

WELLS RURAL ELECTRIC COMPANY

Adopted: March 1976

Revised: May 10, 2006

Reviewed: August 21, 1998

POLICY NO. 4-2

CAPITAL CREDITS

I. OBJECTIVES

- A. To clarify the intent of Article VIII of the Bylaws regarding non-profit operation; and
- B. To establish the policy of the Wells Rural Electric Company (“the Company”) on the allocation and retirement of patronage capital (hereinafter referred to as “capital credits”) so that the allocation and retirement of capital credits are (1) consistent with applicable state and federal law, (2) consistent with operating on a cooperative basis pursuant to federal income tax law, (3) fair and equitable to the patrons and former patrons of the Company, and (4) protects the Company’s financial condition by providing sufficient equity and capital for effectively and efficiently operating the Company.

II. POLICY CONTENT

A. Allocation of Capital Credits

1. Provision of Electric Service (i.e. Sale of electric power and energy)

Annually, following the close of the calendar year of the corporation, the Company shall determine the amount of capital that has been contributed by the patrons, pursuant to Article VIII - COOPERATIVE NON-PROFIT OPERATION of the Bylaws, and allocate the same to a capital credit account of each member who contributed capital to the corporation during the calendar year, on the following basis:

- a. The patrons, who are purchasing electric service, shall be divided into and assigned to classes of service.
- b. A cost of service study shall be made to determine the costs that were incurred in servicing the respective classes of service during the calendar year for which the capital credits are being determined. In making the cost of service study, two or more classes of service may be combined for purposes of determining the amount of capital contributed and the allocation of capital contributed.
- c. The amount of capital contributed each year by each class of service, or each combination of classes of service, shall be determined by subtracting the cost of providing service to said class or each of the combined classes, during the year, from the total revenue received from said class or combined classes during said year.

- d. The amount of capital contributed by each class or combined classes for the calendar year shall be allocated to the patrons of said class or combined classes, and credited to each patron's capital credit account pro rata and on the basis and in the percentage that each patron's billings for such calendar year bears to the total billings of the billings of all patrons within the class or combined classes.

2. Provision of "Other Utility Type Services"

The Board of Directors ("the Board") is authorized to offer "other utility type services" to member and non-member patrons on a cooperative basis. The phrase "other utility type services" shall mean the sale and provision of services, which qualify for exemption under Section 501(c)(12) of the Internal Revenue Code, provided that the Board adopts a resolution or policy to offer such services on a cooperative basis.

As of the date of this policy, the Company offers (1) wireless and satellite Internet access and (2) security installation and monitoring services and (3) electrician services to its patrons. Such services may qualify for exemption under Section 501(c)(12) of the IRC.

However, it is the intent of the Company to currently offer such services, whether to members or non-members, on a non-patronage basis. Should the Company wish to offer such services on a patronage basis as "other utility type services", then the action and timing of such action required by provisions of Policy 4-1 "Financial Management", Section II.D shall be followed.

3. Patron Defined

For purposes of this policy, the term "patron" refers to a member purchasing electric service pursuant to Article VIII, Section 1 of the Bylaws. All consumers purchasing electric service from the Company are members. The term "patron" includes members and non-members purchasing other utility type services for which the Board has resolved to operate at cost on a cooperative basis pursuant to Section II.A.2 of this policy.

4. Cooperative Services Defined

For purposes of this policy, the term "cooperative services" includes the provision of electric service on a cooperative basis pursuant to Section II.A.1 of this policy. The term also includes "other utility type services" for which the Board has determined in Section II.A.2 of this policy to provide and operate on a cooperative basis. See the attached Cooperative Services Schedule.

