains a healthy financial state for the Cooperative.~~

2. SCOPE

2.1. This Policy applies to all Members (including designees) who have Allocated Capital Credits ~~(as defined herein)~~, the Board of Directors ("Board"), and employees of the Cooperative.

~~2.2.1.1. 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. POLICY AND IMPLEMENTATION

3.1. Chief Executive Officer ("CEO") Responsibilities

3.1.1. The CEO is responsible for:

3.1.1.1. Implementing this Policy and for developing the practices and procedures necessary to allocate Capital Credits and retire Allocated Capital Credits according to this Policy;

3.1.1.2. Recommending to the Board the manner, method, timing, and amount for allocating Capital Credits and retiring Allocated Capital Credits. Recommending revisions to this Policy to the Board when changes are believed to be in the best interest of the Cooperative; and

3.1.1.3. 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.

3.2. Board Responsibilities

3.2.1. The Board is responsible for:

3.2.1.1. Reviewing, discussing, and evaluating the CEO's recommendations



regarding the allocation and retirement of Capital Credits;

3.2.1.2. Approving allocations of Capital Credits and retirements of Allocated Capital Credits;

3.2.1.3. Reviewing, discussing, and evaluating this Policy regularly;

3.2.1.4. Reviewing, discussing, and evaluating the CEO's recommendations for revisions of this Policy; and

3.2.1.5. Approving and directing revisions to this Policy.

3.1.3.3. Net Operating Margin Allocations

3.3.1. Each Member purchasing electricity or being billed for electric services or energy from the Cooperative will receive an allocation of the Net Operating Margins.

3.1.1.1.3.3.1.1. Non-utility. Non-Operating Margins will not be included in the allocation of Net Operating Margins.

3.1.2.3.3.2. 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, is~~ not acting 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 credits prior to the Retirement Schedule.

3.1.3.3.3.3. 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.

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

3.2.3.4. Adjustments

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

3.2.2.3.4.2. Prior to any allocation, the Cooperative shall review each Member's 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.

3.5. Net Operating Loss Allocation

3.2.3.3.5.1. 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.

3.6. Notice of Allocation



3.2.4.3.6.1. 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.

3.3.3.7. Capital Credits Retirements

3.3.4.3.7.1. Capital Credits Retirements will be made consistent with the assumptions and limitations contained in the approved Equity Management Plan. ~~The Board will use the Equity Management Plan analysis serves~~ as the basis for ~~its~~ Board determination ~~as to~~ whether a retirement ~~of credits~~ may result in an adverse ~~financial~~ impact to the Cooperative. The Board ~~shall~~ must make ~~this~~ determination prior to any Capital Credit Retirements.

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

3.3.3.3.7.3. 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 Credits Retirements as described in Sections 3.78 and 3.89.

3.3.4.3.7.4. When retiring Allocated Capital Credits outside of the Retirement Schedule, either through General Capital Credits Retirements or Special Capital Credits Retirements, ~~prior to the anticipated Retirement Schedule~~, the Cooperative will pay the discounted (applying the Discount Factor), 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.

3.3.4.1.3.7.4.1. ~~Only those Members~~ with an Active Account may refuse Allocated Capital Credits retired outside the Retirement Schedule 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. Members with Inactive Accounts may not refuse Allocated Capital Credits.

3.4.3.8. General Capital Credits Retirements

3.4.1.3.8.1. In general, Allocated Capital Credits are retired ~~based upon~~ in accordance with the Retirement Schedule as permitted by the financial health of the Cooperative ~~and in accordance consistent~~ with Cooperative policies, but the Board may decide to retire credits under alternative schedules, other time frames may be appropriate as determined by the Board. Unless otherwise directed by the Board, Capital Credits are generally retired as follows:

3.4.1.1.3.8.1.1. A portion of the General Capital Credits Retirements will be from the oldest outstanding year(s) for which allocations have been made that have not yet been retired. To the extent credits from the oldest outstanding year(s) being retired have been retained less than the prescribed period in the Retirement Schedule, the Discount Factor will be applied to those credit amounts being retired ~~will be made after application of the Discount Factor~~.



~~3.4.1.2-3.8.1.2.~~ A portion of the General Capital Credits 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 credits from the most recent year(s) being retired have been retained less than the prescribed period in the Retirement Schedule, the Discount Factor will be applied to those credit amounts being retired ~~will be made after application of the Discount Factor.~~

~~3.4.1.3-3.8.1.3.~~ For members with Active Accounts and unretired credit allocations, Aa portion of the General Capital Credits Retirements may be made from ~~any~~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 credits the most recent year(s) being retired have been retained less than the prescribed period in the Retirement Schedule, the Discount Factor will be applied to those credit amounts being retired ~~will be made after application of the Discount Factor.~~

3.9. Special Capital Credits Retirements

~~3.4.2-3.9.1.~~ The Cooperative may retire Capital Credits outside the Retirement Schedule after considering the determination of the Cooperative's financial health.

