Capital Credits

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Capital Credits

- An allocation of funds that represents a customer's share of the ownership in a cooperative
- Can also be called member equity
- The retirement of capital credits is often compared to dividends in a for-profit company

What Does "Nonprofit" Mean?

- A cooperative is a member-owned, nonprofit organization
- Nonprofit does not mean that the cooperative does not generate margins
- Nonprofit means that the cooperative does not keep any excess margins
  - At the end of each year and after all operating expenses have been paid, the remaining margins are allocated to the members as capital credits
- The amount of capital credits retired is determined by the cooperative's Board

Cooperative Principles

- **Members' Economic Participation** — Members contribute equitably to, and democratically control, the capital of their cooperative
- Is this happening with the rate design currently in place at many cooperatives?

Different Approaches to Capital Credits

- Never retire capital credits and keep current rates as low as possible
- Retire capital credits based on an assessment of the cooperative's current financial condition
- Always retire capital credits

Basis for Capital Credit Allocation

- Amount of energy (kWh) purchased
- Based on customer's contribution to margins
- Gross revenue
- Net revenue – gross revenue less purchased power costs

Customer's Contribution to Margins

- Contribution to margins can vary significantly among customer classes and among customers within a class depending on the rate design
- Range of -10% to 30% and up for residential
- Range of -20% to 50% and up for commercial

Cost of Service Summary

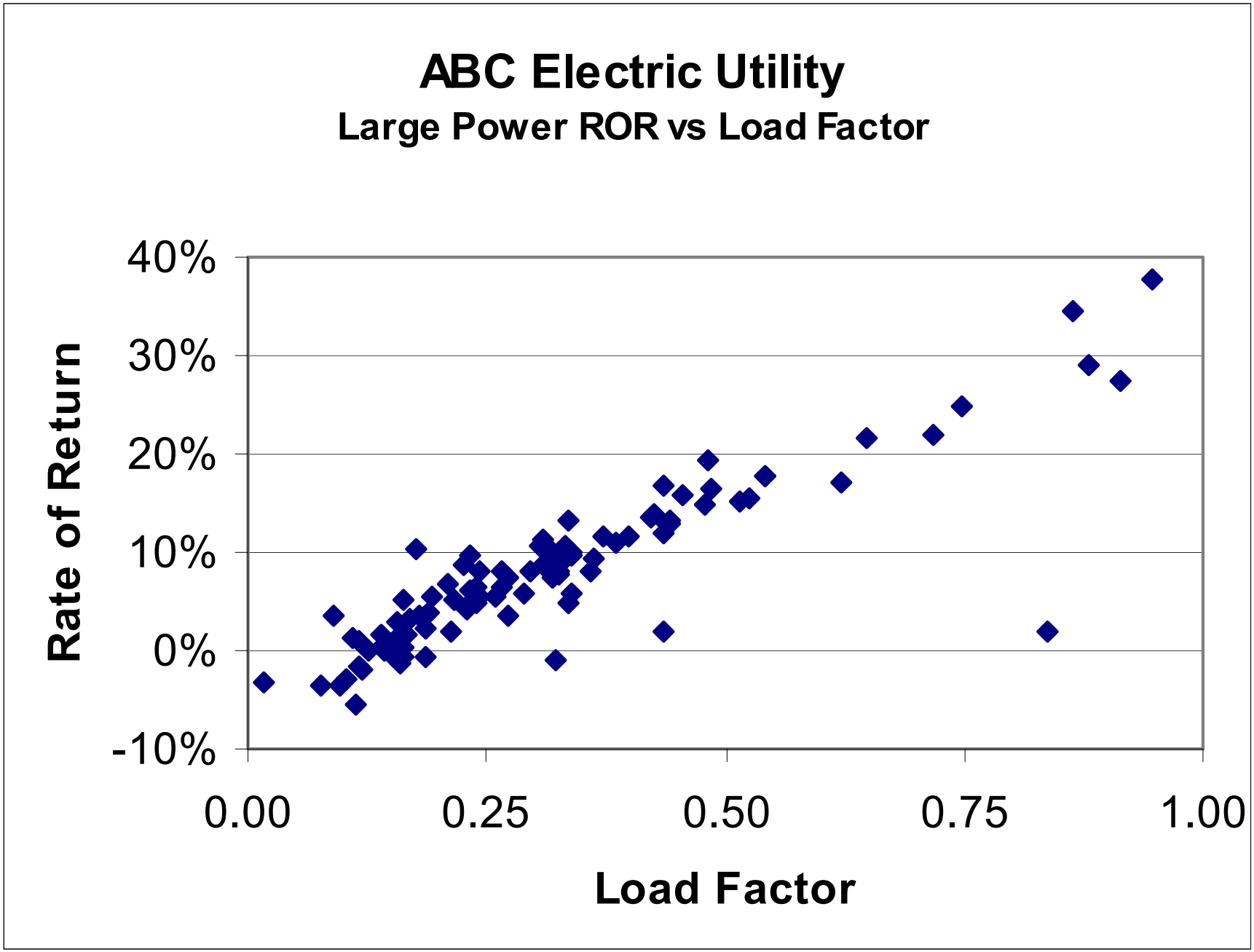
	Total Cost Of Service	Utility Operating Margin	Net Cost Rate Base	Rate of Return
Total System	$2,751,875	$504,722	$5,516,041	9.15%
Residential Service	$1,292,644	$363,607	$2,591,465	14.03%
Residential TOU	$403,122	$48,565	$784,067	6.19%
Small Commercial Service	$290,208	$88,204	$548,380	16.08%
Small Commercial TOU	$203,365	$31,999	$377,870	8.47%
Special Contracts	$461,526	-$1,488	$992,058	-0.15%
Outdoor Lighting	$12,035	-$5,063	$24,072	-21.03%
Irrigation Service	$17,765	-$2,849	$41,793	-6.82%
Irrigation Service TOU	$38,715	-$13,061	$92,105	-14.18%
Commercial Farm Service	$23,425	-$3,056	$44,356	-6.89%
Commercial Farm TOU	$6,503	-$1,585	$13,887	-11.42%
Public Street Lighting	$2,567	-$551	$5,990	-9.20%