5. Tax Margins Defined

Section 3.3(e), Article VIII of the Bylaws provides that the margins for allocating capital credits will be the greater of federal taxable income, as determined before the exclusion of allocations of patronage capital, and alternative minimum taxable income. In any year that the Company is exempt from federal income tax, other than from the unrelated business income tax, (i.e. the Company receives 85% or more of its revenue and income from members), it is assumed that the book margins from the provision of cooperative services will approximate the margins as computed on a federal income tax basis and will be the assignable margin as contemplated under Section 3.3(e) of Article VIII. In any year the Company operates as a non-exempt, taxable cooperative (i.e. the Company receives less than 85% of its revenue and income from members), it is the intent of the Company to calculate and allocate the patronage-sourced margin as computed on a federal income tax basis from the provision of cooperative services.

6. Allocation Units

The margins that shall be allocated in the form of patronage capital from the provision of cooperative services shall be determined separately for each distinctive cooperative service and shall be allocated to the patrons purchasing such cooperative services as follows:

- a. From the provision of electric service pursuant to the provisions of Section II.A.1, and
- b. From the provision of other utility type services pursuant to the provisions of Section II.A.2.

The margins or losses of one allocation unit may not be netted with the losses or margins of another allocation unit unless the Board obtains the approval of a simple majority at the annual meeting of the Company of the patrons purchasing such services.

7. Losses

With respect to losses incurred from the provision of cooperative services to the patrons, the Company will determine the amount of loss associated with each cooperative service.

The Board will then determine the appropriate method for handling the loss separately for each cooperative service. The method chosen will be determined annually by resolution of the Board. However, the Board may consider implementing one or more of the following:

- a. Record an accounts receivable due from the patron(s) generating the loss,
- b. Carry the loss forward to offset future margins from the provision of cooperative services that would otherwise be allocated to the patrons until such loss is fully offset,

- c. Cancel the outstanding capital credits belonging to the patrons who purchase the cooperative service(s) generating loss(es), and/or
- d. Use the loss to offset against unallocated reserves, such as unallocated non-operating margins from prior years and other amounts not distributable to the members, except upon dissolution of the Company.

The loss or losses will be determined separately for each distinctive cooperative service as determined for Section II.A.6 – “Allocation Units”. In accordance with such provision, the losses or margins of one cooperative service shall not be offset with the margins and losses of another cooperative service without prior authorization from the patrons purchasing such services.

Additionally, for any year the Company incurs a loss from the provision of electric service as determined through the cost of service approach, the Board shall determine the appropriate method for addressing the loss for each class of electric service.

8. Margins and Losses from Other than the Provision of Cooperative Services

Margins that are not allocated pursuant to Sections II.A.1 – “Provision of Electric Service” and II.A.2 – “Provision of Other Utility Type Services” shall be retained by the Company as capital that is not allocated and distributed to the patrons except upon dissolution of the Company, unless the Board takes appropriate action to use such margins and capital to offset losses from the provision of cooperative services. Such capital is considered part of the net assets of the Company.

Losses other than from the provision of cooperative services shall be offset against prior margins that have been retained as capital that is not allocated and distributed to the patrons except upon dissolution.

9. Notice of Allocation – Timing and Method of Notification

Within eight and one-half months after the close of the fiscal year, the Company shall (a) allocate to the patrons the margins from the provision of cooperative services as determined pursuant to Section II.A and subsections (1) through (8) above and (b) notify each patron in writing of the dollar amount of capital allocated and credited to his/her/its capital account. If a patron receives an allocation for the purchase of one or more cooperative service, then the patron shall be notified separately of the allocation for each service.

B. Retirement of Capital Credits

The retirement of capital credits is an essential part of truly operating on a cooperative basis. To the extent that the Company is compliant with applicable laws and loan

covenants and to the extent that the financial condition of the Company is not impaired thereby, it is the intent of the Board to consider early retirements of capital credits belonging to estates of deceased natural persons, to consider a general retirement of capital credits for current and former patrons, and to consider early retirements of capital credits for patrons other than deceased natural persons.