~~3.4.2.1-3.9.1.1.~~ Estates - The Cooperative may specially retire Capital Credits when the Cooperative receives proper notification that a Member who is a natural person has died. If a Capital Credits Beneficiary was not established, uUpon request by the appropriate representative of the Member and upon receipt of appropriate legal documentation, the Cooperative will pay the estate its remaining Allocated Capital Credits after application of the Discount Factor. See Section 3.10 of this Policy for information on establishing a Capital Credits Beneficiary.

~~3.4.2.2-3.9.1.2.~~ 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 legal 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.

~~3.4.2.3-3.9.1.3.~~ 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 receiving electric~~ service ~~from 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.

3.10. Establishing a Capital Credits Beneficiary

~~3.10.1.~~ A Capital Credits Beneficiary is either a natural person or the PEC Charity designated by a Member to receive the Member's Capital Credits Retirements.



3.10.2. If a Member has designated a Capital Credits Beneficiary, through PEC's Capital Credits Beneficiary determination process, the Capital Credits Beneficiary may be eligible to receive the Member's Allocated Capital Credits as a Special Capital Credits Retirement or one or more General Capital Credits Retirement authorized by the Board.

3.10.3. Upon a Member designating a natural person as a Capital Credits Beneficiary, and anytime thereafter, the Member may agree to a discounted retirement upon their death. If the Member does not agree to a discounted retirement for its Capital Credits Beneficiary, the Member's Allocated Capital Credits will be retired through one or more General Capital Credit Retirements.

3.10.4. Upon designating the PEC Charity as a Capital Credits Beneficiary, and anytime thereafter, the Member may agree to a discounted retirement upon their death.

3.5.3.11. Discounting of Allocated Capital Credits

3.5.4.3.11.1. The discounting of Allocated Capital Credits is computed by first determining the current net present value of a retirement of Capital Credits that would otherwise have been made upon the anticipated Retirement Schedule based on the Cooperative's cost of equity capital. The discounted amount would be equal to the full retirement amount if it had been invested until the Retirement Schedule.

3.5.2.3.11.2. The amount of the dDiscounted pPayment will be equal to the net present value calculated using the Discount Factor that equals the Cooperative's cost of equity capital and taking into account considering 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.

3.11.3. This discounting of Allocated Capital Credits will apply to both General Capital Credits Retirements and Special Capital Credits Retirements made prior to the period prescribed in the Retirement Schedule.

3.12. Recoupment

3.5.3.3.12.1. 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.

3.13. Forfeiture of Capital Credits

3.5.4.3.13.1. 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.

3.14. Method of pPayment

3.5.5.3.14.1. The Cooperative will retire Capital Credits to pay Members for retired Capital Credits either by cash, check, or bill credits, or other electronic means, depending on what method whichever the Board determines will be most effective, and in the Cooperative's best interest.

3.15. Minimum Amount

3.5.6.3.15.1. 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).

3.16. Records

~~3.5.7.~~**3.16.1.** 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.

3.6.3.17. Unclaimed Retired Capital Credits

~~3.6.4.~~**3.17.1.** ~~To the extent Retired Capital Credits are to be paid to Members via check, Each year~~ the Cooperative will send checks containing Retired Capital Credits amounts 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 ~~If a~~ Members ~~have~~has failed to claim or ~~may receive~~ notifications as a result of Members' failure to cash checks with Retired Capital Credits Amounts. In each instance, the Cooperative will void any such unclaimed or uncashed check Retired Capital Credits within 120 days of issuance.

~~3.6.2.~~**3.17.2.** ~~Notwithstanding Section 3.17.1 of this Policy, if the 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 for~~ a Member with Allocated Capital Credits being retired has been determined by the Cooperative to be non-deliverable with respect to that Member, the Cooperative will not send a check containing Retired Capital Credit amounts for the Member to that address. Members, including former Members, are encouraged to keep the Cooperative informed of their current mailing address to facilitate receiving Allocated Capital Credit amounts as credits are retired. If required by the Texas Property Code, the Cooperative will send notice to a Member's last known address before remitting unclaimed Retired Capital Credits to the State Comptroller's Officer pursuant to Section 3.17.3 of this Policy. that year even if in prior years the address for the Member has been determined as non-deliverable.

