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PSC CONSUMER SERVICES

Request
to
The Kentucky Public Service Commission
for
Investigation
of
Shelby Energy Cooperative

March 6, 2013

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March 6, 2013

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
P.O. Box 615
Frankfort, KY 400602

Regards: request for PSC to examine the management and safety operations of Shelby Energy Cooperative

Dear Mr. Derouen:

The member-owners of Shelby Energy Cooperative (SEC) have been seeking information from SEC concerning the operation of our Cooperative and the costs of the Cooperative that lead to rate increases. We have submitted questions to SEC. What information that has been provided has not been very reassuring. Attached as Exhibit 1 are our Comments on the Reply from SEC (Comments) on our questions that were submitted on October 8, 2012.

We ask that the Public Service Commission (PSC) (1) examine SEC to ascertain whether or not all reasonable measures have been taken and will be taken to keep our rates as low as possible and that safety is appropriately maintained and (2) investigate the methods and practices of SEC to require SEC to conform to the laws of this state, and to all reasonable rules, regulations and orders of the Public Service Commission not contrary to law, so that SEC delivers just and reasonable rates and service.

It is difficult to see how the safety of our linemen and member-owners is adequately addressed by hiring a person trained in hotel management for the position of Safety and Environmental Supervisor. See Exhibit 2, Question #5 (page numbers added). No job description has been provided to the member-owners for this position. This position was not posted for possible applicants. This is in violation of SEC Policy 990. See Exhibit 20, Section II, paragraphs D, E, and F.

The present VP of Operations & Engineering appears to have had no training in Safety & Risk Management in order to be a Safety & Risk Management Supervisor when he first took the job. He was simply elevated to the job after eight years as a SEC lineman. Again, this position was not posted for employment applicants and no job description has been presented to the member-owners.

Not considering current (unionized) and very experienced linemen for safety supervisor jobs may not be in the best interest of safety and may be discriminatory. It may also affect workplace morale.

The SEC Board appears, in the Board minutes, to have little or no information concerning qualifications of safety supervisors. Signatures on safety reports do not necessarily mean that the person signing the report is qualified in safety management and that we can be assured of the safe working conditions for our linemen and member-owners.

In lieu of hiring professional electrical engineers who can meet the signature requirements of PSC for documents submitted by SEC to PSC, SEC has gone to the additional expense of hiring

consulting engineers for these documents. The installations of service, at times, were delayed because the consulting engineer was not available to approve the installations. SEC should employ full-time employees who can fully and timely do the tasks required.

At times, it appears that the Board of Directors approves management actions after the fact.

Along with the concerns given in the Comments in Exhibit 1, the following things are of alarm.

Shelby Energy Cooperative did not make TIER in 2012 which will be used as a reason to seek another rate increase. A significant rate increase was granted in July 2010.

The member-owners have paid a high price and continue to bear the cost of higher energy rates partially due to Shelby Energy's history of a high number of construction worker fatalities between November 1998 and November 2007 (PSC case # 2008-00069). The members have had to pay \$15,000.00 in fines (September 15, 2008) for safety violations; for a Management and Operations Audit in 2009 (at a cost of \$150,000-\$200,000 as reported by CEO in September 2012 Board Minutes, Exhibit 19, p.4); for the hiring of seven additional employees at an estimated annual cost of \$460,000.00 (reported by CEO in the November 2012 Board Meeting minutes, Exhibit 7, p.6) that included an employee position designated as a safety and loss coordinator (SEC titled: Safety & Environmental Supervisor) (paid \$114,851.00 in 2008, paid \$117,125.00 in 2009, paid \$121,282.00 in 2010, and paid \$122,168.00 in 2011 now a VP); employed an outside safety auditor for one year; for all safety training and certification of the safety and loss coordinator and all field employees, and for submission of monthly safety inspections and reports for three years while under probation.

SEC CEO Debbie Martin reported that the ratio for total controllable expenses per member-owner, which is the amount of expense that can be controlled by a cooperative, has been significantly and negatively impacted in the last several years by complying with the audit recommendations which required an increase from 31 to 38 full-time employees. Martin also stated “. . . the \$150,000 to \$200,000 cost of the management audit itself, have significantly contributed to the likely need for a rate increase in the near future” (Board Meeting minutes, September 20, 2012, pp.3-4, see Exhibit 19).

Additionally at the September 20, 2012 Board meeting (Exhibit 19, p.4), Rod Crile, Regional Vice President of the Cooperative Finance Corporation, stated: “(t)he fact that most cooperatives are PSC regulated in Kentucky, as compared to many states where cooperatives are not regulated, significantly contributes to the relatively weak OTIER and MDSC margins of regulated Kentucky cooperatives.” It appears that the SEC Board was told, in numerous ways, that regulation of SEC by PSC drives up costs.

The member-owners ask that the PSC address what appears to be an adverse relationship that SEC has with the PSC. It is generally known among the SEC employees that the SEC CEO refers to the PSC as the “three hundred pound gorilla on my back.” There should a cooperative relationship between the two entities.

Shelby Energy has and continues to have a low set of desired subjective standards for the hiring of qualified safety inspectors and key personnel. Please see Exhibit 2 (page numbers added) for

questions dated November 8, 2012 included in the SEC responses numbered 1, 3, 4, 5, and 13 in as well as correspondingly numbered remarks in the Comments in Exhibit 1.

Cohesiveness is necessary for a safe and efficient operation. Shelby energy management has created a work force that lacks cohesiveness by continually reorganizing, abolishing positions (VP of Accounting) and creating new positions (VP of Operations and Engineering) that are filled with preselected personnel (VP of Administrative & Office Services) that don't meet minimal desired educational requirements without considering qualifications of other employs or seeking outside qualified applicants which violates SEC Policy No. 900, titled Employment of Personnel which states in Section II, Part F: (Exhibit 20): "When an existing position becomes vacant, or a new position is created, this position will be announced inside and outside the Cooperative. It will be posted internally on bulletin boards and/or in the Cooperative Intranet, accessible to employees. Internal and external candidates will receive equal consideration". The action of not considering any employee who belongs to the union for a management position creates discrimination. Some if not all of these actions are not shared by management with the Director(s). These actions increase the cost that member-owners must pay for electricity.

The Trimble County Judge-Executive, a SEC Director, requested that SEC install Christmas lights at the Trimble County Courthouse on November 22, 2010. SEC did so without any compensation. Was that a conflict of interest?

The Little Kentucky River Watershed is a taxing district in Henry County. It has requested and received from SEC a \$50,000 loan at 1% interest to repair weather-related damage. SEC Director Taylor, a member of the Watershed's Board, answered questions concerning the loan, and did not completely reclude himself in the SEC Board's consideration of this matter. (See Exhibit 19, p.7, Economic Development Fund.) Was this a conflict of interest?

Are there other conflicts of interests at SEC that affect the rates that member-owners pay?

The responses to member requests for hours worked by the Directors for compensation did not provide numbers of hours worked. However, the IRS Form 990 for 2011 states average hours worked for Directors and compensations that compute to about \$95 per hour pay rate.

It is noted that the largest share, roughly 60%, of SEC sale of electricity goes to industrial uses. If SEC rates continue to rise, the growth of industrial uses will diminish as new industries locate into cheaper service areas. This will increase the cost to the other members of SEC who cannot locate or change to other electricity distributors. High residential rates also have made houses more difficult to sell.

It is a concern that management practices, including hiring and "reorganizations" of positions, may well lead to higher rates for SEC members. It is also a concern that SEC seems to reflect in its minutes of Board meetings that safety is a burden.

It is of further concern that SEC may be employing retaliation by leaving electrical parts on my property while doing a line job that went through my property. I punctured three tractor tires while mowing my pasture and yard when the tractors and mowers hit the objects left by the contractor hired by SEC. No other property owners had any trash left on their property. See Exhibit 26, p.1 for

photo of trash; p. 3 for Pippin complaint; p. 5 for Pippin complaint; pp.6-7 for item # 8 – description of activities on Pippin property.

SEC has threatened, through its legal counsel, that SEC may well charge member-owners for future requests for information concerning SEC activities. See Exhibit 2, p.8, last paragraph (page numbers added) and Exhibit 4, p.3, last paragraph (page numbers added).

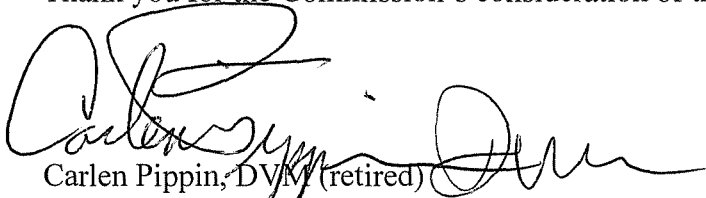
We as member-owners are simply asking that Shelby Energy Cooperative operate with accountability and transparency with facts and figures and not loophole statements, through open records and open meetings with a democratic process of electing Directors so that the member-owners can be reasonably assured that the best management practices are being employed so that our electricity is safely delivered at economical and competitive rates.

Clear and consistent facts have been hard and at times impossible for SEC members to obtain. Please investigate the current actions of SEC before a rate increase is presented to the PSC. The best rates, safety, and results are always desired for Shelby Energy Cooperative.

Additional background and supporting information is enclosed as Exhibits 21-25. See following Table of Contents on the next page.

If there are questions concerning this request, please contact me, Carlen Pippin. My contact information is given below my signature on this request.

Thank you for the Commission's consideration of this request,



Carlen Pippin, DVM (retired)
1556 Vigo Road
Shelbyville, KY 40065
502-321-0221
cpippin@shelbywireless.net

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Comments on SEC counsel's response to members' questions of November 8, 2012

Attached is the response from Mr. Don Prather, Shelby Energy Cooperative counsel, to the questions from members that were submitted to the Board of Shelby Energy Cooperative and dated November 8, 2012. The paragraphs below are ordered so that the comment numbers below correspond to the questions and responses on Mr. Prather's attached reply, Exhibit 2 (page numbers added).

1. In response to member questions dated January 21, 2011 it was stated; "It is the Cooperative's goal to hire an Electrical Engineer who is or will become registered as a professional engineer in the Commonwealth of Kentucky. The Cooperative will have two permanent positions of management; one for Engineering and one for Operations". Does this mean that an Electrical Engineer is yet to be hired?
2. In 2010, the SEC Form 990 report, for organization exempt from income taxes, stated that Mr. Miller was paid \$95,700.00 and Mr. Clark was paid \$108,135.00. In 2011, these two persons were not listed on Form 990. Form 990 requires reporting the name of and compensation to of all officers, Directors, key employees, and up to five of SEC highest paid employees and the five highest compensated independent contractors that receive \$100,000 or more. See Exhibit 3. pp. 25, 36. No independent contractors were listed. Salaries and benefits costs are a management controlled item that is reflected in the rate we pay for energy.
3. On the 2009 Form 990, the "safety coordinator" was paid \$117,125.00. On the 2010 Form 990, the "safety and risk management" titled employee was paid \$121,280.00. On the 2011 Form 990, the "VP Operations and Engineering" was paid \$122,168.00. This is the same employee that has held all three titled positions. It appears that there are no definitive criteria of this job. The member-owners bear the cost for training. Similar practices contributed to the Management & Safety Audit (Audit) in 2009 and we as members are still paying the price every month in our electric bill for this Public Service Commission (PSC) audit. How can this title and pay be justified when we have to pay for an additional consultant who has a degree in electrical engineering and technology with a professional engineering license who can sign documents that the VP Operations and Engineering cannot sign since this VP is not a licensed engineer?
4. It appears again that the subjective phrase "the demonstration of competency" is often referenced along with educational requirements that are only desired with minimal importance in creating and filling a VP position with an executive assistant who is within five years of retirement. The retirement check will be greatly enhanced since the payment amount is based on the compensation of the last five years of employment. We would assume that a VP would be qualified to assume great responsibility and be considered a "key person" that will be included on the 2012 form 990 report.
5. With Shelby Energy's past safety record (three deaths) which triggered the Audit in 2009, we all hope that employees' safety will continue to be of the highest priority. It is agreed that "whoever is placed in any position must be deemed truly 'qualified'". From the Audit came the mandate that a safety inspector position be created with recommendations that SEC seek a "qualified" person from outside the organization. However, a SEC employee with minimal experience and training was placed in "the safety and loss coordinator" position.

The safety for employees and the firing of a field employee gave impetus to the field employees

becoming unionized. Legal fees cost the member-owners \$153,000 to unsuccessfully fight unionization of field personnel. We also had to pay the legal fees and a settlement to a fired employee (amount not disclosed). It is believed to be in the thousands of dollars. We have had to pay fines for safety violations in the past as well.

The bottom line is, we don't want SEC to revert back to old ways by not hiring the most qualified safety personnel available. A safety inspector signing safety reports with a degree in hotel management and no electrical utility experience (other than tree trimming) runs up a red flag. Past management decisions have caused an increase in our costs.

6. The flat "no" is not surprising coming from management and legal counsel. Anytime that great employees are lost for whatever reasons should create concerns for any employer and board of directors. This response raises the question: Did the Directors view or review this response from Mr. Prather? Many of us know these past employees since Shelbyville is a small community and we also know that they served SEC well. The Directors only hear what management tells them when employees depart and especially when not for favorable reasons. We could expound upon the issues but would rather strongly suggest that the Directors seek a full explanation from these personnel. An exit interview would be very enlightening and would tell the rest of the story. To abolish one VP position that has a highly educated and qualified personnel and then create another VP position for an employee with less credentials is questionable at best. Promotion based on longevity and loyalty may not be in the best interest of any organization.

Some great employees have left SEC with less than pleasant memories and don't mind expressing such out in the community. Management appears to operate under a cloak of secrecy on some employee issues. Some employees may have departed due to the constant fear factor of job loss and some others may continue to work with it every day. A fear factor creates a safety hazard especially for field employees working within a few feet of being electrocuted, thinking that a pink slip maybe awaiting them when they return to ground. It appears that there is a policy that no unionized employee will ever be considered for a management position. It is the understanding that policy is that no unionized member may talk to a Director. When a departing employee is forced to sign a confidentially statement in order to receive one month's severance pay, is it hiding some damning information? Why would management not even verify the twelve years of employment of a former employee to a prospective employer? The constant use of reorganization to get rid of some and to enhance other employees is a sure way of creating confusion and turmoil in any operation. These actions can create errors in judgment and safety hazards that cost money and increase our energy rate.

7. The legal summaries posted on the website as minutes of meetings are an improvement over the past information sharing from SEC, but it is expensive because these minutes are drafted by SEC counsel prior to Board approval and posting onto the SEC website. See Exhibit 4, p.2. (page numbers added) last sentence.

These minutes often provide the member-owners scant information. For example in the August 16, 2012 minutes, "The CEO gave her report." It appears that when questions are asked or an opinion is stated that it creates anxiety rather than an opportunity to set the record straight with facts and figures.

Although Mr. Prather prepared the minutes before approval by the Board, the error in recording

the service trucks as bucket trucks was not found until a question was raised by a member-owner on this matter.

We are pleased that the new bucket trucks with two men crews will produce savings and that we can expect the savings to be reported in dollar amounts by the VP of Operations and Engineering at Board of Directors meetings. Placing that information on the SEC website would be informative and proof that this was a good decision. We are also happy that two-man crews will be safer than single-man crews. It was noted that there were no estimates of cost in the purchasing of the three new bucket trucks or any estimate of monthly or annual savings in dollar amounts. We are left to the old idea that we should just believe whatever you say that these changes are working and stop second guessing management with attempts to micromanage the member-owner cooperative. It would appear that such information would be readily available and needed for sharing with the Directors. Where is the face of evidence in dollars and cents that prove SEC is extremely well managed as claimed? Does the response suggest that everyone is entitled to an opinion but everyone is not entitled to the facts?

If the information concerning Josh Lakes was so "wildly incorrect," then a great opportunity to set the record straight with facts and figures was again missed.

8. There was no mention that July 2012 was the hottest month on record and certainly not the mild weather stated in the response from Mr. Prather. There was no mention of the increased revenues generated by the significant rate increase approved by Public Service Commission (PSC) in 2010. Again, there were no facts and figures stating how great the losses experienced for the past several months were which allows one to assume that it could be greater than the \$115,000.00 suggested for each of the two months questioned.

On Form 990's, revenue less expenses shows \$0 for 2011; \$1,100,720.00 for 2010 and \$1,793,045.00 for 2009. It is of concern to see these figures trend downward to zero.

Also, why was there such a high capital investment return in one year? To understand these figures, we would need the account's explanation. There was no mention that we member-owners are paying a higher than average interest rate due to a locked-in high fixed rate on a long term debt. This will not change until interest rates become considerably higher and that certainly doesn't seem to be just around the corner. A rate increase request certainly would appear to be imminent.

9. It would appear that since member-owners have millions of dollars invested in this electrical cooperative that the Internal Revenue Service (IRS) would be interested in auditing SEC as related to its non-profit status as Form 990's prior to 2011 showed six to seven digit profits on line 19 of the Form 990's. A general, favorable audit report with few details is presented to the member-owners at the annual membership meeting.