1. Retirement of Deceased Person's Capital Credits

Pursuant to the provisions of Article VIII, Section 3.8, Bylaws of the Company, the Board may, to the extent possible, considering the financial condition of the company and the provisions of mortgages and security agreements of its primary and supplemental lenders, retire the capital heretofore credited to any deceased natural patron in the present and prior years. The Board has determined that it is in the best interests of the Company to retire the capital credits of deceased persons, on a discounted basis, prior to any general retirement of capital credits for the particular years involved, pursuant to this policy as the same may be amended from time to time, and provided that the financial condition of the Company is not impaired thereby. The current provisions of this policy are:

- a. Written request for such retirement and payment must be made by the legal representative of the estate, by any person lawfully entitled to receive such retirement and payment, or pursuant to court order.
- b. The amount of the deceased person's capital credits shall be discounted and paid at an amount representing net present value of capital credits if such capital credits are retired prior to general retirements, pursuant to this policy. The net present value shall be calculated using the formula of $1/(1+r)^n$, where r is the discount rate and n is the discount period. For purposes of this policy:
 - (i) The discount period is the estimated retirement cycle of the Company (i.e. the period of time from when patronage capital is allocated by the Company to when such allocated patronage capital is retired) and shall be determined at the beginning of each year as the lesser/greater of the following:
 - Number of years of capital credits allocated and outstanding as of the end of the prior fiscal year calculated by subtracting (1) the earliest fiscal year date with capital credits reported as allocated and outstanding from (2) the current fiscal year date. For example, if the current fiscal year ends December 31, 2004 and the oldest year of capital credits allocated and outstanding is 1986, then the estimated retirement cycle is 18 years (Year 2004 less Year 1986). And
 - Number of years determined by dividing (1) the balance of capital credits allocated and outstanding less the balance of capital credits allocated to Newmont Gold by (2) the average retirement of capital

credits authorized by the Board for the previous five [5] years and (3) rounded to the nearest whole number.

- (ii) The discount rate shall be ten percent (10%) on the basis of a compound discount (simplified).
- (iii) At the beginning of each year, the Company will adopt a Net Present Value schedule for implementing Section A of this policy using the discount period and discount rate defined above. See the attached Net Present Value Schedule.

c. The difference between (1) the face amount of the capital credits allocated and outstanding and (2) the net present value of such capital credits, which are approved for early retirement, is the discount. The discount is irrevocably assigned and contributed to the Company and is recorded to general ledger account 217 – “Retired Capital Credits – Gain”.

d. Payment shall only be made:

- (a) upon written application therefore;
- (b) approval of the same by the Board; and
- (c) acceptance of the same by the recipient as payment in full of all capital credits of the deceased.

e. In the event payment is made to other than the executor or administrator of the estate of the deceased, or pursuant to the order of a court of competent jurisdiction, the corporation may require, prior to payment, such bond, warranties, assurances, guaranties and/or hold harmless agreements as it deems appropriate.

f. Capital credit retirements pursuant to this policy, shall not be made for deceased persons who are survived by a widow or widower that continues to be a patron of the corporation.

g. No retirements shall be made under this policy except as to capital credits of deceased natural persons.

h. Payment may be deferred until the calendar year following the application.

i. The amount of cash payment for the retirement of capital credits pursuant to this policy shall be limited to a deceased patron's estate individually and as to all deceased patrons' estates annually by: (a) the Articles of Incorporation as the same may be amended from time to time; (b) the Bylaws of the Corporation as the same may be amended from time to time; (c) One half of one percent (.5%) of the patronage capital that is allocated and outstanding for all patrons at the end of the

immediately preceding fiscal year; and (d) any applicable law, rule or regulation; contractual restrictions or limitations, including but not limited to loan documents, security agreements, mortgages and deeds of trust between the Company and its primary and supplemental lenders; and any order of court relating to the foregoing.

- j. Retirements of capital credits approved but limited in accordance with this Section II.B.1.i shall be paid in the next succeeding year before approval and payment of such future early retirements of capital credits belonging to estates of natural persons. However, such payments in the next succeeding year shall count toward that year's limitation of one half of one percent (.5%) of the patronage capital that is allocated and outstanding for all patrons at the end of the immediately preceding fiscal year.

