

CAPITAL CREDITS POLICY
Amended and Restated: December 20, 2010
Effective Date: January 1, 2011
Implementation Date: April 1, 2011
Amendment: September 19, 2011

I. Objective

The objective of this Capital Credits Policy ("Policy") is to state the general policy of Pedernales Electric Cooperative, Inc. ("Cooperative") for allocating and retiring capital credits.

II. Policy

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.

III. Expectations

A. Board approval. The Cooperative will allocate and retire capital credits in the manner described in this policy and as approved by the Board.

B. Net margin allocations. Each member purchasing electricity from the Cooperative will receive an allocation of the net margins (profits) made by the Cooperative during the year based upon the dollar amount of electricity purchased by the member during the year unless the member has a negative total of purchases during the year.

C. 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.

D. General capital credit retirements. General retirements will be correlated to the assumptions and limitations contained in an Equity Management Plan to be 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 retire capital credits in the following order:

- 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 Unscheduled Retirements).
- 2.) Retire approximately one-half of the remaining capital credits from the oldest outstanding year(s) in which allocations have been made that have not yet been retired.
- 3.) Discount and retire a portion of the remaining capital credits from the most recent year(s) for which allocations have been made (See description below for Discounted Retirements).

E. Capital credit retirements - Unscheduled. The Cooperative may retire capital credits outside the normal schedule for retirements, 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 discounted, net present value of the capital credits to the estate of the deceased member. The amount of such distributions 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.

F. Discounted Retirement. If the Board so directs, the Cooperative will pay the discounted, net present value of the capital credits. Any 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.

G. 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.

IV. Limitations

A. 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.

B. 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.

C. 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.

D. Method of payment. The Cooperative will retire capital credits to members either in cash or by bill credits, whichever the Board of Directors determines will be most effective and in the Cooperative's best interest.

E. Records. The Cooperative will keep complete records of the amount of capital credits that have been allocated to each member, along with a record of the retirements to that member. This information will be available upon request to each member.

F. Unclaimed capital credits. If a member/former member fails to cash or claim a capital credit retirement check, then 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 check remains unclaimed after three years, the distribution may be delivered in accordance with Section 74.3013 of the Property Code to a scholarship fund, to an economic development fund and to an energy efficiency assistance fund, each as further described and to the limits described in such 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.

V. Responsibility

A. Implementation of Policy. The Cooperative's Chief Executive Officer is responsible for implementing this policy and for developing the practices and procedures necessary to allocate and retire capital credits according to this policy.

B. Recommendations to the Board. The Cooperative's Chief Executive Officer 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.

C. Education and Communication. The Cooperative's Chief Executive Officer 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.

D. Review and Approval by Board. The Board is responsible for: (1) reviewing, discussing, and evaluating the Chief Executive Officer's recommendations regarding the allocation and retirement of capital credits; (2) approving or proposing changes to these recommendations; (3) reviewing, discussing, and evaluating this policy every year; (4) reviewing, discussing, and evaluating the Chief Executive

Officer's s recommendations for revising this policy; (5) approving and directing revisions to this policy.

E. Compliance with Policy. The Board is responsible for the Cooperative's compliance with this policy.