In the past, a member-owner found and reported to SEC a 1.1 million dollar omission on the 2009 Form 990 which is by the website has a revised Form 990 with a cover letter from the SEC certified public accountant. See Exhibit 5, p.5, Question 8 Response; Exhibit 6, p.4.

Since all expenses are passed on to the member-owners and revenues are based on electrical consumption, there is no real benefit for management to want their member-owners to reduce

electrical usage. When revenues go down, rates go up.

10. The amount for installing new units (\$28,602.00) was provided, so it appears that \$3,999.49 was spent on normal HAC maintenance. The criterion was for the “best bid” and not necessarily the most economical. There is no open bidding process which deters some bidders. Since the winning bidder already had a five year HAC maintenance contract and was not the low bidder plus his wife was an Executive Assistant (now a VP) with SEC, concerns are raised about keeping rates as low as possible.
11. It is suggested that legal services should be on a contract for bid basis to ensure the best price for services. It appears that this is an employment for life. Also, the SEC counsel receives free health insurance benefits. See Exhibit 7, p. 1.
12. Again the member-owners of SEC have to take Mr. Prather’s word that a “comprehensive, written ethics policy” exists since a copy was not presented. (The 2011 Form 990 reports that one exists.) The member-owners are assured by the response that the benefits to the member-owners outweigh the “potential conflict of interest.”

Policy No. 312 – Purchase and Use of Cooperative Vehicles (Exhibit 8) and Policy No. 312 – Purchasing of Goods and Services (Exhibit 9) strongly suggest that there is not and have not been a competitive bidding procedure in place and used for any purchases.

This selection process may deter the some contractors and vendors from seeking SEC business in the future since they could feel that they are wasting their time and efforts.

It seems inconsistent that employees of SEC are prohibited from receiving prizes, of small nominal values, at the annual meetings but the spouse of a VP receives a five figure compensation for contracted work.

13. Since Mr. Grubbs was wearing a SEC shirt with the logo visible in the mug shot (Exhibit 10) when he was arrested in Graves County, Ky. on October 19, 2012 for soliciting prostitution and has signed many documents requesting action by PSC on behalf of SEC but yet not technically considered an employee is at least confusing. He was provided with an office, shirts, equipment, and maybe an identification card and credit. See Exhibit 11, pp. 1,2, where Mr. Grubbs was listed as a Consulting Engineer in the April Board meetings and gave the engineering report to the Board, signed a letter from SEC to PSC as a SEC Interim Engineer (See Exhibit 12.), and was the contributing utility partner for SEC for *Kentucky’s Smart Grid Roadmap* published September 18, 2012, a month before his arrest in Graves County (Only the first 3 pages of the 51 pages of the *Kentucky’s Smart Grid Roadmap* are included in Exhibit 13, see p.3 of the *Roadmap*). Management was aware of the arrest of Mr. Grubbs but did not disclose that information to the Directors at the October 23, meeting. It is our understanding that he was sent a letter which indicated that he was no longer employed by SEC or that his services were no longer needed and that he was to return all SEC shirts and other items immediately.

So, when a person wearing a SEC issued shirt driving a truck with a magnetic SEC sign and possibly a SEC issued ID card stating that he or she works for SEC, it may or may not be technically true. This could create problems especially during a time of disastrous electrical

power restoration work and for crews clearing right-of-ways. The public is always being warned to be on the look out for unscrupulous and unapproved workers posing as repair personnel. The public has been told that all SEC subcontractors are held to the same high standards and work under the same rules of safety as SEC employees and have the same right of access. This is a security issue for the SEC member-owners.

In the week of February 25 – March 1, 2013, Mr. Grubbs pleaded guilty to an amended charge of Disorderly Conduct, paid a \$100 fine and \$150 in court costs.

14. The signers of the questions of November 8th are diligently seeking information and do support the “green” initiatives of SEC and including getting the word out to members-owners. It is difficult for many member-owners to have \$2.75 extra per month while trying to survive under these difficult economic conditions especially when our electrical rates continue to rise with the prospect of another rate increase looming ahead.

We can understand that there may have been some shock to the Board of Directors by these questions since the Cooperative has operated for 76 years with few or no questions being asked of the Board. There have been no member-owners requesting transparency and accountability and the theory that we have always done things that way because it is “traditional” has been the order of the day.

The response states that “ the Board has deemed it prudent to have the answers to these and past questions reviewed by legal council due to the possibility they may be used against the Board and /or SEC in future litigation”. The Board should be able to reply to inquiries simply and straightforwardly without using legal counsel. It is hoped that all Board meetings are recorded for historical purposes and to be available to set the record straight legally when needed for everyone including the member-owners. It should be a simple and economical process for a clerk to put the minutes in writing from the recording. It is questionable as to why there is so much secrecy surrounding the conducting of business and the availability of such information.

There have been responses to questions but few have been answered with definitive facts and figures. At times, there has been somewhat of an attempt at intimidation with threats than providing answers. There is no problem in spending \$30,000 plus to entertain 200-300 members-owners benefits of a 20 minute business meeting, entertainment, a blue bucket, two light bulbs, a sandwich and a drink with a chance to vote (159 voted last year with over 900 proxy votes).

The \$5,333.06 reported as having been spent answering questions over the past three years appears to be an expense that can be greatly reduced or eliminated through open meetings and open records. The statement in the response “that any member-owner is free to attend the Board of Directors meeting to observe the workings” left out important information in that one must have Board permission at least four working days prior to the meeting and that one is NOT permitted to ask questions without being placed on the agenda. Getting on the agenda must be approved by the Board at least 30 days prior to any meeting and has its own limitations. The response that any member-owner can speak directly to Board Members outside the meetings has been reoccurring and is appreciated.

The statement in the response that any member-owner can challenge an incumbent up for

reelection or seek a Director position that becomes vacant is correct. The response failed to point out that applications for the last two vacancies have been accepted but the remaining Directors made the selection and not the member-owners. Under the provisions of the Bylaws, it is practically impossible for an incumbent candidate for director to be unseated as it would take approximately 300 members attending the annual meeting, each with 3 proxy votes and all voting for the non-Board selected person for the challenger to be elected. See Exhibit 14, p.7; Exhibit 15; Exhibit 16. At the 2012 annual meeting, about 160 members voted by voting machine and there were over 900 proxy votes. (Note that in Exhibit 15, the number of total proxy votes reported in the minutes does not equal the sum of the proxy votes for McElroy and Stevens.)

A challenger tried in 2012 and was defeated with proxy votes which will deter future challengers. Why spend time, money, and effort while being assured of certain defeat?

Some of the deficiencies in the democratic control of our Cooperative are:

- 1) The candidate of the Board benefits by the actions of the Board as the Board sends out proxy requests to every member-owner and these proxies that don't even acknowledge that there will be an election at the meeting. See Exhibit 17. The challenger does not have a listing of the names and addresses of the SEC members and really has little idea whom to contact to ask for their vote.
- 2) The minutes of the annual meeting are approved at the next annual meeting instead of at the next Board meeting in July. There is a year or longer wait before SEC produces an official report of the election.
- 3) At the 2012 annual meeting, 161 qualified members voted on the voting machine. Proxies were not needed, and usually aren't needed, to provide a quorum. Therefore and in essence, proxies serve to deliver election of the Board's predetermined winner.
- 4) Only 100 members are required by the Bylaws (Exhibit 14, p.7, Section 3.6) for a quorum. There are approximately 15,300 member-owners, as indicated on the SEC 2011 Form 990. A 100 member quorum is only 0.65% of the membership. Since the proxy votes determine the outcomes of elections, only 6 members of the Cooperative, 0.039% of the membership, controls the election results. This is not coop control by a democratic majority.
- 5) Should a spouse of a person whose name appears on the SEC account attend the annual meeting, the spouse cannot vote for the account even if the spouse has documentation authorizing the spouse to vote, as such documentation would have to be delivered seven days in advance of the meeting (Exhibit 14, p.7, Section 3.6).

All the items in the preceding three paragraphs seriously call into question the compliance of SEC to be democratically controlled by its members as required by the IRS (Exhibit 18, IRS Manual 7.25.12.5).

A more democratic and fairer process to elect directors would be to have mail voting along with voting machines at the annual meetings supervised by an independent third party.

Questions are a fact of life, should be expected, and looked upon as an opportunity to share information with member-owners of SEC.

MATHIS, RIGGS & PRATHER, P.S.C.
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January 3, 2013

Carlen Pippin, DVM
1556 Vigo Road
Shelbyville, Kentucky 40065

Re: November 8, 2012 Member Information Requests

Dear Dr. Pippin:

Enclosed are the responses of the Board of Directors to your November 8, 2012 member questions.

Yours Truly,

MATHIS, RIGGS & PRATHER, P.S.C.

By: 

Donald T. Prather

DTP/pm

Enclosure

cc: Paul D. Wilson
Mary Hano
Jim Ellis
James Z. Hester
Jane and Gus Thomas
Mary Matthews
Tommy Pontrich
Christopher Kremer
Patrick King
Joyce Dotson

SHELBY ENERGY COOPERATIVE, INC.
Responses to November 8, 2012 Member Questions

Question 1: Please explain the justification for the hiring of a civil engineer instead of an electrical engineer since you are an electric cooperative? Will this position be listed on the 990 report?

Question 1 Response: Shelby Energy Cooperative, Inc. ("SEC") sought to obtain the most qualified engineer available for the position, whether an electrical, civil or architectural engineer. The previous Vice President of Engineering was an Architectural Engineer and he worked out just fine for this organization. After a two-year search, we are pleased that management has found an ideal employee for this role. The Manger of Engineering will be listed in the IRS Form 990 if the auditor determines he qualifies to be there.

Question 2: What are the criteria that Shelby Energy uses for the listing of personnel with pay and benefits on the 990 report? Why were Keith Miller and Mike Clark not on the 2011 report? Did they take a reduction in pay and benefits?

Question 2 Response: The requirements can be found at the IRS website: www.IRS.gov. SEC's auditor follows the IRS rules. Overtime and/or other benefits can shift up or down and cause different employees to be included on the Form 990 from year to year.

Question 3: What are (were) the educational requirements for the VP Operations & Engineering position?

Question 3 Response: A bachelor's degree in electrical engineering and technology is preferred. A professional license in Kentucky is desired. A combination of education, training, and relative experience may be considered as a substitute for formal educational requirements when competency in the role is demonstrated.

Question 4: What are (were) the educational requirements for the VP Administrative & Office Services position? Was this position created for a designated person already employed by Shelby Energy? Will this position be listed on the next 990 report? What is the annual salary and benefits for this employee?

Question 4 Response: An associates degree in business management, business administration or other business related degree from an accredited college is desired; however, a combination of education and experience may be substituted when competency is demonstrated.

This position was created to meet the needs of SEC, which as a small cooperative must meet the needs of its 15,000 members with a relatively small staff. As always, the best person was chosen for the job, who in this particular case happened to be a talented internal staff member who had worked for SEC for many years. The position was not custom created for any particular person, whether an existing employee or other candidate.

This position will be listed on IRS Form 990 if required by IRS regulations; otherwise, the salary and benefits for this employee is confidential as it is in virtually all non-government companies in America.

Question 5: What is the educational and experience required for the Safety & Loss Coordinator position? Is the person in this position qualified with experience and education? Was this position posted or offered to any of the experienced and qualified field personnel? How do you justify hiring someone trained in hotel management with a brief stint of supervising tree trimmers as a safety inspector? Would the PSC look favorably on such action based on the 2009 audit and Shelby Energy's earlier safety record?

Question 5 Response: The correct title is Safety & Environmental Supervisor. A high school diploma or general education degree (GED) is required. Post-secondary education in a technical school or at a university, plus five years of experience is helpful. Specialized courses completed in areas associated with the job position or utility industry is highly desirable. Ability and willingness to gain knowledge of specific safety practices necessary to perform work required in the construction and maintenance of electric distribution facilities. Two to five years of responsible experience in the electric distribution industry or other safety and environmental field is desired.

The President/CEO of SEC is empowered to staff SEC to reach its goals and objectives with the primary objective of providing excellent service to members, while maintaining a safe and healthy workplace. Whomever is placed in any position must be deemed "qualified". There is no requirement to post management or supervisory positions; however, posting may occur to expand the applicant pool, if it is in the best interest of the Cooperative. No posting occurs when duties and responsibilities are restructured based on reorganizational changes resulting from retirements, etc. The restructured duties and responsibilities of this employee means SEC will have two, not one, employees thoroughly trained in safety rules and supervision. We are confident that filling this additional safety supervisory position meets the requirements of the PSC and will NEVER result in a compromise of the safety and well-being of SEC employees and the

outstanding record of 52,410 safe hours worked. Thank you for sharing our concern for employee safety.

Question 6: Does the Board of Directors have concerns about the losses of so many experienced personnel in management positions over the last 18 months and why such a turnover?

Question 6 Response: No. Employees choose to retire or cease working for an employer for a number of personal reasons. The Board of Directors is pleased with the work and the progress of SEC over the last four years and applauds the management staff for their excellent work. A review of the operation will confirm progress has steadily occurred as steps have been taken to fill various roles, duties and responsibilities on many levels. We are confident the success of SEC operations has been the result of a competent and well-trained staff.

Question 7: How do you economically justify the purchase of three new bucket trucks and using two men per truck to replace two pickup trucks with one man per truck doing similar work? It appears that one man works and one watches? If it is a safety issue, why has it taken three years since the safety audit to implement this change? Jason Ginn reported to the Board of Directors at the July 19, 2012 meeting "that the AMI system has dramatically decreased the frequency bucket trucks are needed in the field and significantly changed they type of work for which they are used." There was no explanation as to how that this would widen the type of work by these small bucket truck crews. It is difficult to see that this change will give better overall member service and save money. How do you justify paying Josh Lakes (employed by Elliot Electrical Contractor) for 20 hours per week at \$120.00 per hour when Ginn continues to report that new construction is down?

Question 7 Response: Your questions appear to be the result of second-hand information provided by a person who lacks an understanding of the operations and/or did not have all of the facts. The three new bucket trucks to which you refer are small bucket trucks, two of which replaced small bucket trucks currently in the fleet that were previously scheduled for replacement.

Mr. Ginn's statement, which you quote, refers to service trucks rather than bucket trucks and was recorded incorrectly in the minutes. The change was efficiency motivated, not safety motivated. For safety reasons, two utility employees, rather than one, are required to be available when climbing is necessary such as changing out, installing or repairing an outdoor light. An analysis of field work showed that many times an initial inspection by an employee in a single-person pickup truck resulted in the need to call for a two-person bucket truck. The result has been that three employees, instead of two, were actually dispatched for what was often only a two-person job. In addition to the waste of employee time, trucks were incurring

unnecessary expense, wear and tear, and there were increased costs for fuel by crisscrossing the system in an inefficient manner. The presence of the two-person truck allowed work nearby to be completed without dispatching an additional service truck. The new method has corrected these types of inefficiencies.

The results of the changes made by the Operations Department confirm the management decisions were sound. Although we appreciate your concern for the effective and efficient management of SEC, your opinions and attempts to continually second-guess the decisions of management and attempts to micromanage the business operations is inappropriate, especially in the face of evidence that SEC is extremely well-managed. It has resulted in devoting an inordinate amount of staff time preparing responses to inquiries from only a few of SEC's members. In addition to payroll costs, there are additional legal and advisory fees. It is a very poor use of Cooperative resources. SEC has a small staff and they need to be able to focus their time and resources on serving all of the more than 15,000 Cooperative members.

If the comments you made regarding Josh Lakes are the result of information you received second-hand, your source is wildly incorrect. It should give you reason to verify information before you react and to question the motive of whomever is providing you with false information.

Question 8: Did Shelby Energy show a loss of \$115,000 for each of the last two months? If so, why? How is TIER being met?

Question 8 Response: SEC has experienced several months of losses; however, the amount of loss you suggest is not correct. Residential energy use has decreased 11% from last year, which has resulted in reduced revenues. The milder weather has had a similar impact on most other electric, gas, and other energy-related utilities. Despite SEC's best efforts, decreased revenue due to the mild weather makes it unlikely TIER will be met this year.

Question 9: How many years has Shelby Energy had the same auditor (10, 20 years)? Why?

Question 9 Response: 22 years. He was initially selected using the same criteria we use to select all professional providers: knowledge, ability, level of service, experience, and cost. Based on these criteria, the current auditor was and has remained the best choice. The wisdom of SEC's choice has been confirmed by the fact that many other Kentucky electric cooperatives and several telephone cooperatives use the same auditor.

Question 10: What was spent in 2011 for contracted heating and air conditioning services and to date for 2012?

Question 10 Response: According to the financial statements, the amount spent to keep our facility in good repair, protect sensitive equipment, and maximize productivity for 38 employees by maintaining a comfortable working environment was \$32,001.51 in 2011, \$28,602 of which was spent for installation of new units. This information was provided in a prior response to you in February 2012. \$2,296 has been spent in 2012.