2. General Retirement of Capital Credits

- a. Decisions of the Board to make general retirement of capital credits to patrons will be consistent with sound management practices and the provisions of the mortgage and security agreements of the Company's primary and supplemental mortgage lenders and a target level of equity (i.e. equity to assets ratio) of 38 to 42%.
- b. Commencing with capital credits retired from and after January 1, 1990, of capital credits accrued prior to said date, the priority and order of retirement for capital credits retired during any calendar year shall be as follows:
 - (i) First to pay capital credits of deceased persons, pursuant to Section II.B.1 above, to the extent there has been application for payment approved by the Board.
 - (ii) Of the remaining amount of capital credits to be retired, fifty percent (50%) of the amount to be retired during any calendar year shall be paid to the persons or entities who have the oldest capital credit accounts, on a first-in, first-out basis. That is, retirement of capital credits by this portion of the amount to be retired shall be applied to retire the capital credits for the earliest year in total before being applied to retire capital credits for any later year.
 - (iii) The remaining fifty percent (50%) shall be prorated and paid across-the-board to all other persons or entities who have unpaid capital credit accounts for capital contributed to and including the last full audited calendar year; that is, there shall be a percentage allocation of this portion of the amount to be retired to each year for which there are remaining capital credits not retired, on the basis of the ratio that each of such year's outstanding capital credits bears to the outstanding capital

credits for all such years; and the payments to each person or entity shall be pro rata on the basis and in the percentage that each person's or entity's total outstanding capital credits for such years bears to the total outstanding capital credits of all persons and entities for such years.

- (iv) The corporation shall not disburse any capital credits to a person or entity if the total of the capital credits approved for retirement does not exceed ten dollars (\$10.00). However, any such undisbursed capital credit retirement shall remain a capital credit of the person or entity, and at such time as the total of accumulated undisbursed capital credit retirements of a person or entity exceeds ten dollars (\$10.00), the same shall, at the time of the next general retirement of capital credits, be disbursed to the person or entity entitled to the same, subject to subparagraph (e) hereof. However, if the approved but undisbursed retirement belongs to a current patron that is purchasing electric service, and then approved but undisbursed retirement of less than \$10.00 may be applied to the current patron's next monthly invoice for services purchased.
 - (v) Except as provided for in subsection iv above, the Company shall distribute checks for the retirement of patronage capital to the patrons or notify the patrons of the availability of the retirement within six (6) months of the date the retirement is authorized for distribution by the Board. The retirement check or notice of availability of such retirement shall be mailed to the last known address of the patrons, as it appears in the records of the Company.
- d. The Board is authorized pursuant to Section 3.6 of Article VIII of the Bylaws, solely at its discretion, to negotiate and/or offer a general retirement to current and former patrons at a discounted amount in satisfaction of the full face amount of such outstanding patronage capital. The negotiated and offered amount will be either a flat cents per dollar percentage or on the basis of net present value. Except when the Company must borrow to retire the negotiated amount, the net present value of the respective patronage capital allocated and outstanding will be calculated using the Net Present Value Schedule used by the Company to implement Section II.B.1 of this policy 4-2. When the Company borrows to retire the negotiated amount, the net present value will be calculated using a discount rate that is not less than the interest rate for the amounts borrowed with respect to the negotiated retirement.

The negotiated and offered amount pursuant to this Section II.B.2.d shall be offered to all patrons, whether current or former, with outstanding balances of capital credits and the acceptance of such negotiated offer shall be optional at the discretion of the patron. No action will be taken by the Company that forfeits the patronage capital that is outstanding for patrons not accepting such offer.

The difference between the face amount of the outstanding patronage capital and the negotiated amount that has been offered to and accepted by the patron is the discount. Such discount is assigned and contributed to the Company as contributed capital and is recorded to general ledger account 217 – “Retired Capital Credits – Gain”.