3.6.3. ~~The Cooperative may post on its website the names of Members with Retired Capital Credits that have been unclaimed or uncashed.~~

~~3.6.4.~~**3.17.3.** When Retired Capital Credits amounts remain unclaimed after three years, those amounts may be remitted to the State Comptroller's Office 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 Members, such Retired Capital Credits will be reported and remitted to the State Comptroller's Office as required by law.~~

3.7. PROCEDURE RESPONSIBILITIES



- ~~3.8. **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.~~
- ~~3.9. **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.~~
- ~~3.10. **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.~~

4. DEFINITIONS

- 4.1. **Active Account** – An account of a Member that is receiving electric service or energy from PEC.
- 4.2. **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.
- 4.3. **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.
- ~~4.3.4.4. **Capital Credits Beneficiary** – A natural person or the PEC Charity designated by a Member to receive the Member's Capital Credit Retirements.~~
- ~~4.4.4.5. **Capital Credits Retirements (or Retired Capital Credits)** – The payment ~~retired~~ made to a Member or a designee based on ~~from~~ Allocated Capital Credits at the time ~~when~~ the Board declares a retirement of credits after determination of the Cooperative's financial health.~~
- 4.6. **Discount Factor** – The Discount Factor will be ~~factor to be applied~~ based upon the Cooperative's cost of equity capital rate and the Retirement Schedule and calculated in accordance with Section ~~4.93.119~~ of this Policy.
- ~~4.5.4.7. **Discount Payment** – The amount paid to the Member equal to the net present value based upon the Cooperative's cost of equity capital rate and the number of years remaining in the Retirement Schedule.~~
- ~~4.6.4.8. **Equity Management Plan** – The Cooperative's plan for equity stabilization as outlined in the Equity Management Plan Policy.~~
- ~~4.7.4.9. **General Capital Credits Retirements** – The Allocated Capital Credits retained by the Cooperative and retired in accordance with Section ~~4.73.8~~ of this Policy.~~
- ~~4.8.4.10. **Inactive Accounts** – A Member ~~account under the membership of a natural person or Non-Natural Member~~ that is no longer receiving electric service or energy from PEC, and whose membership fee has been applied to the final bill or refunded.~~



4.9.4.11. Member – ~~As defined in PEC's Tariff and Business Rules, a Member is a~~Any Person, firm, corporation, or body politic or governmental entity that has applied for electric service and has paid the Cooperative's membership fee and agrees to be bound by the Cooperative's governing documents~~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 Rules. Under this Policy, A~~ Member may include a former Member. ~~A Member may be a natural person or a Non-Natural Member.~~

4.10.4.12. 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.

4.11.4.13. Net Operating Margins – The excess revenue remaining after all operating expenses and cost of capital, including but not limited to, cost of power, depreciation, interest, and taxes have been deducted from the Cooperative's total operating revenue.

4.12.4.14. Net Operating Loss – The lack of revenue remaining when revenues are less than the aggregate amount of all operating expenses and other costs, including but not limited to, cost of power, depreciation, interest, and taxes.

4.13. Non-Natural Member – A membership in PEC held by an business entity, trust organization, or group or legal entity other than a natural person.

4.15.

4.14.4.16. 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, realized monetary settlements, and any other activities that would not be considered related to providing electric services or energy.

4.17. Patronage Capital – The capital component a Member furnishes the Cooperative through payment of amounts billed for electric services or energy.

4.15.4.18. PEC Charity – A nonprofit organization established by PEC that Cooperative Members may designate as a beneficiary for Capital Credits.

4.19. Person – Any natural person, organization, or legal entity.

4.16.4.20. Retirement Schedule – An approximate thirty-year schedule for retirement of Capital Credits as determined by the Board.

4.17.4.21. Special Capital Credits Retirements – The Allocated Capital Credits retained by the Cooperative and retired in accordance with Section 4.83.9 of this Policy.

4.18.4.22. 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.

5. POLICY ENFORCEMENT

The Board oversees and enforces this Policy. The CEO, through the Policy Administrator, shall implement and comply with this Policy. Violations of this Policy may result in disciplinary action, up to and including, termination.



6. REFERENCES AND RELATED DOCUMENTS

[Texas Property Code \(Unclaimed Property Title 6\)](#)

[Articles of Incorporation](#)

[Bylaws](#)

[Texas Utilities Code Section 161.059](#)

[Texas Utilities Code Section 41.055](#)

[Equity Management Plan Policy](#)

[Unclaimed Property Policy](#)

~~Capital Credits Handbook~~

[Tariff and Business Rules](#)

Date adopted:	December 20, 2010
Last reviewed:	November 22, 2019 <u>TBD</u>
Review frequency:	Every 3 years
Amendment dates:	December 20, 2010; September 19, 2011; September 15, 2014; November 14, 2016; September 17, 2018; November 22, 2019; <u>TBD</u>
Effective date:	November 22, 2019 <u>TBD</u>
Approver:	Board of Directors
Applies to:	All PEC members, former members, Board of Directors and employees
Policy 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.