Cost of Providing Service Within a Class

- Typically, rate classes include customers with very different energy usage patterns
- Results in significant differences in cost of serving customers within a class
- Results in significant differences in individual customer profitability within a class

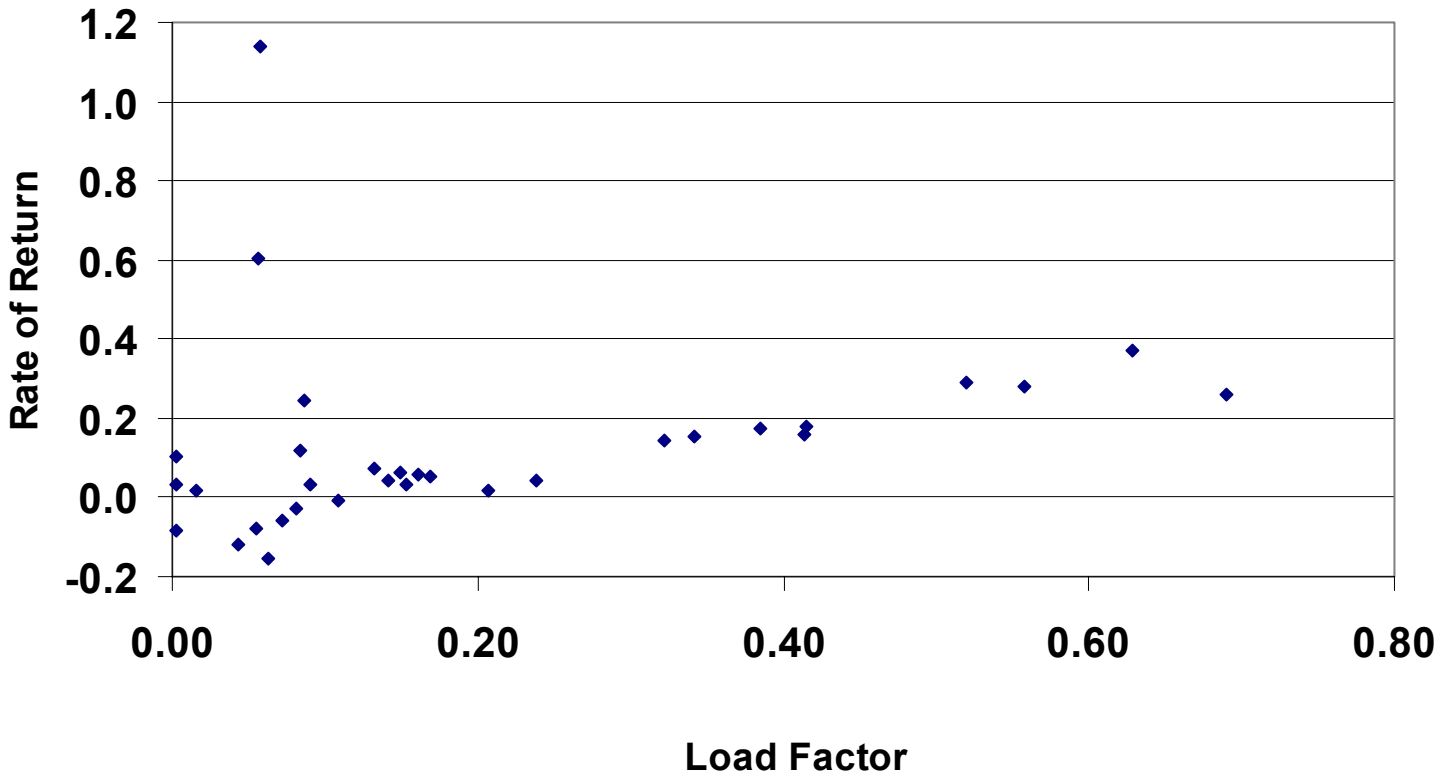
Individual Customer Profitability

Account Number	Customer Name	Rate	Margins	Rate Base	Rate of Return
51112400	C&I Customer 72	GSD	(289)	14,671	-2.0%
51144900	C&I Customer 73	GSD	1,179	6,153	19.2%
51195700	C&I Customer 74	GSD	(519)	8,836	-5.9%
51253100	C&I Customer 75	GSD	31	2,974	1.0%
51254400	C&I Customer 76	GSD	(2,600)	9,161	-28.4%
51500100	C&I Customer 77	GSD	1,487	8,361	17.8%
51500200	C&I Customer 78	GSD	1,002	3,739	26.8%
51947300	C&I Customer 79	GSD	845	2,472	34.2%
51947401	C&I Customer 80	GSD	1,291	26,671	4.8%


ABC Electric Utility
Large Power ROR vs Load Factor
Rate of Return
40%
30%
20%
10%
0%
-10%
0.00
0.25
0.50
0.75
1.00
Load Factor