Question 11: What was spent for legal counsel services in 2011 and to date for 2012?

Question 11 Response: According to the financial statements, the amount spent for legal services was \$42,397 in 2011 and \$30,401 thus far in 2012. These amounts include costs for the Board attorney and other outside legal services. As you can see, the amounts have significantly declined.

Question 12: Why is it that no employee or their wife, child, or grandchild can participate in the drawing for a bicycle at the annual meeting due to a conflict of interest and yet the spouse of a VP can hold a business contract with Shelby Energy and it not be considered a conflict of interest?

Question 12 Response: SEC has a comprehensive, written ethics policy which guides all decisions relating to conflicts of interest and is carefully monitored by the Board and President/CEO. The prize drawings at the annual meeting encourage members to attend the meeting and convey SEC's appreciation for those who do so. Employees are paid for their presence and work at the annual meeting and it is not appropriate to provide additional incentives for employees or their immediate family to attend.

The current heating & air conditioning contractor has performed superior service at a lesser cost than other service providers. The Board of Directors thoroughly reviewed the relationship between that contractor and the VP Administrative & Office Services and determined the advantages of using this particular contractor far outweighed any potential conflict of interest, particularly when that VP is not in any way involved in the selection process of the contractor, awarding of and supervision of work by the contractor, and payment for those services.

Question 13: What is the status of Gary E. Grubb as a Shelby Energy employee? Was he recently terminated due to being arrested in Graves County and charged with Soliciting Prostitution? Was he issued a Shelby Energy credit card? Was a background check conducted prior to his employment? If not, why not?

Question 13 Response: Mr. Grubbs was not and never has been an employee of SEC. You may want to seek answers to any questions you have about him from his employer, Patterson and Dewar Engineers.

Question 14: Is any of the money collected from the sale of EnviroWatts blocks used toward making other renewable energy resources available to member-owners? We are strong supporters of alternative renewable sources of energy and will pay the \$2.75 per month/per block additionally for the cleaner energy. We understand that each block will save 1,200 pounds of coal, be like planting 1.5 acres of trees and save importing 2 barrels of oil per year. It is encouraging to note that the CEO/President, Directors and some member-owners are participating. We suggest that more information with encouragement to participate should be made available to all member-owners.

Question 14 Response: The money collected from the sale of EnviroWatts is used toward operating and maintaining the EnviroWatts program. Thank you for your interest in supporting our mission of preserving our environment. We will continue to involve and encourage our members to support all of our "Green" initiatives and programs. Unfortunately, almost none of the persons indicated as "/s/" on your question presently purchase any EnviroWatts blocks, so your statement "We are strong supporters of alternative renewable sources of energy and will pay the \$2.75 per month/per block additionally for the cleaner energy." is not consistent with most of these persons' actions.

The legal relationship between a corporation, its board of directors, its management, and its members or shareholders is well established. Members or shareholders elect the board of directors. The board of directors sets policies and makes major decisions regarding the affairs of the corporation and hires competent management to implement those policies and directives, including the day-to-day workings of the corporation. The members or shareholders do not have any legally recognized right to interject themselves into the management of a corporation, and their attempts to do so are not only improper but also potentially disruptive. These and prior written questions to the Board of Directors by a relatively few have proven to be an expense the Board of Directors questions whether it is appropriate to require to be paid by other cooperative members through their rates.

The Board has deemed it prudent to have the answers to these and past questions reviewed by legal counsel due to the possibility they may be used against the Board and/or SEC in future litigation. The total cost

of this was at least \$2,482.50 in 2010, \$1,505.06 in 2011, and \$1,347.50 in 2012. The Board has in the interest of transparency answered these and previous questions without asking the requesting members to pay these unbudgeted costs, even though some of the questions continue to focus on the same issues.

You need to be aware that if written questions continue to be submitted the Board may at some point in the future require the requesting member to pay the cost for SEC's attorney to review and revise answers to written questions similar to these. Any member is free to attend the Board of Directors meeting to observe the workings of the Board. Any member is also free to express their opinions directly to individual directors, and to exercise their rights as a member by running for a position on the Board of Directors and attending the annual meeting and voting for directors. You are encouraged to pursue these other legitimate member activities.



2012

Instructions for Form 990 Return of Organization Exempt From Income Tax

**Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code
(except black lung benefit trust or private foundation)**

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H. Failure-to-File Penalties	7	Future Developments	
I. Group Return	7	For the latest information about developments related to Form 990 and its instructions, such as legislation enacted after they were published, go to www.irs.gov/form990 .	
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Specific Instructions	8	2012 Significant Changes	
Heading, Items A–M	8	1. The <i>General Instructions</i> :	
Part I. Summary	10	<ul style="list-style-type: none"> • Remind filers not to include social security numbers on Form 990, because the filing organization and the IRS are required to publicly disclose the organization's annual information returns upon request. • Clarify which year's Form 990 may be used to file for a short period. • Clarify that a short period return cannot be filed electronically unless it is a final return for which the "Terminated" box is checked in Item B of the Form 990 Heading. • Clarify that only hospital organizations should attach a copy of their most recent audited financial statements to Form 990. 	
Part II. Signature Block	10	2. In <i>Part IV, Checklist of Required Schedules</i> :	
Part III. Statement of Program Service Accomplishments	11	<ul style="list-style-type: none"> • Lines 12a and 12b now ask filers that obtained audited financial statements to complete Schedule D, Parts XI and XII (rather than Parts XI, XII, and XIII), because the former 	
Part IV. Checklist of Required Schedules	12		
Part V. Statements Regarding Other IRS Filings and Tax Compliance	15		
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Section A. Governing Body and Management

Line 1a. The **governing body** is the group of one or more persons authorized under state law to make governance decisions on behalf of the organization and its shareholders or members, if applicable. The governing body is, generally speaking, the board of **directors** (sometimes referred to as board of **trustees**) of a corporation or association, or the trustee or trustees of a trust (sometimes referred to as the board of trustees).

Enter the number, as of the end of the organization's tax year, of **members of the governing body** of the organization with power to vote on all matters that come before the governing body (other than when a conflict of interest disqualifies the member from voting). If members of the governing body do not all have the same voting rights, explain material differences on Schedule O (Form 990 or 990-EZ).

If the organization's governing body or governing documents delegated authority to act on its behalf to an executive committee or similar committee with broad authority to act on behalf of the governing body, and the committee held such authority at any time during the organization's **tax year**, describe on Schedule O (Form 990 or 990-EZ) the composition of the committee, whether any of the committee's members are not on the governing body, and the scope of the committee's authority. The organization need not describe on Schedule O (Form 990 or 990-EZ) delegations of authority that are limited in scope to particular areas or matters, such as delegations to an audit committee, investment committee, or compensation committee of the governing body.

Example. A voluntary employees' beneficiary association (VEBA) is a trust under state law. Bank B is the sole trustee of the trust. In completing line 1a, the VEBA will report one voting member of the governing body.

Line 1b. Enter the number of **independent voting members of the governing body** as of the end of the organization's tax year. A member of the governing body is considered "independent" only if all four of the following circumstances applied at all times during the organization's tax year.

1. The member was not compensated as an **officer** or other employee of the organization or of a **related organization** (see the instructions for Schedule R (Form 990)) except as provided in the religious exception discussed below. Nor was the member compensated by an unrelated organization or individual for services provided to the filing organization or to a related organization, if such compensation is required to be reported in Part VII, Section A.

2. The member did not receive total **compensation** or other payments exceeding \$10,000 during the organization's tax year from the organization and related organizations as an **independent contractor**, other than **reasonable compensation** for services provided in the capacity as a member of the governing body. For example, a person who receives reasonable expense reimbursements and reasonable compensation as a director of the organization does not cease to be independent merely because he or she also receives payments of \$7,500 from the organization for other arrangements.

3. Neither the member, nor any **family member** of the member, was involved in a transaction with the organization (whether directly or indirectly through affiliation with another organization) that is required to be reported on Schedule L (Form 990 or 990-EZ) for the organization's tax year.

4. Neither the member, nor any family member of the member, was involved in a transaction with a taxable or tax-exempt related organization (whether directly or indirectly through affiliation with another organization) of a type and

amount that would be reportable on Schedule L (Form 990 or 990-EZ) if required to be filed by the related organization.

A member of the governing body is not considered to lack independence merely because of the following circumstances.

1. The member is a donor to the organization, regardless of the amount of the contribution.

2. Religious exception: The member has taken a *bona fide* vow of poverty and either (a) receives **compensation** as an agent of a **religious order** or a section 501(d) religious or apostolic organization, but only under circumstances in which the member does not receive taxable income (see Rev. Rul. 77-290, 1977-2 C.B. 26 and Rev. Rul. 80-332, 1980-2 C.B. 34) or (b) belongs to a religious order that receives sponsorship or payments from the organization or a related organization which do not constitute taxable income to the member.

3. The member receives financial benefits from the organization solely in the capacity of being a member of the charitable or other class served by the organization in the exercise of its exempt function, such as being a member of a section 501(c)(6) organization, so long as the financial benefits comply with the organization's terms of membership.

Example 1. B is a voting member of the organization's board of directors. B is also a partner with a profits and capital interest greater than 5% in a law firm, C, that charged \$120,000 to the organization for legal services in a court case. The transaction between C and the organization must be reported on Schedule L (Form 990 or 990-EZ) because it is a transaction between the organization and an entity of which B is a more than 5% owner, and because the payment to C from the organization exceeded \$100,000 (see the instructions to Schedule L (Form 990 or 990-EZ), Part IV, regarding both factors). Accordingly, B is not an independent member of the governing body because the \$120,000 payment must be reported on Schedule L (Form 990 or 990-EZ) as an indirect business transaction with B. If B were an associate attorney (an employee) rather than a partner with a greater than 5% interest, and not an officer, director, trustee, or owner of the law firm, the transaction would not affect B's status as an independent member of the organization's governing body.

Example 2. D is a voting member of both the organization's governing body and the governing body of C, a related organization. D's daughter, E, received \$40,000 in taxable compensation as a part-time employee of C. D is not an independent member of the governing body, because E received compensation from C, a related organization to D, and the compensation was of a type (compensation to a family member of a member of C's governing body) and amount (over \$10,000) that would be reportable on Schedule L (Form 990 or 990-EZ) if the related organization, C, were required to file Schedule L (Form 990 or 990-EZ).

Example 3. C was Board Chair of X school during the tax year. X's Bylaws designate the following as officer positions: Board Chair, Secretary, and Treasurer. C set the agenda for board of directors meetings, officiated board meetings, coordinated development of board policy and procedure, was an ex officio member of all committees of the board, conducted weekly staff meetings, and performed teacher and staff evaluations. X compensated C during the tax year for C's services. This compensation was attributable to C's board and committee activities, and to C's non-director activities involving staff meetings and evaluations. Because X compensated C for services as an officer/employee, C is not an independent member of the governing body. See Rev. Rul. 68-597 and Rev. Rul. 57-246 for a description of the distinction between director services and officer services.

Example 4. Same facts as in Example 3, except that the Board Chair position was not designated as an officer position under X's Bylaws, board resolutions, or state law. Nevertheless, because X compensated C for non-director activities involving staff meetings and evaluations during the tax year, C is deemed to have received compensation as an employee—not as a governing body member—for those activities. Therefore, C is not an independent member of the governing body.

Example 5. Same facts as in Example 3, except that (1) C conducted only director and committee activities during the tax year; (2) C did not conduct staff meetings and evaluations; and (3) X compensated C a reasonable amount for C's Board Chair services during the tax year, but did not provide any other compensation to C in any other capacity. C's independence as a Board member is not compromised by receiving compensation from X as a Board member (and not as an officer or employee). See also *Examples 2 and 3* in the Instructions for Part VII, Section A, line 5, later.

Reasonable effort. The organization need not engage in more than a **reasonable effort** to obtain the necessary information to determine the number of **independent voting members of its governing body** and can rely on information provided by such members. For instance, the organization can rely on information it obtains in response to a questionnaire sent annually to each member of the governing body that includes the member's name and title, blank lines for the member's signature and signature date, and the pertinent instructions and definitions for line 1b, to determine whether the member is or is not independent.

Line 2. Answer "Yes" if any of the organization's current **officers, directors, trustees, or key employees**, as reported in Part VII, Section A, had a **family relationship** or business relationship with another of the organization's current officers, directors, trustees, or key employees, as reported in Part VII, Section A, at any time during the organization's **tax year**. For each family and business relationship, identify the persons and describe their relationship on Schedule O (Form 990 or 990-EZ). It is sufficient to enter "family relationship" or "business relationship" without greater detail.

Business relationship. Business relationships between two persons include any of the following.

1. One person is employed by the other in a sole proprietorship or by an organization with which the other is associated as a **trustee, director, officer**, or greater-than-35% owner, even if that organization is tax-exempt. However, do not report a person's employment by the filing organization as a business relationship.
2. One person is transacting business with the other (other than in the ordinary course of either party's business on the same terms as are generally offered to the public), directly or indirectly, in one or more contracts of sale, lease, license, loan, performance of services, or other transaction involving transfers of cash or property valued in excess of \$10,000 in the aggregate during the organization's tax year. *Indirect transactions* are transactions with an organization with which the one person is associated as a trustee, director, officer, or greater-than-35% owner. Such transactions do not include charitable contributions to tax-exempt organizations.
3. The two persons are each a director, trustee, officer, or greater than 10% owner in the same business or investment entity (but not in the same tax-exempt organization).

Ownership is measured by stock ownership (either voting power or value, whichever is greater) of a corporation, profits or capital interest in a partnership or limited liability company (whichever is greater), membership interest in a nonprofit organization, or beneficial interest in a trust. Ownership includes indirect ownership (for example, ownership in an entity that has

ownership in the entity in question); there may be ownership through multiple tiers of entities.

Privileged relationship exception. For purposes of line 2, a "business relationship" does not include a relationship between an attorney and client, a medical professional (including psychologist) and patient, or a priest/clergy and penitent/communicant.

Example 1. B is an officer of the organization, and C is a member of the organization's governing body. B is C's sister's spouse. The organization must report that B and C have a family relationship.

Example 2. D and E are officers of the organization. D is also a partner in an accounting firm with 300 partners (with a $\frac{1}{300}$ interest in the firm's profits and capital) but is not an officer, director or trustee of the accounting firm. D's accounting firm provides services to E in the ordinary course of the accounting firm's business, on terms generally offered to the public, and receives \$100,000 in fees during the year. The relationship between D and E is not a reportable business relationship, either because (1) it is in the ordinary course of business on terms generally offered to the public, or (2) D does not hold a greater-than-35% interest in the accounting firm's profits or capital.

Example 3. F and G are trustees of the organization. F is the owner and CEO of an automobile dealership. G purchased a \$45,000 car from the dealership during the organization's tax year in the ordinary course of the dealership's business, on terms generally offered to the public. The relationship between F and G is not a reportable business relationship because the transaction was in the ordinary course of business on terms generally offered to the public.

Example 4. H and J are members of the organization's board of directors. Both are CEOs of publicly traded corporations and serve on each other's boards. The relationship between H and J is a reportable business relationship because each is a director or officer in the same business entity.

Example 5. K is an officer of the organization, and L is on its board of directors. L is a greater-than-35% partner of a law firm that charged \$60,000 during the organization's tax year for legal services provided to K that were worth \$600,000 at the law firm's ordinary rates. Thus, the ordinary course of business exception does not apply. However, the relationship between K and L is not a reportable business relationship, because of the privileged relationship of attorney and client.

Reasonable effort. The organization is not required to provide information about a family or business relationship between two **officers, directors, trustees, or key employees** if it is unable to secure the information after making a **reasonable effort** to obtain it. An example of a reasonable effort would be for the organization to distribute a questionnaire annually to each such person that includes the name and title of each person reporting information, blank lines for those persons' signatures and signature dates, and the pertinent instructions and definitions for line 2.

Line 3. Answer "Yes" if at any time during the organization's tax year the organization used a management company or other person to perform any management duties customarily performed by or under the direct supervision of **officers, directors, trustees, or key employees**. Such management duties include, but are not limited to, hiring, firing, and supervising personnel, planning or executing budgets or financial operations, or supervising exempt operations or unrelated trades or businesses of the organization. Management duties do not include administrative services (such as payroll processing) that do not involve significant managerial decision-making. Management duties also do not include

investment management unless the filing organization conducts investment management services for others.

If 'Yes,' on Schedule O list the name(s) of the management company or companies or other person(s) performing management duties; describe the services they provided to the organization; list any of the organization's current or former officers, directors, trustees, key employees, and **highest compensated employees** who were compensated by the management company or companies or other person(s) during the calendar year ending with or within the organization's tax year; and list the amounts of compensation they received from the management company or companies or other person(s).

Line 4. The organization must report significant changes to its organizing or enabling document by which it was created (articles of incorporation, association, or organization; trust instrument; constitution; or similar document), and to its rules governing its affairs commonly known as bylaws (or regulations, operating agreement, or similar document). Report significant changes that were not reported on any prior Form 990, and that were made before the end of the **tax year**. Do not report changes to policies described or established outside of the organizing or enabling document and bylaws (or similar documents), such as adoption of, or change to, a policy adopted by resolution of the **governing body** that does not entail a change to the organizing document or bylaws.