The Board is authorized to and may consider offering a general retirement of capital credits that is optional to the patrons when to do so would, including but not limited to the following:

- Improve the financial condition of the Company, and
- Shorten the number of years for which capital credits is outstanding.

A patron may not request an early retirement of his/her/its outstanding capital credits under the provisions of this Section II.B.2.d. When the Board determines that a retirement at a discount under this Section II.B.2.d is appropriate, it will adopt an appropriate resolution that will establish the offer, the parameters of such offer, and the timing of acceptance.

- e. The amount of any general retirement of capital credits that is approved pursuant to Section II.B.2 “General Retirement of Capital Credits”, including optional retirements at a discount”, will be determined separately for the following:
- (i) Capital credits that are allocated and outstanding for sales of electric service to members, excluding the sale of electric service to large commercial members that meet the provisions of Section II.B.2.e.(ii).
 - (ii) Capital credits that are allocated and outstanding for sales of electric service to members with a large commercial contract that provides for a depreciation recovery charge for the constructed electric utility plant required to provide such service over a shorter period than the applicable electric utility plant is depreciated.
 - (iii) Capital credits that are allocated and outstanding for sales of other utility type services for which the Board approves operating on a cooperative basis.

The amount retired will be determined on the contractual and operational needs of each, as well as the overall financial condition and loan covenants of the Company.

3. Dissolution of Corporations or other Legal Entities

When Corporations or other patrons that are not natural persons cease to exist, at time of cessation or dissolution, their legal representatives will be encouraged to assign its capital credits to a successor in interest or to make an irrevocable assignment of its

capital credits as contribution to the capital of the Company. Pursuant to Section 3.5(d) of Article VIII of the Company's By-laws, the Board is authorized to negotiate capital credit settlement arrangements with the legal representatives of such dissolving legal entities requesting an early retirement of the patronage capital of the legal entity that is allocated and outstanding. The request must be made in writing, must be approved by the Board or an authorized representative of the Company as designated by the Board and must be either a flat cents per dollar percentage or on the basis of net present value. Except when the Company must borrow to retire the negotiated amount, the net present value of the respective patronage capital allocated and outstanding will be calculated using the Net Present Value Schedule used by the Company to implement Section II.B.1 of this policy 4-2. When the Company borrows to retire the negotiated amount, the net present value will be calculated using a discount rate that is not less than the interest rate for the amounts borrowed with respect to the negotiated retirement.

The difference between the face amount of the outstanding patronage capital and the negotiated amount that has been negotiated and offered by the Company and accepted by the patron, is the discount. Such discount is assigned and contributed to the Company as contributed capital and is recorded to general ledger account 217 – "Retired Capital Credits – Gain".

Each request will be considered by the Board and/or its appointed authorized representative on a case by case basis.

4. Inactive Patrons other than Corporations and other Legal Entities

Pursuant to the provisions of Article VIII, Section 3.6 of the Bylaws of the Company, the Board may adopt the method, basis, priority and order of retirement. Additionally, the Board may authorize the retirement of patronage capital at a discount. Such retirements may be made to the extent allowed by the financial condition of the

company and the provisions of mortgages and security agreements of its primary and supplemental lenders, retire the capital heretofore credited to any inactive patron, other than a corporation or other legal entity, in the present and prior years. Pursuant to these provisions, the Board has determined that it is in the best interests of the Company to retire the outstanding patronage capital of inactive patrons, other than a corporation or other legal entity, on a discounted basis, prior to any general retirement of capital credits for the particular years involved, pursuant to this policy, as the same may be amended from time to time. The current provisions of this policy are:

- a. The patron must have left the Company's service territory and must have been inactive for a period of 2 years.
- b. The patron must have signed an agreement with the Company at the time the patron cancelled his service that the Company may retire his/her outstanding