ABC Electric

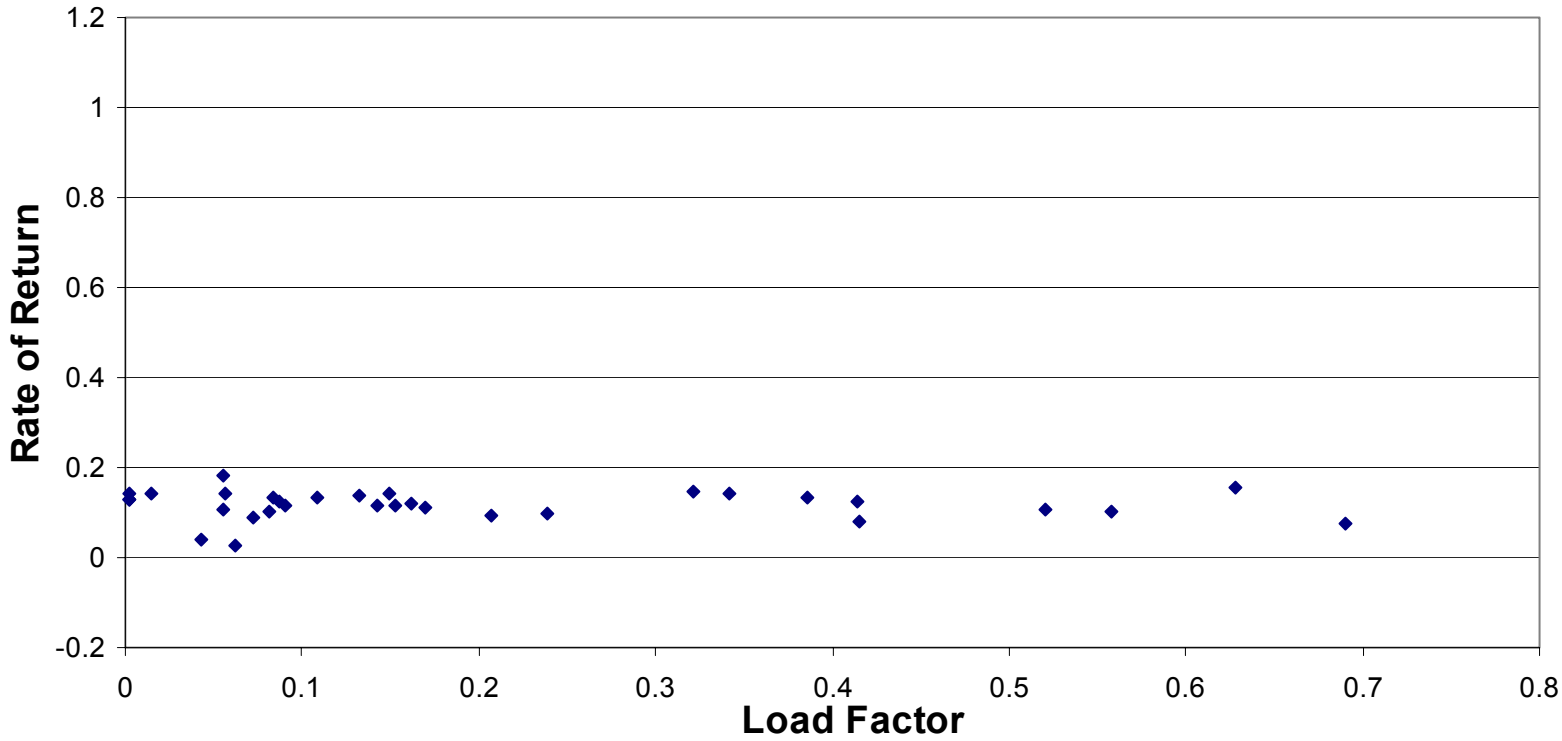
Large General Serv. ROR vs Load Factor



ABC Electric

Large General Service ROR vs Load Factor

@ Cost Based Rates



Impact of Rates That Are Not Cost Based

- Large differences in profitability frequently result from rates that are not cost based
- For many cooperatives, customer charges are too low, demand charges are too low and energy charges are too high
- Results in fixed cost and margin being collected in kWh charge rather than in the customer charge

Impact of Rates That Are Not Cost Based

- Customers with above average kWh usage pay more than their fair share of fixed costs and margins
- Customers with low levels of kWh usage pay less than their fair share of fixed costs and margins
- Is it fair to pay capital credits based on usage?
  - Depends on rate design

Allocation Based on Revenue

- Does there need to be a revenue level established below which capital credits would not be paid?
  - Where is breakeven?
  - Bigger issue with gross revenue than net revenue

Allocation Based on Profitability

- Can be difficult to calculate
- Would the allocation for each customer be pro rata share of contribution to cooperative margins?

Capital Credit Retirement Policy

- Capital credit retirement cycle varies by cooperative
  - Fixed year rotation cycle – e.g. 15-year rotation cycle
  - FIFO – oldest year that has not been retired
  - Split cycle rotation – e.g. 50% oldest and 50% current
  - Never
- What happens if a retirement during a fixed cycle is not made during a year
  - Becomes the next year eligible for retirement whenever a retirement is authorized
  - What happens to the allocated amount when a retirement has not been made for many years?

Capital Credit Retirement Policy

- Capital credits of a deceased member?
  - Payment of full value
  - Payment of discounted value
  - What discount rate is used?
- If a member moves?
- Can a large customer take reduced rates in lieu of capital credits?
- What happens to unclaimed retirements?
  - State gets it
  - Civic contributions
  - Retained by the cooperative