Examples of significant changes to the organizing or enabling document or bylaws include changes to:

- The organization's exempt purposes or mission;
- The organization's name (see also the instructions for *Heading, Item B*);
- The number, composition, qualifications, authority, or duties of the governing body's voting members;
- The number, composition, qualifications, authority, or duties of the organization's **officers** or **key employees**;
- The role of the stockholders or membership in governance;
- The distribution of assets upon dissolution;
- The provisions to amend the organizing or enabling document or bylaws;
- The quorum, voting rights, or voting approval requirements of the governing body members or the organization's stockholders or membership;
- The policies or procedures contained within the organizing documents or bylaws regarding **compensation** of officers, directors, trustees, or key employees, conflicts of interest, whistleblowers, or document retention and destruction; and
- The composition or procedures contained within the organizing document or bylaws of an audit committee.

Example. Organization X has a written conflicts of interest policy that is not contained within the organizing document or bylaws. The policy is changed by board resolution. The policy change does not need to be reported on line 4.

Examples of insignificant changes made to organizing or enabling documents or bylaws that are not required to be reported here include changes to the organization's registered agent with the state and to the required or permitted number or frequency of governing body or member meetings.

Describe significant changes on Schedule O (Form 990 or 990-EZ), but do not attach a copy of the amendments or amended document to Form 990 (or recite the entire amended document verbatim), unless such amended documents reflect a change in the organization's name. See the instructions for *Item B* under *Heading, Items A–M*, regarding attachments required in the event of a change in the organization's name.



An organization must report significant changes to its organizational documents in Form 990, Part VI, rather than in a letter to EO Determinations. EO

Determinations no longer issues letters confirming the tax-exempt status of organizations that report significant changes to their organizational documents, though it will, on request, issue an affirmation letter confirming an organization's name change. If an exempt organization becomes a different legal entity, such as by changing its legal structure from a trust to a corporation or by dissolving in one state and incorporating in another, then a new exemption application is required to establish that the new legal entity qualifies for exemption.

Line 5. Answer "Yes" if the organization became aware during the organization's **tax year** of a significant diversion of its assets, whether or not the diversion occurred during the year. If "Yes," explain the nature of the diversion, amounts or property involved, corrective actions taken to address the matter, and pertinent circumstances on Schedule O (Form 990 or 990-EZ), although the person or persons who diverted the assets should not be identified by name.

A *diversion of assets* includes any unauthorized conversion or use of the organization's assets other than for the organization's authorized purposes, including but not limited to embezzlement or theft. Report diversions by the organization's **officers, directors, trustees, employees, volunteers, independent contractors**, grantees (diverting grant funds), or any other person, even if not associated with the organization other than by the diversion. A diversion of assets does not include an authorized transfer of assets for **FMV** consideration, such as to a **joint venture** or for-profit subsidiary in exchange for an interest in the joint venture or subsidiary. For this purpose, a diversion is considered significant if the gross value of all diversions (not taking into account restitution, insurance, or similar recoveries) discovered during the organization's tax year exceeds the lesser of (1) 5% of the organization's gross receipts for its tax year, (2) 5% of the organization's total assets as of the end of its tax year, or (3) \$250,000.

Note. A diversion of assets can in some cases be inurement of the organization's net earnings. In the case of section 501(c)(3), 501(c)(4), and 501(c)(29) organizations, it also can be an **excess benefit transaction** taxable under section 4958 and reportable on Schedule L (Form 990 or 990-EZ).

Line 6. Answer "Yes" if the organization is organized as a stock corporation, a joint-stock company, a partnership, a **joint venture**, or a limited liability company. Also answer "Yes" if the organization is organized as a non-stock, nonprofit, or not-for-profit corporation or association with members. For purposes of Form 990, Part VI, *member* means (without regard to what a person, including a corporation or other legal entity, is called in the governing documents) any person who, pursuant to a provision of the organization's governing documents or applicable state law, has the right to participate in the organization's governance or to receive distributions of income or assets from the organization. Members do not include governing body members. For purposes of Part VI, a membership organization includes members with the following kinds of rights.

1. The members elect the members of the **governing body** (but not if the persons on the governing body are the organization's only members) or their delegates.
2. The members approve significant decisions of the governing body.
3. The members can receive a share of the organization's profits or excess dues or a share of the organization's net assets upon the organization's dissolution.

Describe on Schedule O (Form 990 or 990-EZ) the classes of members or stockholders with the rights described above.

Line 7a. Answer "Yes" on line 7a if at any time during the organization's tax year there were one or more persons (other than the organization's **governing body** itself, acting in such capacity) that had the right to elect or appoint one or more members of the organization's governing body, whether periodically, or as vacancies arise, or otherwise. If "Yes," describe on Schedule O (Form 990 or 990-EZ) the class or classes of such persons and the nature of their rights.

Line 7b. Answer "Yes" on line 7b if at any time during the organization's tax year any governance decisions of the organization were reserved to (or subject to approval by) members, stockholders, or persons other than the **governing body**, whether or not any such governance decisions were made during the tax year, such as approval of the governing body's election or removal of members of the governing body, or approval of the governing body's decision to dissolve the organization. If "Yes," describe on Schedule O (Form 990 or 990-EZ) the class or classes of such persons, the decisions that require their approval, and the nature of their voting rights.

Line 8. Answer "Yes" on lines 8a and 8b if the organization contemporaneously documented by any means permitted by state law every meeting held and written action taken during the organization's tax year by its **governing body** and committees with authority to act on behalf of the governing body (which ordinarily do not include advisory boards). Documentation permitted by state law can include approved minutes, email, or similar writings that explain the action taken, when it was taken, and who made the decision. For this purpose, *contemporaneous* means by the later of (1) the next meeting of the governing body or committee (such as approving the minutes of the prior meeting) or (2) 60 days after the date of the meeting or written action. If the answer to either line 8a or 8b is "No," explain on Schedule O (Form 990 or 990-EZ) the organization's practices or policies, if any, regarding documentation of meetings and written actions of its governing body and committees with authority to act on its behalf. If the organization had no committees, answer "No" to line 8b.

Line 9. The IRS needs a current mailing address to contact the organization's **officers, directors, trustees, or key employees**. The organization can use its official mailing address stated on the first page of Form 990 as the mailing address for such persons. Otherwise, enter on Schedule O (Form 990 or 990-EZ) the mailing addresses for such persons that are to be contacted at a different address. Such information will be available to the public.

Section B. Policies

Answer "Yes" to any question in this section that asks whether the organization had a particular policy or practice only if the organization's governing body (or a committee of the governing body, if the governing body delegated authority to that committee to adopt the policy) adopted the policy by the end of its **tax year**, and if the policy applied to the organization as a whole. If the policy applied only on a division-wide or department-wide level, answer "No." The organization may explain the scope of such policy on Schedule O.

Line 10a. Answer "Yes" if the organization had during its tax year any local chapters, local branches, local lodges, or other similar local units or affiliates over which the organization had the legal authority to exercise direct or indirect supervision and control (whether or not in a **group exemption**) and local units that are not separate legal entities under state law over which the organization had such authority. An affiliate or unit is considered "local" for this purpose if it is responsible for a smaller geographical area than the filing organization is responsible for. Thus, a regional organization would be considered local for a national organization.

Example 1. X is a national organization dedicated to the reform of K. X has affiliates in 15 states which conduct activities to carry out the purposes of X at the state level. X has the authority to approve the annual budget of each affiliate. X must answer "Yes" to line 10a.

Example 2. Y is a section 170(b)(1)(A)(iii) hospital located in M City. Y appoints a majority of the board of directors of Z, a section 509(a)(3) supporting organization that invests funds and makes grants for the benefit of Y. Although Y controls Z, Z is not a local affiliate of Y that would require Y to answer "Yes" to line 10a.

Line 10b. *Written policies and procedures governing the activities of local chapters, branches, and affiliates to ensure their operations are consistent with the organization's tax-exempt purposes* are documents used by the organization and its local units to address the policies, practices, and activities of the local unit. Such policies and procedures can include policies and procedures similar to those described in lines 11-16 of this section, whether separate or included as required provisions in the chapter's articles of organization or bylaws, a manual provided to chapters, a constitution, or similar documents. If "No," explain on Schedule O (Form 990 or 990-EZ) how the organization ensures that the local unit's activities are consistent with the organization's tax-exempt purposes.

Note. The **central organization** (parent organization) named in a **group exemption** letter is required to have general supervision or control over its **subordinate organizations** as a condition of the group exemption.

Line 11a. Answer "Yes" only if a complete copy of the organization's final Form 990 (including all required schedules), as ultimately filed with the IRS, was provided to each person who was a **voting member of the governing body** at the time the Form 990 was provided, whether in paper or electronic form, before its filing with the IRS. The organization can answer "Yes" if it emailed all of its governing body members a link to a password-protected web site on which the entire Form 990 can be viewed, and noted in the email that the Form 990 is available for review on that site. However, answer "No" if the organization merely informed its governing body members that a copy of the Form 990 is available upon request. Answer "No" if the organization redacted or removed any information from the copy of its final Form 990 that it provided to its governing body members before filing the form. For example, answer "No" if the organization, at the request of a donor, redacted the name and address of that donor from the copy of its Form 990, Schedule B that it provided to its governing body members. Under those circumstances, the organization may explain on Schedule O why it answered "No" to line 11a.

Line 11b. Describe on Schedule O (Form 990 or 990-EZ) the process, if any, by which any of the organization's **officers, directors, trustees**, board committee members, or management reviewed the prepared Form 990, whether before or after it was filed with the IRS, including specifics about who conducted the review, when they conducted it, and the extent of any such review. If no review was or will be conducted, enter "No review was or will be conducted."

Example. The return preparer emails a copy of the final version of Form 990 to each Board member before it was filed. However, no Board member undertakes any review of the form either before or after filing. Because such a copy of the final version of the form was provided to each voting member of the organization's governing body before it was filed, the organization can answer "Yes" even though no review took place. The organization must describe its Form 990 review process (or lack thereof) on Schedule O (Form 990 or 990-EZ).

Line 12a. Answer “Yes” if as of the end of the organization's tax year, the organization had a written **conflict of interest policy**. A conflict of interest policy defines conflicts of interest, identifies the classes of individuals within the organization covered by the policy, facilitates disclosure of information that can help identify conflicts of interest, and specifies procedures to be followed in managing conflicts of interest. A *conflict of interest* arises when a person in a position of authority over an organization, such as an **officer, director, manager, or key employee** can benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to family members or businesses with which the person is closely associated. For this purpose, a conflict of interest does not include questions involving a person's competing or respective duties to the organization and to another organization, such as by serving on the boards of both organizations, that do not involve a material financial interest of, or benefit to, such person.

Example. B is a member of the governing body of X Charity and of Y Charity, both of which are section 501(c)(3) public charities with different charitable purposes. X Charity has taken a public stand in opposition to a specific legislative proposal. At an upcoming board meeting, Y Charity will consider whether to publicly endorse the same specific legislative proposal. While B may have a conflict of interest in this decision, the conflict does not involve a material financial interest of B's merely as a result of Y Charity's position on the legislation.

Line 12b. Answer “Yes” if the organization's **officers, directors, trustees, and key employees** are required to disclose or update annually (or more frequently) information regarding their interests and those of their **family members** that could give rise to conflicts of interest, such as a list of family members, substantial business or investment holdings, and other transactions or affiliations with businesses and other organizations and those of family members.

Line 12c. If “Yes” to line 12c, describe on Schedule O (Form 990 or 990-EZ) the organization's practices for monitoring proposed or ongoing transactions for conflicts of interest and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred. The description should include an explanation of which persons are covered under the policy, the level at which determinations of whether a conflict exists are made, and the level at which actual conflicts are reviewed. Also explain any restrictions imposed on persons with a conflict, such as prohibiting them from participating in the **governing body's** deliberations and decisions in the transaction.

Lines 13 and 14. A whistleblower policy encourages staff and volunteers to come forward with credible information on illegal practices or violations of adopted policies of the organization, specifies that the organization will protect the individual from retaliation, and identifies those staff or board members or outside parties to whom such information can be reported. A document retention and destruction policy identifies the record retention responsibilities of staff, **volunteers**, board members, and outsiders for maintaining and documenting the storage and destruction of the organization's documents and records.



Certain federal or state laws provide protection against whistleblower retaliation and prohibit destruction of certain documents. For instance, while the federal Sarbanes-Oxley legislation generally does not pertain to tax-exempt organizations, it does impose criminal liability on tax-exempt as well as other organizations for (1) retaliation against whistleblowers that report federal offenses, and (2) for destruction of records with the intent to obstruct a federal investigation. See 18 U.S.C. sections 1513(e) and 1519. Also note that an organization is required to keep books and records

relevant to its tax exemption and its filings with the IRS. Some states provide additional protection for whistleblowers.

Line 15. Answer “Yes” on line 15a if, during the tax year, the organization used a process for determining **compensation** (reported in Part VII or Schedule J (Form 990)) of the CEO, executive director, or other person who is the **top management official**, that included all of the following elements.

- Review and approval by a **governing body** or compensation committee, provided that persons with a conflict of interest regarding the compensation arrangement at issue were not involved. For purposes of this question, a member of the governing body or compensation committee has a conflict of interest regarding a compensation arrangement if any of the following circumstances apply.

1. The member (or a family member of the member) is participating in or economically benefiting from the compensation arrangement.
2. The member is in an employment relationship subject to the direction or control of any person participating in or economically benefiting from the compensation arrangement.
3. The member receives compensation or other payments subject to approval by any person participating in or economically benefiting from the compensation arrangement.
4. The member has a material financial interest affected by the compensation arrangement.
5. The member approves a transaction providing economic benefits to any person participating in the compensation arrangement, who in turn has approved or will approve a transaction providing economic benefits to the member. See Regulations section 53.4958-6(c)(1)(iii).

- Use of data as to comparable compensation for similarly qualified persons in functionally comparable positions at similarly situated organizations.

- Contemporaneous documentation and recordkeeping for deliberations and decisions regarding the compensation arrangement.

Answer “Yes” on line 15b if the process for determining compensation of one or more **officers or key employees** other than the **top management official** included all of the elements listed above.

If the answer was “Yes” on line 15a or 15b, describe the process on Schedule O (Form 990 or 990-EZ), identify the offices or positions for which the process was used to establish compensation of the persons who served in those offices or positions, and enter the year in which this process was last undertaken for each such person.

If the organization did not compensate its CEO, executive director, or top management official during the **tax year**, answer “No” to line 15a. If the organization did not compensate any of its other officers or key employees during the tax year, answer “No” to line 15b.

Line 16. Answer “Yes” on line 16a if at any time during its tax year the organization invested in, contributed assets to, or otherwise participated in a joint venture or similar arrangement with one or more taxable persons. For purposes of line 16, a joint venture or similar arrangement (or a “venture or arrangement”) means any joint ownership or contractual arrangement through which there is an agreement to jointly undertake a specific business enterprise, investment, or exempt-purpose activity without regard to (1) whether the organization controls the venture or arrangement, (2) the legal structure of the venture or arrangement, or (3) whether the venture or arrangement is treated as a partnership for federal income tax purposes, or as an association, or corporation for federal income tax purposes. Disregard ventures or arrangements that meet both of the following conditions.

1. 95% or more of the venture's or arrangement's income for its tax year ending with or within the organization's **tax year** is described in sections 512(b)(1)–(5) (including unrelated debt-financed income).

2. The primary purpose of the organization's contribution to, or investment or participation in, the venture or arrangement is the production of income or appreciation of property.

Answer "Yes" on line 16b if, as of the end of the organization's tax year, the organization had both:

1. Followed a written policy or procedure that required the organization to negotiate, in its transactions and arrangements with other members of the venture or arrangement, such terms and safeguards as are adequate to ensure that the organization's exempt status is protected, and

2. Taken steps to safeguard the organization's exempt status for the venture or arrangement.

Some examples of safeguards include the following:

- Control over the venture or arrangement sufficient to ensure that the venture furthers the exempt purpose of the organization.
- Requirements that the venture or arrangement give priority to exempt purposes over maximizing profits for the other participants.
- The venture or arrangement not engage in activities that would jeopardize the organization's exemption (such as political intervention or substantial lobbying for a section 501(c)(3) organization).
- All contracts entered into with the organization be on terms that are at arm's length or more favorable to the organization.

Section C. Disclosure

Line 17. Use Schedule O (Form 990 or 990-EZ) if additional space is necessary.



Some states require or permit the filing of Form 990 to fulfill state exempt organization or charitable solicitation reporting requirements.

Line 18. Check the box for "Own website" only if the organization posted an exact reproduction (other than for information permitted by law to be withheld from public disclosure, such as the names and addresses of contributors listed in Form 990, Schedule B) of its Form 990, Form 990-T (for section 501(c)(3) organizations), or application for recognition of exemption (Form 1023 or 1024) on its website during its **tax year**. Check the box for "Another's website" only if the organization provided to another individual or organization, and that other individual or organization posted on its website, an exact reproduction (other than for information permitted by law to be withheld from public disclosure, such as the names and addresses of contributors listed in Form 990, Schedule B) of any such forms during the tax year.