- patronage capital balance at a discount when he/she has been inactive for 2 years.
- c. The amount of the inactive patrons' patronage capital shall be discounted and paid at an amount representing net present value of capital credits if such capital credits are retired prior to general retirements, pursuant to this policy. The net present shall be calculated using the same Net Present Value Schedule used by the Company to implement Section II.B.1 of this policy.
 - d. The difference between (1) the face amount of the capital credits allocated and outstanding and (2) the net present value of such capital credits, which are approved for early retirement, is the discount. The discount is irrevocably assigned and contributed to the Company and is recorded to general ledger account 217 – "Retired Capital Credits – Gain".
 - e. Payment shall only be made:
 - (a) upon written application therefore, as provided for in Section II.B.2.b;
 - (b) approval of the same by the Board; and
 - (c) acceptance of the same by the inactive patron as payment in full of all outstanding patronage capital belonging to him/her/it.
 - f. No retirements shall be made under this policy, except as to outstanding patronage capital of inactive patrons meeting the requirements of this Section II.B.4.
 - g. Payment may be deferred until the calendar year following the year the retirement becomes payable.
 - h. The amount of cash payment for the retirement of outstanding patronage capital pursuant to this policy shall be limited to inactive patrons individually and as to all inactive patrons annually by: (a) the Articles of Incorporation as the same may be amended from time to time; (b) the Bylaws of the Corporation as the same may be amended from time to time; (c) One half of one percent (.5%) of the patronage capital that is allocated and outstanding for all patrons at the end of the immediately preceding fiscal year and (d) any applicable law, rule or regulation; contractual restrictions or limitations, including but not limited to loan documents, security agreements, mortgages and deeds of trust between the Company and its primary and supplemental lenders; and any order of court relating to the foregoing.
 - i. Retirements of capital credits approved but limited in accordance with this Section II.B.4.h shall be paid in the next succeeding year before approval and payment of

such future early retirements of capital credits belonging to inactive patrons. However, such payments in the next succeeding year shall count toward that year's limitation of one half of one percent (.5%) of the patronage capital that is allocated and outstanding for all patrons at the end of the immediately preceding fiscal year.

5. Applying Capital Credits to Delinquent Accounts

Patronage capital credited to the account of a patron shall not be available or used to reduce an obligation owed to the corporation by the patron in advance of the general retirement of that capital credit, but the capital credit account of the patron and the account due the company by the patron shall be flagged with a notation that when said capital credit is retired pursuant to Section II.B, then the capital credit retirement shall be applied to the unpaid balance of any obligations due and owing the corporation, pursuant to Section 3.5 of Article VIII of the Bylaws. This Section II.B.5 applies to any accounts receivable recorded by the Company pursuant to Section II.A.6 of this policy to reflect the amount due by a patron for the patron's share of losses resulting from the provision of cooperative services.

6. Unclaimed Retirements of Capital Credits

Capital Credits of a patron, which are (1) declared retired and payable pursuant to any provision or subsection of Section II.B and (2) remains unclaimed for one year after the retirement is authorized and declared payable, shall be assigned to the Company as a contribution of capital if:

- a. The Company distributed the retirement check or notice of availability to the patron (collectively or individually referred to as "the notification") within six (6) months of the date the Board approved the retirement;
- b. The notification was mailed to the patron via first class mail to the patron's last known address, as it appears in the records of the Company; and
- c. The patron fails to respond to such notification within thirty (30) days after his/her/its receipt of the notification. The notification is deemed to have been received by the patron at the end of the third business day the notification is mailed by the Company.

In the event a patron is located, a sum equal to the retired but unpaid capital credits of the patron that was assigned to the Company as a contribution of capital, pursuant to this Section II.B.5, shall be paid to the patron.

III. RESPONSIBILITY

- A. The chief executive officer is responsible for the overall administration of this policy.

- B. The chief executive, or other designated staff member(s), shall periodically review the needs for revisions and the implementation of this policy.