If "Other" is checked, explain in Schedule O (Form 990 or 990-EZ). Also explain in Schedule O (Form 990 or 990-EZ) if the organization did not make publicly available upon request any of Forms 1023, 1024, 990, or 990-T that are subject to public inspection requirements. Exempt organizations must make available for public inspection their Form 1023 or 1024 application for recognition of exemption. Applications filed before July 15, 1987, need not be made publicly available unless the organization had a copy on July 15, 1987. Organizations that file Form 990 must make it publicly available for a period of three years from the date it is required to be filed (including extensions) or, if later, is actually filed. Organizations are not required to make publicly available the names and addresses of contributors (as set forth on Schedule B (Form 990, 990-EZ, or 990-PF), and on Form 1023 or 1024). Section 501(c)(3) organizations that file Form 990-T also are required to make their

Form 990-T publicly available for the corresponding three-year period, for forms filed after August 17, 2006 (unless the form was filed solely to request a refund of telephone excise taxes). See *Appendix D* for more information on public inspection requirements.

Line 19. Explain on Schedule O (Form 990 or 990-EZ) whether the organization made its governing documents (for example, articles of incorporation, constitution, bylaws, trust instrument) **conflict of interest policy**, and **financial statements** (whether or not audited) available to the general public during the tax year, and if so, how it made them available to the public (for example, posting on the organization's website, posting on another website, providing copies on request, inspection at an office of the organization, etc.). If the organization did not make any of these documents available to the public, enter "No documents available to the public."

Federal tax law does not require that such documents be made publicly available unless they were included on a form that is publicly available (such as Form 1023 or 1024).

Line 20. Provide the name of the person who possesses the organization's books and records, and the business address and telephone number of such person (or of the organization if the books and records are kept by such person at a personal residence). If the books and records are kept at more than one location, provide the name, business address, and telephone number of the person responsible for coordinating the maintenance of the books and records. The organization is not required to provide the address or telephone number of a personal residence of an individual. If provided, however, such information will be available to the public.

Part VII. Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors

Check the box in the heading of Part VII if Schedule O (Form 990 or 990-EZ) contains any information pertaining to this part.

Overview. Form 990, Part VII requires the listing of the organization's current or former **officers, directors, trustees, key employees, and highest compensated employees**, and **current independent contractors**, and reporting of certain **compensation** information relating to such persons.

All organizations are required to complete Part VII, and when applicable, Schedule J (Form 990), for certain persons. Compensation must be reported for the calendar year ending with or within the organization's **tax year**. In some cases, persons are reported in Part VII or Schedule J (Form 990) only if their **reportable compensation** (as explained below) and "other compensation" (as explained below) from the organization and **related organizations** (as explained in the *Glossary* and in the instructions for Schedule R (Form 990)) exceeds certain thresholds. In some cases, compensation from an **unrelated organization** must be reported on Form 990. See the instructions for Part VII, Section A, line 5, later. The amount of compensation reported on Form 990, Part VII, for a listed person may differ from the amount reported on Form 990, Part IX, line 5, for that person due to factors such as a different accounting period (calendar vs. **fiscal year**) or a different accounting method.

Form 990, Part VII relies on definitions of reportable compensation and other compensation. *Reportable compensation* generally refers to compensation reported on Form W-2, box 1 or 5 (whichever amount is greater); and Form 1099-MISC, box 7. Organizations also must report other

compensation in Part VII, as discussed in the instructions to Part VII, Section A, column (F), later.

Organizations must report compensation for both current and former officers, directors, trustees, key employees, and highest compensated employees. The distinction between current and former such persons is discussed below. The determination of "former" uses a 5-year look-back period.

Organizations must report compensation from themselves and from related organizations, which generally consist of parents, subsidiaries, brother/sister organizations, supporting organizations, supported organizations, sponsoring organizations of voluntary employees' beneficiary associations (VEBAs), and contributing employers to VEBAs. See the instructions for Schedule R (Form 990) for a fuller discussion of related organizations.

Part VII, Section A requires reporting of officers, directors, trustees, key employees, and up to five of the organization's highest compensated employees. Compensation from related organizations must also be taken into account in determining a person's compensation and reported separately in Part VII, Section A, columns (E) and (F).

Up to 28 persons can be reported on the Form 990, Part VII, Section A table. If more space is needed to enter additional persons, use as many duplicates of the Section A table as are needed, and change the numbering to reflect additional persons (for example, if five additional persons are reported on a duplicate Section A table, change the numbers along the left hand margin of the table from 1-5 to 29-33).

Section B requires reporting of the five highest compensated independent contractors. Section B does not require reporting of compensation from related organizations.

Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

Overview. Organizations are required to enter in Part VII, Section A, the following **officers, directors, trustees, and employees** of the organization whose **reportable compensation** from the organization and **related organizations** (as explained in the *Glossary* and the instructions for Schedule R (Form 990)) exceeded the following thresholds for the tax year.

- Current officers, directors, and trustees (no minimum compensation threshold).
- Current **key employees** (over \$150,000 of reportable compensation).
- Current five highest compensated employees other than officers, directors, trustees, or listed key employees (over \$100,000 of reportable compensation).
- Former officers, key employees, and **highest compensated employees** (over \$100,000 of reportable compensation, with special rules for former highest compensated employees).
- Former directors and trustees (over \$10,000 of reportable compensation in the capacity as a former director or trustee).

Special rules apply to **disregarded entities** of which the organization is the sole member. See instructions for *Disregarded Entities*, later.

To determine which persons are current or former officers, directors, trustees, key employees, or highest compensated employees, see the instructions to Part VII, Section A, column (C) beginning later.

Fiscal year filers. To determine which persons are listed in Part VII, Section A, the organization must use the calendar year ending with or within the organization's **fiscal year** for some (those whose **compensation** must exceed minimum thresholds in order to be reported) and the fiscal year for others. Report

officers, directors, and trustees that served at any time during the fiscal year (such as "current" **officers, directors, and trustees**). Report the following persons based on **reportable compensation** and status for the calendar year ending within the fiscal year.

- Current **key employees** (over \$150,000 of **reportable compensation** from the organization and **related organizations**).
- Current five **highest compensated employees** (over \$100,000 of reportable compensation from the organization and related organizations), other than current officers, directors, trustees, and key employees.
- Former officers, key employees, and five highest compensated employees (over \$100,000 of reportable compensation from the organization and related organizations, with special rules for former highest compensated employees).
- Former directors and trustees (over \$10,000 of reportable compensation for services in the capacity as director or trustee of the organization, from the organization and related organizations).

Report compensation on Form 990, Part VII, for the calendar year ending within the organization's **fiscal year**, including that of current officers, directors, and trustees, even if the fiscal year is used to determine which such persons must be listed in Part VII.

Director or trustee. A "director or trustee" is a member of the organization's **governing body**, but only if the member has voting rights. A director or trustee that served at any time during the organization's **tax year** is deemed a current director or trustee. Members of advisory boards that do not exercise any governance authority over the organization are not considered directors or trustees.

An "institutional trustee" is a trustee that is not an individual or natural person but an organization. For instance, a bank or trust company serving as the trustee of a trust is an institutional trustee.

Officer. An **officer** is a person elected or appointed to manage the organization's daily operations. An officer that served at any time during the organization's **tax year** is deemed a current officer. The officers of an organization are determined by reference to its organizing document, bylaws, or resolutions of its **governing body**, or as otherwise designated consistent with state law, but, at a minimum, include those officers required by applicable state law. Officers can include a president, vice-president, secretary, treasurer and, in some cases, a Board Chair. In addition, for purposes of Form 990, including Part VII, Section A, and Schedule J (Form 990), treat as an officer the following persons, regardless of their titles.

1. *Top management official.* The person who has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization; for example, the organization's president, CEO, or executive director.

2. *Top financial official.* The person who has ultimate responsibility for managing the organization's finances; for example, the organization's treasurer or chief financial officer.

If ultimate responsibility resides with two or more individuals (for example, co-presidents or co-treasurers), who can exercise such responsibility in concert or individually, then treat all such individuals as officers.

Key employee. For purposes of Form 990, a current **key employee** is an **employee** of the organization (other than an **officer, director, or trustee**) who meets all three of the following tests, applied in the following order:

1. *\$150,000 Test:* Receives **reportable compensation** from the organization and all **related organizations** in excess of

\$150,000 for the **calendar year** ending with or within the organization's **tax year**.

2. **Responsibility Test:** At any time during the calendar year ending with or within the organization's **tax year**:

- a. Has responsibilities, powers, or influence over the organization as a whole that is similar to those of officers, directors, or trustees;
- b. Manages a discrete segment or activity of the organization that represents 10% or more of the activities, assets, income, or expenses of the organization, as compared to the organization as a whole; or
- c. Has or shares authority to control or determine 10% or more of the organization's capital expenditures, operating budget, or compensation for **employees**.

3. **Top 20 Test:** Is one of the 20 employees other than officers, directors, and trustees who satisfy the **\$150,000 Test** and **Responsibility Test** with the highest reportable compensation from the organization and **related organizations** for the calendar year ending with or within the organization's **tax year**.

If the organization has more than 20 individuals who meet the **\$150,000 Test** and **Responsibility Test**, report as **key employees** only the 20 individuals that have the highest reportable compensation from the organization and related organizations. Note that any others, up to five, might be reportable as **current highest compensated employees**, with over \$100,000 in reportable compensation. Use the calendar year ending with or within the organization's tax year for determining the organization's current key employees.

An individual that is not an employee of the organization (or of a **disregarded entity** of the organization) is nonetheless treated as a key employee if he or she serves as an officer or director of a disregarded entity of the organization and otherwise meets the standards of a key employee set forth above. See *Disregarded Entities*, later, for treatment of certain employees of a disregarded entity as a key employee of the organization.

If an employee is a key employee of the organization for only a portion of the year, that person's entire compensation for the calendar year ending with or within the organization's tax year, from both the filing organization and related organizations, should be reported in Part VII, Section A.

Management companies and similar entities that are **independent contractors** should not be reported as key employees. The organization's **top management official** and **top financial official** are deemed officers rather than key employees.

In the examples set forth below, assume the individual involved is an employee that satisfies the **\$150,000 Test** and **Top 20 Test** and is not an **officer, director, or trustee**.

Example 1. T is a large section 501(c)(3) university. L is the dean of the law school of T, which generates more than 10% of the revenue of T, including contributions from alumni and foundations. Although L does not have ultimate responsibility for managing the university as a whole, L meets the **Responsibility Test** and is reportable as a key employee of T.

Example 2. S chairs a small academic department in the College of Arts and Sciences of the same university, T, described above. As department chair, S supervises faculty in the department, approves the course curriculum, and oversees the operating budget for the department. The department represents less than 10% of the university's activities, assets, income, expenses, capital expenditures, operating budget, and employee compensation. Under these facts and circumstances, S does not meet the **Responsibility Test** and is not a key employee of T.

Example 3. U is a large acute-care section 501(c)(3) hospital. U employs X as a radiologist. X gives instructions to staff for the radiology work X conducts, but X does not supervise other U employees, manage the radiology department, or have or share authority to control or determine 10% or more of U's capital expenditures, operating budget, or employee compensation. Under these facts and circumstances, X does not meet the **Responsibility Test** and is not a key employee of U.

Example 4. W is a cardiologist and head of the cardiology department of the same hospital U described above. The cardiology department is a major source of patients admitted to U and consequently represents more than 10% of U's income, as compared to U as a whole. As department head, W manages the cardiology department. Under these facts and circumstances, W meets the **Responsibility Test** and is a key employee of U.

Five highest compensated employees. The organization is required to enter its current five **highest compensated employees** whose **reportable compensation** combined from the organization and **related organizations** is greater than \$100,000 for the calendar year ending with or within the organization's **tax year** and who are not also current **officers, directors, trustees, or key employees** of the organization. Such individuals are the "current" five highest compensated employees. These can include persons who meet some but not all of the tests for key employee status. The organization is not required to enter more than the top five such persons, ranked by amount of reportable compensation. Use the calendar year ending with or within the organization's tax year for determining the organization's current five highest compensated employees.

Example. X is an employee of Y University and is not an officer, director, or trustee. X's reportable compensation for the calendar year exceeds \$150,000, and X meets the **Responsibility Test**. X would qualify as a key employee of Y, except that 20 employees had higher reportable compensation and otherwise qualify as key employees; therefore, those 20 are listed as the organization's key employees. X has the highest reportable compensation from the organization and related organizations of all employees other than the 20 key employees. X must be listed as one of the organization's five highest compensated employees.

\$10,000 exceptions for reporting compensation. Report compensation paid or accrued by the filing organization and **related organizations**. Special rules apply for reporting **reportable compensation** and other compensation.

All reportable compensation paid by the filing organization must be reported. Reportable compensation paid by a related organization is not required to be reported unless (1) it is \$10,000 or more for the calendar year ending with or within the organization's tax year (the "\$10,000-per-related-organization exception"), or (2) it is paid for past services to the filing organization in the person's capacity as a former director or trustee.

A particular item of other compensation (such as listed in the compensation table, later) paid or accrued by the filing organization is not required to be reported unless (1) it is \$10,000 or more for the calendar year ending with or within the organization's tax year (the "\$10,000-per-item exception") or (2) it is one of the five types of compensation (generally constituting deferred compensation (including retirement plan benefits) and health benefits) that must be reported regardless of amount (see the instructions for column (F)). The same principles apply to items of other compensation paid or accrued by a related organization (applied separately to each related organization).



The \$10,000 exceptions do not apply to reporting compensation on Schedule J (Form 990), Part II.

Reportable compensation. Reportable compensation consists of:

- For **officers** and other **employees**, amounts required to be reported on Form W-2, box 1 or 5 (whichever amount is greater) (plus Form 1099-MISC, box 7 if the officer or employee is also compensated as an independent contractor of the filing organization or a related organization);
- For **directors** and individual **trustees**, amounts required to be reported on Form 1099-MISC, box 7 (plus Form W-2, box 1 or 5 (whichever amount is greater) if also compensated as an officer or employee of the filing organization or a related organization); and
- For **institutional trustees**, fees for services paid pursuant to a contractual agreement or statutory entitlement. While the compensation of institutional trustees must be reported on Form 990, Part VII, it need not be reported on Schedule J (Form 990).

If the organization did not file a Form 1099-MISC because the amounts paid were below the threshold reporting requirement, then include and report the amount actually paid. For a full definition of **reportable compensation**, see *Glossary*.

TIP *Corporate officers are considered employees for purposes of Form W-2 reporting, unless they perform no services as officers, or perform only minor services and neither receive nor are entitled to receive, directly or indirectly, any compensation. Corporate directors are considered independent contractors, not employees, and director compensation, if any, generally is required to be reported on Form 1099-MISC. See Regulations section 31.3401(c)-1(f).*

For certain kinds of employees and for retirees, the amount in box 5 of Form W-2 can be zero or less than the amount in Form W-2, box 1. For instance, recipients of disability pay, certain members of the clergy, and religious workers who are not subject to social security and Medicare taxes as employees can receive compensation that is not reported in box 5. In that case, the amount required to be reported on Form W-2, box 1 must be reported as reportable compensation.

If an officer, director, trustee, key employee, or highest compensated employee of the organization is a foreign person who received U.S. source income during the calendar year ending with or within the organization's **tax year** from the filing organization or a **related organization**, and if such income was reported on Form 1042-S, box 2, then treat this income as **reportable compensation** and report it in Part VII, Section A, column (D) or (E). For foreign persons for whom compensation reporting on Form W-2, Form 1099-MISC, or Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, is not required, treat as reportable compensation in column (D) or (E) the total value of the compensation paid in the form of cash or property during the calendar year ending with or within the organization's tax year. Report other compensation from foreign organizations as "other compensation" in column (F).

To determine whether an individual received more than \$100,000 (or \$150,000) in reportable compensation in the aggregate from the filing organization (and, as discussed later, certain third parties such as common paymasters, payroll/reporting agents, and certain **unrelated organizations**, compensation from which is considered compensation from the filing organization) and **related organizations**, add the following amounts.

- The amount reported on Form W-2, box 1 or 5 (whichever amount is greater), and/or Form 1099-MISC, Miscellaneous Income, box 7, issued to the individual by the organization.
- Amounts reported on Form W-2, box 1 or 5 (whichever amount is greater), or Form 1099-MISC, box 7, issued to the individual by each related organization that reported \$10,000 or more.

To determine whether an individual received solely in his or her capacity as a former trustee or director of the organization more than \$10,000 in reportable compensation for the calendar year ending with or within the organization's **tax year**, in the aggregate, from the organization and all related organizations (and thus must be reported on Form 990, Part VII and Schedule J (Form 990), Part II), add the amounts reported on all Forms 1099-MISC, box 7, and, if relevant, all Forms W-2, box 1 or 5, (whichever amount is greater) issued to the individual by the organization and all related organizations for the calendar year ending with or within the organization's tax year. Report such amounts only to the extent that such amounts relate to the individual's past services as a trustee or director of the organization, and do not disregard any payments from a related organization if below \$10,000, for such purpose.

Other compensation. Other compensation includes **compensation** other than **reportable compensation**, including **deferred compensation** not currently reportable on Form W-2, box 1 or 5 or Form 1099-MISC, box 7, and certain nontaxable benefits, as discussed in detail in the instructions for Schedule J, (Form 990), Part II. See the instructions for other compensation reported in column (F), later, which includes a table to show where and how to report certain types of compensation in Part VII, Section A, and Schedule J (Form 990).

Note. Do not report the same item of compensation in more than one column of Part VII, Section A for the tax year.

Disregarded entities. **Disregarded entities** (such as a limited liability company that is wholly owned by the organization and not treated as a separate entity for federal tax purposes) are generally treated as part of the organization rather than as **related organizations** for purposes of Form 990, including Part VII and Schedule J (Form 990). A person is not considered an **officer** or **director** of the organization by virtue of being an officer or director of a disregarded entity, but he or she can qualify as a **key employee** or **highest compensated employee** of the organization. An officer, director, or employee of a disregarded entity is a key employee of the organization if he or she meets the *\$150,000 Test* and *Top 20 Test* for the filing organization as a whole, and if, for the *Responsibility Test*, the person has responsibilities, powers or influence over a discrete segment or activity of the disregarded entity that represents at least 10 percent of the activities, assets, income, or expenses of the filing organization as a whole, or has or shares authority to control or determine the disregarded entity's capital expenditures, operating budget, or compensation for employees that is at least 10 percent of the filing organization's respective items as a whole. If an officer or director of a disregarded entity also serves as an officer, director, trustee, or key employee of the organization, report this individual as an officer, director, trustee, or key employee, as applicable, of the organization, and add the compensation, if any, paid by the disregarded entity to this individual to the compensation, if any, paid directly by the organization to this individual. Report the total aggregate amount in Column (D).

TIP *A disregarded entity generally must use the EIN of its sole member. An exception applies to employment taxes: for wages paid to employees of a disregarded entity, the disregarded entity must file separate employment tax returns and use its own EIN on such returns. See Regulations sections 301.6109-1(h) and 301.7701-2(c)(2)(iv).*

Management companies. **Management companies**, as **independent contractors**, are reported on Form 990, Part VII (if at all) only in Section B. *Independent Contractors*, and are not reported on Schedule J (Form 990), Part II. If a current or former **officer**, **director**, **trustee**, or **key employee** has a relationship with a management company that provides services to the

organization, then the relationship can be reportable on Schedule L (Form 990 or 990-EZ), Part IV. A key employee of a management company can be reported as a current officer of the filing organization if he or she is the filing organization's **top management official** or **top financial official** or is designated as an officer of the filing organization. However, that person does not qualify as a key employee of the filing organization solely on the basis of being a key employee of the management company. If a current or former officer, director, trustee, key employee, or **highest compensated employee** receives **compensation** from a management company that provides services to the organization and is a related organization, then the individual's compensation from the management company must be reported on Form 990, Part VII, Section A, columns (E) and (F). Questions pertaining to management companies also appear on Form 990, Part VI, line 3 and Schedule H (Form 990), Part IV.

Leased employees. In some cases, instead of hiring a management company, an exempt organization "leases" one or more "employees" from another company, which may be in the business of leasing employees. The compensation paid to the leasing company should be treated like compensation to a management company for purposes of Form 990 compensation reporting.

The organization should treat employees of an employee leasing company or a management company as the organization's own employees if such persons are common law employees of the filing organization under state law.

Common paymaster or payroll/reporting agent. Treat amounts paid by a common paymaster (as defined in Regulations section 31.3121(s)-1(b)(2)) or a payroll or reporting agent (which is or should be appointed by the organization on Form 2678, Employer/Payer Appointment of Agent, or authorized by the organization on Form 8655, Reporting Agent Authorization, to perform certain employment tax services on behalf of the organization) for services performed for the organization as if the organization had paid such amounts directly and report these amounts in Part VII, Section A, columns (D) and (F). Similarly, treat amounts paid by a common paymaster or a payroll or reporting agent for services performed for a **related organization** as if such amounts were paid directly by the related organization, and report these amounts in Part VII, Section A, columns (E) and (F).

Compensation from common paymasters, payroll/reporting agents, and unrelated organizations or individuals (except for compensation from **management companies** or leasing companies, and compensation described in *Taxable organization employee exception*, later) must be treated as reportable compensation in determining whether the dollar thresholds are met for reporting (1) current or former employees as current or former key employees or highest compensated employees, or (2) former officers, directors, or trustees, on Form 990, Part VII, Section A. If the Form 990, Part VII thresholds for reporting are met, then the compensation from the common paymaster, payroll/reporting agent, or unrelated organization or individual must be reported as compensation from the filing organization in Part VII. The compensation may also need to be reported in Form 990, Schedule J, Part II (see the instructions for Form 990, Part VII, Section A, line 5).



The use of a leasing company, common paymaster, payroll/reporting agent, or other payroll service provider does not relieve an employer of its obligation for employment tax liabilities. The IRS strongly suggests that you do not change your organization's address of record to that of your payroll service provider or other third party payer. Doing so could limit your ability to stay informed of tax matters involving the organization, because the IRS sends correspondence regarding

problems with an employer's account to the employer's address of record. Alternatively, an employer may grant permission for a third party payer to receive copies of IRS correspondence by using Form 8822-B, Form 2848, or Form 8655, as appropriate.

Compensation from unrelated organizations or individuals. If a current or former **officer, director, trustee, key employee, or highest compensated employee** received or accrued compensation or payments from an **unrelated organization** (other than from **management companies** or leasing companies, as discussed above) or an individual for services rendered to the filing organization in that person's capacity as an officer, director, trustee, or employee of the filing organization, then the filing organization must report (subject to the *taxable organization employee exception* on this page) such amounts as **compensation** from the filing organization if it has knowledge of the arrangement, whether or not the unrelated organization or the individual treats the amounts as compensation, grants, contributions, or otherwise. Report such compensation from unrelated organizations in Section A, columns (D) and (F), as appropriate. If the organization cannot distinguish between reportable compensation and other compensation from the unrelated organization, report all such compensation in column (D).

Taxable organization employee exception. Do not report as compensation any payments from an unrelated taxable organization that employs the individual and continues to pay the individual's regular compensation while the individual provides services without charge to the filing organization, but only if the unrelated organization does not treat the payments as a charitable contribution to the filing organization.

Column (A). For each person required to be listed, enter the name in the top of each row and the person's title or position with the organization in the bottom of the row. If more than one title or position, list all. List persons in the following order: individual **trustees** or **directors**, **institutional trustees**, **officers**, **key employees**, **highest compensated employees**, and former such persons.

Column (B). For each person listed in column (A), estimate the average hours per week devoted to the organization during the year. Entry of a specific number is required for a complete answer. Enter "-0-" if applicable. Do not include statements such as "as needed," "as required," or "40+." If the average is less than one hour per week, then the organization can enter a decimal rounded to the nearest tenth (for example, 0.2 hours per week).

For each person listed in column (A), list below the dotted line an estimate of the average hours per week (if any) devoted to related organizations.

Column (C). For each person listed in column (A), check the box that reflects the person's position with the organization during the tax year. Do not check more than one box, unless the person was both an officer and a director/trustee of the organization during the tax year. For a former **officer, director, trustee, key employee, or highest compensated employee**, check only the "Former" box and indicate the former status in the person's title.

"Current" officers, directors, trustees, key employees, and highest compensated employees. A "current" officer, director, or trustee is a person that was an officer, director, or trustee at any time during the organization's **tax year**. A "current" key employee or highest compensated employee is a person who was a key employee or highest compensated employee for the calendar year ending with or within the organization's tax year.

If the organization files Form 990 based on a **fiscal year**, use the fiscal year to determine the organization's "current" officers, directors, and trustees. Whether or not the organization files

Form 990 based on a **fiscal year**, use the calendar year ending with or within the organization's **tax year** to determine the organization's "current" **key employees** and five highest compensated employees.

Do not check the "Former" box if the person was a current officer, director, or trustee at any time during the organization's tax year, or a current key employee or among the five highest compensated employees for the calendar year ending with or within the organization's tax year. A current employee (other than a current officer, director, trustee, key employee, or highest compensated employee) can be reported on Form 990, Part VII and Schedule J (Form 990), Part II: (1) as a former director or trustee because he or she formerly served as a director or trustee and received more than \$10,000 in **reportable compensation** in the capacity as a former director or trustee, or (2) a former officer or key employee (but not as a former highest compensated employee) because he or she qualified as an officer or key employee within the last five years and received more than \$100,000 of reportable compensation. In such a case, indicate the individual's former position in his or her titles (for example, "former president").

"Former" officers, directors, trustees, key employees, and highest compensated employees. Check the "Former" box for former officers, directors, trustees, and key employees only if both conditions below apply.

- The organization reported (or should have reported, applying the instructions in effect for such years) an individual on any of the organization's Forms 990, 990-EZ or 990-PF, for any one or more of the five prior years in one or more of the following capacities: officer, director, trustee, or key employee.
- The individual received **reportable compensation**, from the organization and/or **related organizations**, in the calendar year ending with or within the organization's current **tax year** in excess of the threshold amount (\$100,000 for former officers and key employees, \$10,000 paid to former directors and trustees for services rendered in their former capacity as directors or trustees.)

If a person was reported (or should have been reported) as an officer, director, trustee, or key employee on any of the organization's prior five Forms 990, 990-EZ, or 990-PF, if the person was still employed at any time during the organization's tax year either (1) by the organization in a lesser capacity other than as an officer, director, trustee, key employee, or highest compensated employee; or (2) by a related organization in any capacity, but not by the filing organization, and if the person received reportable compensation that exceeded the threshold amount described above, then check only the "Former" box. For example, do not check both the "Former" and "Officer" boxes for a former president of the organization who was not an officer of the organization during the tax year.

Whether or not the organization files Form 990 based on a **fiscal year**, use the calendar year ending within the organization's tax year to determine all "former" officers, directors, trustees, key employees, and five highest compensated employees (because their status depends on their reportable compensation, which is reported for the calendar year).

Check the "Former" box for the former five highest compensated employees only if all four conditions below apply.

1. The individual was not an **employee** of the organization at any time during the calendar year ending with or within the organization's tax year.
2. The individual was reported (or should have been reported, under the instructions in effect for such years) on any of the organization's Forms 990, 990-EZ, or 990-PF for one or more of the five prior years as one of the five highest compensated employees.

3. The individual's reportable compensation exceeded \$100,000 for the calendar year ending with or within the organization's tax year.

4. The amount of the individual's reportable compensation for such year would place him or her among the organization's current five highest compensated employees if the individual were an employee during the calendar year ending with or within the organization's tax year.

Example 1. X was reported as one of Y Charity's five highest compensated employees on one of Y's Forms 990, 990-EZ, or 990-PF from one of its five prior tax years. For 2012, X is not a current officer, director, trustee, key employee, or highest compensated employee of Y. X is not an employee of Y during the 2012 calendar year ending with or within Y's tax year. X receives reportable compensation in excess of \$100,000 from Y for past services and would be among Y's five highest compensated employees if X were a current employee. Y must report X as a former highest compensated employee on Y's 2012 Form 990, Part VII, Section A.

Example 2. T was reported as one of Y Charity's five highest compensated employees on one of Y's Forms 990, 990-EZ, or 990-PF from one of its five prior tax years. For 2012, T is not a current officer, director, trustee, key employee, or highest compensated employee of Y, although T is still an employee of Y during the 2012 calendar year ending with or within Y's tax year. T receives reportable compensation in excess of \$100,000 from Y and related organizations for such calendar year. T is not reportable as a former highest compensated employee on Y's 2012 Form 990, Part VII, Section A, because T was an employee of Y during the calendar year ending with or within Y's tax year.

Example 3. Z was reported as one of Y Charity's key employees on Y's 2011 Form 990. For 2012, Z is not a current officer, director, trustee, key employee, or highest compensated employee of Y. For 2012, Z receives reportable compensation of \$90,000 from Y as an employee (and no reportable compensation from related organizations). Because Z receives less than \$100,000 reportable compensation in 2012 from Y and its related organizations, Y is not required to report Z as a former key employee on Y's 2012 Form 990, Part VII, Section A.

Columns (D) & (E). Enter the amounts required to be reported (whether or not actually reported) on Form W-2, box 1 or 5 (whichever is greater) and/or Form 1099-MISC, box 7, issued to the person for the calendar year ending with or within the organization's **tax year**. Enter an amount for each person in each of columns (D) and (E). Enter "-0-" if the person received **no reportable compensation**. For **institutional trustees** that do not receive a Form 1099-MISC, enter the amount that the organization would have reported in box 7 if a Form 1099-MISC had been required.

Reportable compensation paid to the person by a **related organization** at any time during the entire calendar year ending with or within the filing organization's tax year should be reported in column (E). If the related organization was related to the filing organization for only a portion of the tax year, then the filing organization may choose to report only compensation paid or accrued by the related organization during the time it was actually related. If the filing organization reports compensation on this basis, it must explain in Schedule O (Form 990 or 990-EZ) and state the period during which the related organization was related.

\$10,000-per-related-organization exception. For purposes of column (E), the organization need not include payments from a single related organization if less than \$10,000 for the calendar year ending with or within the organization's tax year, except to the extent paid to a former **director** or former **trustee** of the filing organization for services as a director or trustee of the organization. For example, if an officer of the organization

received **compensation** of \$6,000, \$15,000, and \$50,000 from three separate related organizations for services provided to those organizations, the organization needs to report only \$65,000 in column (E) for the officer.

Volunteer exception. The organization need not report in column (E) or (F) compensation from a related organization paid to a **volunteer officer, director, or trustee** of the filing organization if the related organization is a for-profit organization, is not owned or controlled directly or indirectly by the organization or one or more related tax-exempt organizations, and does not provide management services for a fee to the organization.

Bank or financial institution trustee. If the organization is a trust with a bank or financial institution trustee that is also a trustee of another trust, it need not report in column (E) or (F) compensation from the other trust for services provided as the trustee to the other trust, because the other trust is not a related organization (see *Glossary* definition of **Related organization**).

Reasonable effort. The organization is not required to report compensation from a **related organization** to a person listed on Form 990, Part VII, Section A, if the organization is unable to secure the information on compensation paid by the related organization after making a **reasonable effort** to obtain it, and if it is unable to make a reasonable estimate of such compensation. If the organization makes reasonable efforts but is unable to obtain the information or provide a reasonable estimate of compensation from a related organization in column (E) or (F), then it must report the efforts undertaken on Schedule O (Form 990 or 990-EZ). An example of a reasonable effort is for the organization to distribute a questionnaire annually to each of its current and former officers, directors, trustees, key employees, and highest compensated employees that includes the name and title of each person reporting information, blank lines for those persons' signatures and signature dates, and the pertinent instructions and definitions for Form 990, Part VII, Section A, columns (E) and (F).

Short year and final returns. For a short year return in which there is no calendar year that ends with or within the short year, leave columns (D) and (E) blank, unless the return is a final return. If the return is a final return, report the compensation that is reportable compensation on Forms W-2 and 1099 for the short year, from both the filing organization and related organizations, whether or not Forms W-2 or 1099 have been filed yet to report such compensation.

Column (F). Other compensation generally includes compensation not currently reportable on Form W-2, box 1 or 5 or Form 1099-MISC, box 7, including nontaxable benefits other than disregarded benefits, as discussed in **Disregarded benefits** and in the instructions for Schedule J, (Form 990), Part II. Treat amounts paid or accrued under a **deferred compensation** plan, or held by a deferred compensation trust, that is established, sponsored, or maintained by the organization (or a **related organization**) as paid, accrued, or held directly by the organization (or the related organization). Deferred compensation to be reported in column (F) includes compensation that is earned or accrued in one year and deferred to a future year, whether or not funded, vested, qualified or nonqualified, or subject to a substantial risk of forfeiture. But do not report in column (F) a deferral of compensation that causes an amount to be deferred from the tax year to a date that is not more than 2 1/2 months after the end of the tax year.

Enter an amount in column (F) for each person listed in Part VII, Section A. (Enter "-0-" if applicable.) Report a reasonable estimate if actual numbers are not readily available.

Other compensation paid to the person by a **related organization** at any time during the calendar year ending with or within the filing organization's tax year should be reported in

column (F). If the related organization was related to the filing organization for only a portion of the tax year, then the filing organization may choose to report only other compensation paid or accrued by the related organization during the time it was actually related. If the filing organization reports compensation on this basis, it must explain in Schedule O (Form 990 or 990-EZ) and state the period during which the related organization was related.

The following items of compensation provided by the filing organization and related organizations must be reported as "other compensation" in column (F) in all cases regardless of the amount, to the extent they are not included in column (D).

1. Tax-deferred contributions by the employer to a qualified defined contribution retirement plan.
2. The annual increase or decrease in actuarial value of a qualified defined benefit plan, whether or not funded or vested.
3. The value of health benefits provided by the employer, or paid by the employee with pre-tax dollars, that are not included in reportable compensation. For this purpose, health benefits include: (1) payments of health benefit plan premiums; (2) medical reimbursement and flexible spending programs, and (3) the value of health coverage (rather than actual benefits paid) provided by an employer's self-insured or self-funded arrangement. Health benefits include dental, optical, drug, and medical equipment benefits. They do not include disability or long-term care insurance premiums or allocated benefits for this purpose.
4. Tax-deferred contributions by the employer and employee to a funded nonqualified defined contribution plan, and deferrals under an unfunded nonqualified defined contribution plan, whether or not such plans are vested or subject to a substantial risk of forfeiture. See examples in Schedule J (Form 990), Part II instructions.
5. The annual increase or decrease in actuarial value of a nonqualified defined benefit plan, whether or not funded, vested, or subject to a substantial risk of forfeiture.

\$10,000-per-item exception. Except for the five items listed above, neither the organization nor a **related organization** is required to report on Form 990, Part VII, Section A any item of "other compensation" (as set forth in the compensation table beginning later) if its total value is less than \$10,000 for the calendar year ending with or within the organization's tax year.

Amounts excluded under the two separate \$10,000 exceptions (the \$10,000-per-related-organization and \$10,000-per-item exceptions) are to be excluded from **compensation** in determining whether an individual's total **reportable compensation** and other compensation exceeds the thresholds set forth on Form 990, Part VII, Section A, line 4. If the individual's total compensation exceeds the relevant threshold, then the amounts excluded under the \$10,000 exceptions are included in the individual's compensation reported on Schedule J (Form 990). Thus, the total amount of compensation reported on Schedule J (Form 990) can be higher than the amount reported on Form 990, Part VII, Section A.

The \$10,000-per-item exception applies separately for each item of other compensation from the organization and from each related organization.

Example 1.

Organization X provides the following compensation to its current officer:

\$110,000	Reportable compensation (including pre-tax employee contributions of \$5,000 to a qualified defined contribution retirement plan and \$2,500 to a qualified health benefit plan)
5,000	Tax-deferred employer contribution to qualified defined contribution retirement plan
5,000	Nontaxable employer contributions to health benefit plan
4,000	Nontaxable dependent care assistance
500	Nontaxable group life insurance premium
8,000	Moving expense (nontaxable as qualified under section 132)

Organization Y, a related organization, also provides compensation to the officer as follows:

\$21,000	Reportable compensation (including \$1,000 pre-tax employee contribution to qualified defined contribution retirement plan)
1,000	Tax-deferred employer contribution to qualified defined contribution retirement plan
5,000	Nontaxable tuition assistance

The officer receives no compensation in the capacity as a former director or trustee of X, and no unrelated organization pays the officer for services provided to X. The organization can disregard as other compensation the (a) \$4,500 in dependent care and group life insurance payments from the organization (under the \$10,000-per-item exception); (b) the \$8,000 moving expense from the organization (excluded under section 132) on both Form 990, Part VII and Schedule J (Form 990), Part II; and (c) the \$5,000 in tuition assistance from the related organization (under the \$10,000-per-item exception) in determining whether the officer's total reportable and other compensation from the organization and related organizations exceeds \$150,000. In this case, total reportable compensation is \$131,000, and total other compensation (excluding the excludible items below \$10,000) is \$11,000. Under these circumstances, the officer's dependent care, group life, moving expenses, and tuition assistance items need not be reported as other compensation on Form 990, Part VII, Section A, column (F), and the officer's total reportable and other compensation (\$142,000) is not reportable on Schedule J (Form 990). If instead, the officer's reportable compensation from Y were \$30,000 rather than \$21,000, then the officer's total reportable and other compensation (\$151,000) would be reportable on Schedule J (Form 990), including the dependent care, group life, and tuition assistance items, even though these items would not have to be reported as other compensation in Form 990, Part VII.

Example 2. Organization S provides health benefits to B (its CEO) under a self-insured medical reimbursement plan. The value of the plan benefits for the tax year is \$10,000, which represents the estimated cost of providing coverage for the year if the employer paid a third-party insurer for similar benefits, as

determined on an actuarial basis. The actual benefits paid for B and B's family for the year are \$30,000. If the benefits are not reportable compensation to B, then Organization S must report the \$10,000 value of plan benefits as other compensation to B in Form 990, Part VII, Section A, column (F).

Disregarded benefits. Disregarded benefits under Regulations section 53.4958-4(a)(4) need not be reported in column (F). Disregarded benefits generally include fringe benefits excluded from gross income under section 132. These benefits include the following:

- No-additional cost service;
- Qualified employee discount;
- Working condition fringe;
- De minimis fringe;
- Qualified transportation fringe;
- Qualified moving expense reimbursement;
- Qualified retirement planning services; and
- Qualified military base realignment and closure fringe.

For descriptions of each of these disregarded benefits, see instructions for Schedule J (Form 990 and 990-EZ), *Compensation Information*.

Short year and final returns. For a short year return in which there is no calendar year that ends with or within the short year, leave column (F) blank, unless the return is a final return. If the return is a final return, report the other compensation for the short year, from both the filing organization and related organizations.

Compensation table for reporting in Part VII, Section A, or Schedule J (Form 990), Part II. The following table may be useful in determining how and where to report items of **compensation** on Form 990, Part VII, Section A and on Schedule J, (Form 990), Part II. The list is not comprehensive but covers most items for most organizations. Many items of compensation may or may not be taxable or currently taxable, depending on the plan or arrangement adopted by the organization and other circumstances. The list attempts to take into account these varying facts and circumstances. The list is merely a guideline to report amounts for those persons required to be listed. In all cases, items included on Form W-2, box 1 or 5 (whichever is greater) and/or Form 1099-MISC, box 7 are required to be reported on Part VII, Section A and, for applicable persons, Schedule J, (Form 990), Part II, column (B). Items listed as "taxable" or "taxable in current year" are currently includible in reportable compensation, but are not necessarily subject to federal income tax in the current year.

Any item listed in the following compensation table that is not followed by a star (x) or asterisk (*) in any column should not be

reported in Part VII, Section A or in Schedule J, Part II (Form 990).

Type of Compensation	Where to Report				
	Form 990, Part VII, Section A, column (D) or (E)			Form 990, Part VII, Section A, column (F)	
	Schedule J (Form 990), Part II, column B(i)	Schedule J (Form 990), Part II, column B(ii)	Schedule J (Form 990), Part II, column B(iii)	Schedule J (Form 990), Part II, column C	Schedule J (Form 990), Part II, column D
Base salary/wages/fees paid	x				
Base salary/wages/fees deferred (taxable)	x				
Base salary/wages/fees deferred (nontaxable)				x	
Bonus paid (including signing bonus)		x			
Bonus deferred (taxable in current year)		x			
Bonus deferred (not taxable in current year)				x	
Incentive compensation paid		x			
Incentive compensation deferred (taxable in current year)		x			
Incentive compensation deferred (not taxable in current year)				x	
Severance or change of control payments made			x		
Sick pay paid by employer	x				
Third party sick pay			x		
Other compensation amounts deferred (taxable in current year)		x			
Other compensation amounts deferred (not taxable in current year)				x	
Tax gross-ups paid			x		
Vacation/sick leave cashed out			x		
Stock options at time of grant				x	
Stock options at time of exercise			x		
Stock awards paid by taxable organizations substantially vested			x		
Stock awards paid by taxable organizations not substantially vested				x	
Stock equivalents paid by taxable organizations substantially vested			x		
Stock equivalents paid by taxable organizations not substantially vested				x	
Loans—forgone interest or debt forgiveness			x		
Contributions (employer) to qualified retirement plan				x	
Contributions (employee deferrals) to section 401(k) plan	x				
Contributions (employee deferrals) to section 403(b) plan	x				
Qualified or nonqualified retirement plan defined benefit accruals (reasonable estimate of increase or decrease in actuarial value)				x	
Qualified retirement (defined contribution) plan investment earnings or losses (not reportable or other compensation)					
Taxable distributions from qualified retirement plan, including section 457(b) eligible governmental plan (reported on Form 1099-R but not reportable or other compensation on Form 990)					

Type of Compensation	Where to Report				
	Form 990, Part VII, Section A, column (D) or (E)			Form 990, Part VII, Section A, column (F)	
	Schedule J (Form 990), Part II, column B(i)	Schedule J (Form 990), Part II, column B(ii)	Schedule J (Form 990), Part II, column B(iii)	Schedule J (Form 990), Part II, column C	Schedule J (Form 990), Part II, column D
Distributions from nongovernmental section 457(b) plan			x		
Amounts includible in income under section 457(f)			x		
Amounts deferred by employer or employee (plus earnings) under section 457(b) plan (substantially vested)			x		
Amounts deferred by employer or employee under section 457(b) or 457(f) plan (not substantially vested)				x	
Amounts deferred under nonqualified defined contribution plans (substantially vested)			x		
Amounts deferred under nonqualified defined contribution plans (not substantially vested)				x	
Earnings or losses of nonqualified defined contribution plan (substantially vested)			x		
Earnings or losses of nonqualified defined contribution plan (not substantially vested)					
Scholarships and fellowship grants (taxable)			x		
Health benefit plan premiums paid by employer (taxable)	x				
Health benefit plan premiums paid by the employee (taxable)	x				
Health benefit plan premiums (nontaxable)					x
Medical reimbursement and flexible spending programs (taxable)			x		
Medical reimbursement and flexible spending programs (nontaxable)					x
Other health benefits (taxable)			x		
Other health benefits (nontaxable)					x
Life, disability, or long-term-care insurance (taxable)			x		
Life, disability, or long-term-care insurance (nontaxable)					*
Split-dollar life insurance (see Notice 2002-8, 2002-1 C.B. 398)			x		
Housing provided by employer or ministerial housing allowance (taxable)			x		
Housing provided by employer or ministerial housing allowance (nontaxable) (but see Schedule J instructions regarding working condition fringes)					*
Personal legal services (taxable)			x		
Personal legal services (nontaxable)					*
Personal financial services (taxable)			x		
Personal financial services (nontaxable)					*
Dependent care assistance (taxable)			x		
Dependent care assistance (nontaxable)					*
Adoption assistance (taxable)			x		
Adoption assistance (nontaxable)					*
Tuition assistance for family (taxable)			x		

Type of Compensation	Where to Report				
	Form 990, Part VII, Section A, column (D) or (E)			Form 990, Part VII, Section A, column (F)	
	Schedule J (Form 990), Part II, column B(i)	Schedule J (Form 990), Part II, column B(ii)	Schedule J (Form 990), Part II, column B(iii)	Schedule J (Form 990), Part II, column C	Schedule J (Form 990), Part II, column D
Tuition assistance for family (nontaxable)					*
Cafeteria plans (nontaxable health benefit)					x
Cafeteria plans (nontaxable benefit other than health)					*
Liability insurance (taxable)			x		
Employer-provided automobile (taxable)			x		
Employer-subsidized parking (taxable)			x		
Travel (taxable)			x		
Moving (taxable)			x		
Meals and entertainment (taxable)			x		
Social club dues (taxable)			x		
Spending account (taxable)			x		
Gift cards			x		
Disregarded benefits under Regulations section 53.4958-4(a)(4) (see Schedule J, Part II instructions)					

Note. Items marked with asterisk (*) instead of a star (x) are excludible from Form 990, Part VII, Section A, column (F), if below \$10,000.

Line 1b. Report the sub-totals of compensation from the Section A, line 1a table in line 1b, columns (D), (E), and (F).

Line 1c. Report the sub-totals of compensation from continuation sheets (duplicate Section A tables for filers that report more than 28 persons in Section A, line 1a table) in line 1c, columns (D), (E), and (F).

Line 1d. Add the totals of lines 1b and 1c in line 1d for columns (D), (E), and (F).

Line 2. Report the total number of individuals, both those listed in the Part VII, Section A table and those not listed, to whom the filing organization (not **related organizations**) paid over \$100,000 in **reportable compensation** during the **tax year**.

Line 3. Complete Schedule J (Form 990) for each of the following persons.

- Each individual listed in Part VII, Section A, as a former **officer**, former **key employee**, or a former **highest compensated employee**. To determine whether an individual received more than \$100,000 in **reportable compensation** in the aggregate from the organization and **related organizations**, add the amounts reported on all Forms W-2, box 1 or 5 (whichever is greater) and/or Forms 1099-MISC, box 7 issued to the individual by the organization and all related organizations (disregarding amounts from a related organization if below \$10,000) for the **calendar year** ending with or within the organization's **tax year**.

- Each individual that received, solely in the capacity as a former **director** or former **trustee** of the organization, more than \$10,000 of reportable compensation (Part VII, Section A, columns (D) and (E)) during the year from the organization or related organizations. To determine whether an individual received or accrued more than \$10,000 in reportable compensation solely in the capacity as a former trustee or director of the organization, add the amounts reported on all Forms 1099-MISC, box 7 and, if applicable, Forms W-2, box 1 or 5 (whichever is greater) and/or issued to the individual by the organization and all related organizations, to the extent that such amounts relate to the individual's past services as a trustee or director of the organization and not of a related organization. The \$10,000-per-related-organization exception does not apply for this purpose.

Line 4. Complete Schedule J (Form 990) for each individual listed in Section A who received or accrued more than \$150,000 of reportable and other compensation from the organization and related organizations. To determine whether any listed individual received or accrued more than \$150,000 of reportable and other compensation, add all **compensation** included in Part VII, Section A, columns (D), (E), and (F), but disregard any decreases in the actuarial value of defined benefit plans.

The following chart explains which **officers**, **directors**, **trustees**, **key employees**, and **highest compensated employees** must be reported on Form 990, Part VII, Section A, and on Schedule J (Form 990), as well. See also line 5 for additional individuals who must be reported on Schedule J, (Form 990), Part II.

Matrix for Part VII, Section A, Lines 3 and 4

Position	Current or former	Enter on Form 990, Part VII, Section A . . .	Enter on Schedule J (Form 990), Part II . . .
Directors and Trustees	Current	All	If reportable and other compensation is greater than \$150,000 in the aggregate from organization and related organizations (do not report institutional trustees)
	Former	If reportable compensation in capacity as former director or trustee is greater than \$10,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A (do not report institutional trustees)
Officers	Current	All	If reportable and other compensation is greater than \$150,000 in the aggregate from organization and related organizations
	Former	If reportable compensation is greater than \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A
Key employees	Current	All	All
	Former	If reportable compensation is greater than \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A
Other Five Highest Compensated Employees	Current	If reportable compensation is greater than \$100,000 in the aggregate from organization and related organizations	If reportable and other compensation is greater than \$150,000 in the aggregate from organization and related organizations
	Former	If reportable compensation is greater than \$100,000 in the aggregate from organization and related organizations	If listed on Form 990, Part VII, Section A

Line 5. Complete Schedule J (Form 990) for any individual listed on Form 990, Part VII, Section A if the person receives or accrues **compensation** from an **unrelated organization** (other than certain management companies and leasing companies, as discussed earlier) for services rendered to the filing organization in the person's capacity as an **officer, director, trustee, or employee** of the filing organization. Also, specify on Schedule J (Form 990), Part III, the name of the unrelated organization, the type and amount of compensation it paid or accrued, and the person receiving or accruing such compensation. See *Compensation from unrelated organizations*, earlier.

For purposes of line 5, disregard:

1. Payments from a **deferred compensation** trust or plan established, sponsored, or maintained by the organization (or a related organization), and deferred compensation held by such trust or plan;
2. Payments from a common paymaster for services provided to the organization (or to a related organization) (see instructions for **Common paymaster or payroll/reporting agent**, earlier); or
3. Payments from an unrelated taxable organization that employs the individual and continues to pay the individual's regular compensation while the individual provides services without charge to the filing organization, but only if the unrelated organization does not treat the payments as a charitable contribution to the filing organization.

Example 1. A is the CEO (and the **top management official**) of the organization. In addition to compensation paid by the organization to A, A receives payments from B, an unrelated corporation (using the definition of relatedness on Schedule R (Form 990)), for services provided by A to the organization. B also makes rent payments for A's personal residence. The organization is aware of the compensation arrangement between A and B, and does not treat the payments as paid by

the organization for Form W-2 reporting purposes. A, as the top management official of the organization, must be listed as an officer of the organization in Part VII, Section A. However, the amounts paid by B to A require that the organization answer "Yes" on line 5 and complete Schedule J (Form 990) about A.

Example 2. C is an attorney employed by a law firm that is not a related organization to the organization. The organization and the law firm enter into an arrangement where C serves the organization, a section 501(c)(3) legal aid society pro bono, on a full-time basis as its vice-president and as a board member while continuing to receive her regular compensation from the law firm. The organization does not provide any compensation to C for the services provided by C to the organization, and does not report C's compensation on Form W-2 or Form 1099-MISC. The law firm does not treat any part of C's compensation as a charitable contribution to the legal aid society. Under these circumstances, the amounts paid by the law firm to C do not require that the organization answer "Yes" on line 5, about C. Also, nothing in these facts would prevent C from qualifying as an independent member of the organization's governing body for purposes of Form 990, Part VI, line 1b.

Example 3. D, a volunteer director of the organization, is also the sole owner and CEO of M management company (an unrelated organization), which provides management services to the organization. The organization pays M an annual fee of \$150,000 for management services. Under the circumstances, the amounts paid by M to D (in the capacity as owner and CEO of M) do not require that the organization answer "Yes" on line 5, regarding D. However, the organization must report the transaction with M, including the relationship between D and M, on Schedule L (Form 990 or 990-EZ), Part IV. Also, D does not qualify as an independent member of the organization's governing body because D receives indirect financial benefits from the organization through M that are reportable on Schedule L (Form 990 or 990-EZ), Part IV.

Section B. Five Highest Compensated Independent Contractors

Complete this table for the five highest compensated **independent contractors** that received more than \$100,000 in compensation for services, whether professional or other services, from the organization. Independent contractors include organizations as well as individuals and can include professional fundraisers, law firms, accounting firms, publishing companies, **management companies**, and investment management companies. Do not report public utilities or insurance providers as independent contractors. See Pub. 1779, Independent Contractor or Employee, and Pub. 15-A, Employer's Supplemental Tax Guide, for distinguishing **employees** from independent contractors.

Column (C). Enter the amount the organization paid, whether reported on Form 1099-MISC, box 7, or paid under the parties' agreement or applicable state law, for the calendar year ending with or within the organization's tax year.

For a short year return in which there is no calendar year that ends with or within the short year, do not report any information in columns (A) through (C), unless the return is a final return. If the return is a final return, report the compensation paid to the independent contractor(s) under the parties' agreement during the short year or the compensation that is reportable compensation on Form 1099 for the short year, whether or not Form 1099 has been filed yet to report such compensation.

Compensation includes fees and similar payments to independent contractors but not reimbursement of expenses unless incidental to providing the service. However, for this purpose, the organization must report gross payments to the **independent contractor** that include expenses and fees if the expenses are not separately reported to the organization.



Form 1099-MISC may be required to be issued for payments to an independent contractor, with compensation reported in box 7.

Part VIII. Statement of Revenue

Check the box in the heading of Part VIII if Schedule O (Form 990 or 990-EZ) contains any information pertaining to this part.

Column (A).

All organizations must complete column (A), reporting their **gross receipts** for all sources of revenue. All organizations (except section 527 political organizations) must complete columns (B) through (D), which must add up to the amount in column (A) for each line in Part VIII. Refer to specific instructions in this part for completing each column.



If the organization enters an amount in column (A) for lines 2a through 2e or lines 11a through 11c, it must also enter a corresponding business activity code from Appendix K, Business Activity Codes. If none of the listed codes, or other 6-digit codes listed on the NAICS website at http://www.census.gov/eos/www/naics/reference_files_tools/2007/naics07_6.txt, accurately describe the activity, enter "900099." Use of these codes does not imply that the business activity is unrelated to the organization's exempt purpose.

Column (B).

In column (B), report all revenue from activities substantially related to the organization's exempt purposes. Use of revenue for the organization's exempt purposes does not make the activity that produced the income (for example, fundraising activity) substantially related to the organization's exempt purposes. Also report here any revenue that is excludable from gross income other than by section 512, 513, or 514, such as interest on state and local bonds that is excluded from tax by section 103.

Column (C).

In column (C), report any **unrelated business** revenue received by the organization during the **tax year** from an **unrelated trade or business**, unless that revenue is reportable in Part VIII, column (D). See Pub. 598 and Instructions for Form 990-T for more information.



*A section 501(c)(3) organization that is an S corporation shareholder must treat all allocations of income from the S corporation as **unrelated business income**. Gain on the disposition of stock is also treated as unrelated business income. See section 512(e).*

Column (D).

In column (D), report any revenue excludable from **unrelated business income** by section 512, 513, or 514. Examples of such revenue include receipts from the sale of donated merchandise, interest (unless debt-financed), and receipts from **bingo** games.

Neither Form 5500 nor DOL Forms L-2 or L-3 should be substituted for the Form 990, Parts VIII or IX.

Line 1. In General

On lines 1a through 1f, report cash and noncash amounts received as voluntary **contributions**, gifts, grants or other similar amounts from the general public; **governmental units**, foundations, and other exempt organizations. The general public includes individuals, corporations, trusts, estates, and other entities. Voluntary contributions are payments, or the part of any payment, for which the payer (donor) does not receive full retail value (**fair market value**) from the recipient (donee) organization. Contributions are reported on line 1 regardless of whether they are deductible by the contributor. The noncash portion of contributions reported on lines 1a through 1f is also reported on line 1g.

Report gross amounts of contributions collected in the organization's name by fundraisers.

Report all expenses of raising contributions in Part IX, column (D), *Fundraising Expenses*. The organization must enter on Part IX, line 11e fees for **professional fundraising services** relating to the gross amounts of contributions collected in the organization's name by professional fundraisers.

Report on line 1 assets contributed to the organization by another entity in the course of the entity's liquidation, dissolution, or termination.

Report the value of **noncash contributions** at the time of the donation. For example, report the **FMV** of a donated car at the time the car was received as a donation.

Do not net losses from uncollectible pledges from prior years, refunds of contributions and service revenue from prior years, or reversal of grant expenses from prior years on line 1. Rather, report any such items as "Other changes in net assets or fund balances" on Part XI, line 9, and explain in Schedule O.

The organization must report any contributions of **conservation easements** and other **qualified conservation contributions** consistently with how it reports revenue from such contributions in its books, records, and financial statements.

Reporting on line 1 according to **SFAS 116** (ASC 958) generally is acceptable (though not required) for Form 990 purposes, but the value of donated services or use of materials, equipment, or facilities may not be reported. An organization that receives a grant to be paid in future years should, according to SFAS 116 (ASC 958), report the grant's present value on line 1. Accruals of present value increments to the unpaid grant should be reported on line 1 in future years.

MATHIS, RIGGS & PRATHER, P.S.C.
ATTORNEYS AT LAW
500 MAIN STREET, SUITE 5
SHELBYVILLE, KENTUCKY 40065

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E-MAIL: mrp@iglou.com

November 24, 2010

Albert Moffett
264 Mill Circle Drive
Shelbyville, Kentucky 40065

Re: Shelby Energy Cooperative, Inc.

Dear Mr. Moffett:

I have been asked to respond to your November 9, 2010 letter to Debbie Martin, your recommended actions given to the Board of Directors on November 18, and your request to Larry Bauer.

In the third paragraph of your letter, you request an explanation of why the EPA concluded East Kentucky Power Cooperative was not complying with federal laws. It is my general understanding that EKPC made alterations to a 25-megawatt generating unit, which boosted its efficiency from time to time to 26 or 27 megawatts. The EPA took the position the occasional increase above 25 megawatts shifted that unit into a much more stringent emission regulation. There was a good-faith dispute between the two sides. At some point, which I believe was during Bob Marshall's tenure, after Roy Palk retired, and after the EKPC senior management person in the environmental area retired, a business judgment decision was made to settle the case to avoid the continuing significant legal fees required to continue to contest the violation. If you wish additional information, I suggest you contact your Director, Wayne Stratton, who is very familiar with the situation, or even better, EKPC directly.

Shelby Energy does not presently have any standing Board committees other than the Audit Committee. Because of the Board's small size, the entire Board serves as that Committee. Wayne Stratton serves on the Cooperative Finance Corporation

Board, George Busey serves on the Board of the Kentucky Electric Cooperative Association, Roger Taylor serves as the Shelby Energy representative on the "Fresh Look" Committee of all EKPC distribution cooperatives. You will need to contact each director individually to determine how much time each Director devotes to Cooperative business.

All employee compensation information is confidential. Efforts are made to ensure equitable treatment of both union and non-union employees.

Travel and entertainment expenses for office and staff are similar to the average of past years, with the exception of the training expenses of the Safety Coordinator, who has undergone extensive training required by the Kentucky Public Service Commission. Any "entertainment" expenses are nominal.

Debbie Martin previously advised you that Shelby Energy has little or no control over which letters to the Editor are published by Kentucky Living magazine. We do not know the criteria used by that magazine.

During the last Board meeting, Ms. Martin pointed out that the February 2008 article entitled "Shelby Energy's Power Provider Prepares for the Future" contained in the February 2008 edition of Kentucky Living was over two years prior to, and had nothing to do with, the April 23, 2010 article entitled "Audit Scorches Power Co-op".

The four items mentioned on a separate document you have tendered regarding recommendations of actions which should be taken by Shelby Energy Cooperative are all under consideration by the Board of Directors and President and CEO. The time required to deal with the continuing information requests from members has unfortunately severely decreased the amount of time Debbie Martin and I have to deal with proposed changes to the Cooperative Bylaws. I have spent over 4 hours reviewing your correspondence and enclosures and responding to your current requests. Additionally, a number of Board policies are being changed each month in accordance with the PSC Management Audit. Your suggestions are important, and the Board of Directors, President and CEO, and I will deal with them as soon as we reasonably can do so given other time constraints. I will, however, tell you that Minutes of the Board meetings will not be published within five (5) days after the Board meeting, based upon my advice. The Minutes are not final until approved by the Board. Since I draft the Minutes and am far from perfect, there are corrections made to my draft Minutes prior to Board approval.

I believe your statement that "Two government regulators suggested the members should become more involved in the direction being taken by the Cooperative Management" should be directed at EKPC and its member distribution cooperatives rather than Shelby Energy and its individual member-customers.

The Bylaws are being "followed to the letter" regarding Directors. In particular, enclosed as we discussed is the relevant portion of Article IV dealing with Director qualifications. I have circled the relevant portions. Ashley Chilton's district is defined to include "all" of Henry County. Ashley Chilton is a member and is a resident of Henry County. Ashley Chilton is one of the two Directors from District 2, which includes all of Henry County.

You are certainly entitled to your opinion, as expressed in Paragraph 6B of your November 9, 2010 letter. Shelby Energy's Board of Directors respectfully disagree. In our lengthy conversation on the morning of November 22, 2010, I attempted to point out to you that Wayne Stratton favored the departure of Mr. Palk as the head of EKPC prior to Mr. Stratton's election as Chairman of the EKPC Board. It was not long after Mr. Stratton became Chairman that Mr. Palk retired. All of the environmental issues existed prior to Mr. Stratton's Chairmanship. The settlement with the EPA occurred during his Chairmanship. You stated you have a copy of the Bylaws, therefore you have all the material relating to election of Directors, including proxy rules. You have received a proxy each year as a member of Shelby Energy and should be familiar with the contents of that document. The names of members of past Nominating Committees and Credentials and Elections Committees are not disclosed to minimize harassment. Joe Butler and Roger Taylor were nominated by the most recent Nominating Committee. There has never been a Board action for removal of a Director. Bylaw 4.4 compliance is ensured by each Director and common knowledge.

As I stated in my conversation with you, responding to repeated information requests has become unreasonably time consuming and expensive. A cooperative member is, in many ways, similar to a shareholder of a public corporation. Shareholders elect Directors who run the corporation, not the other way around. A member's role of a cooperative is similar to that of a shareholder. Members can contact any of the Board members regarding their concerns and are free to attend Board meetings, unlike corporate shareholders. Members are free to run for office as a Director and express their preference in all Board elections by voting.

Wayne Stratton has been a Shelby Energy Director since approximately March, 1987. He has been Shelby Energy's Director (one of 16 Directors) at EKPC since June, 1990. He has been EKPC Board Chairman since June, 2004.

We are working on a process for member review of past Minutes. There is an expense associated with a Shelby Energy staff member's presence during such a review, which is needed to protect the integrity of the Minutes. The more Minutes reviewed, the greater the expense. We will contact you once a decision is made.

Finally, enclosed is a copy of the upcoming ad notifying members of the vacant director position, and application to apply for consideration. It is universal corporate practice that vacant board positions are filled by appointment by the Board for the remainder of the vacant term.

While I suspect my responses in this letter have not been completely satisfactory, I have answered your questions truthfully and to the best of my ability given the ever-increasing time demands of member information requests.

Yours Truly,

MATHIS, RIGGS & PRATHER, P.S.C.

By: 
Donald T. Prather

cc: Board of Directors
Debbie Martin, President and CEO
Virginia Smith, Kentucky Public Service Commission

Member's Information Request

Exhibit 5

Dated: August 19, 2010

Question 1:

What was the total amount spent for office remodeling, including furniture during 2008, 2009 and what was budgeted to be spent in 2010?

Responses: Not Good Timing

The following are the total amounts spent for repairs, office renovations and furnishings:

2008 - \$38,533.98

2009 - \$48,723.53

2010 - \$99,611.48—through 08/27/10

The total 2010 budget for repairs, renovations and furnishings was

The office of Shelby Energy was constructed almost 50 years ago. The lower level of the building has not been remodeled in many years. It has been over 30 years since we replaced the flooring. Desk drawers would not open and close properly, legs fell off and the chairs were worn out. In addition, carpet in the lower office was severely stained and worn from the heavy traffic of contractors and construction employees. The break room carpet smelled musty because of constant dampness. Significant mold was found spread over the entire floor surface beneath the carpet when it was pulled up. That was not healthy for our employees.

The renovation permits operations, engineering, and safety employees to be located on the same floor. It promotes better communications and efficiency between three areas that have a direct relationship to the safety and daily functions of employees in the field.

The PSC Management Audit recommended an improved dispatching system be implemented with an estimated cost of \$250,000. To comply with this recommendation, an improved dispatching station was needed that provided space for the equipment necessary to monitor SCADA, view the CRCLink software reporting outage calls, observe the vehicle location system, watch weather conditions and other programs that assist with knowing the location of crews, mapping of areas without service, local weather and provide an overall safe environment for all employees while restoring service during a major outage. The management and employees of Shelby Energy have been very frugal in implementing this recommendation. Our costs are far below those estimated by the auditors. Yet, results comply with the recommendation and provide the resources to offer improved and safer dispatching.

In 2008, following armed robberies that took place at three different locations nearby the cooperative office in Shelbyville, security enclosures were installed at each office, along with the installation of an updated security system, to prevent unauthorized entry into the building or onto the cooperative property. Copper wire theft directly from the cooperative headquarters property and destruction of perimeter fencing was another area of security that the system assisted in controlling. Security cameras are an effective deterrent. Our employees can be assured only those authorized are in the building or on the property.

Member's Information Request

Dated: August 19, 2010

In addition, the aging buildings have required repairs to warehouse and garage walls that have shifted, concrete that has deteriorated, water lines that have ranged from minor to somewhat significant, lights that must be replaced or improved and outdated electrical service. Changes in service and technology required establishing a protected information technology area, building a garage to hold bigger construction vehicles, providing emergency restoration plans, equipment and alternate sites, along with others areas of maintenance and improvements. Our buildings require the same upkeep as any other buildings.

We have not listed every single repair or improvement made from 2008~2010 here, but the costs listed are accurate and all were reasonable and handled in a conservative manner by responsible employees.

The Cooperative has an obligation to provide safe, healthy, and up-to-date work facilities for all of our employees. Shelby Energy provides this level of standard for the vehicles, equipment and tools used by employees in the field and cannot provide less for those employees working in the office.

Monthly cost per member (15,290) @ 15 years of value = .07147 cents

Question 2:

How much does each "smart meter" cost and what is the average installation cost for each?

How many have been purchased to date and when was the purchase contract signed?

What is the considered time span needed for payback in cost savings to the members/customers?

Response:

a.

The cost for each type of AMI meter and the installation costs are as follows:

Cost of single phase meter! up to 400 amps	\$98, 56
Cost of single phase meter / over 400 amps	\$132.00
Installation cost	\$13.27

Cost of three phase meter	\$450.00
Installation cost	\$118.85

b.

As of today, 4,650 AMI meters have been received and the purchase orders for the meters were submitted in March, 2010

c.

The time span needed for payback of the AMI project is between 5-6 years. The largest component contributing to payback is the savings on the cost of meter reading services.

**Member's Information Request
Dated: August 19, 2010**

Exhibit 5

Question 3:

What is the excuse for NOT getting a "certificate of Public Convenience and Necessity" from the PSC which is required before proceeding with any capital investment of member customers money; SUCH AS 3.1 MILLION DOLLARS FOR "SMART METERS"?

Response:

a.

It was our intention to include this matter in our recent application for approval of our next five-year work plan; however the consulting engineer, who prepared the attachments, was working consistent with the instructions given by the RUS representative. The RUS Representative stated the filing with PSC was not necessary, and therefore it was not included. Contrary to the assumption in this question, a CPCN for the AMI meter project would not be required from P5G. Our attorney has advised us there has been a long-standing informal rule at P50 that a CPCN will not be required where the total project construction is 10% or less of existing plant value, as long as money is not being borrowed to pay for the project. This is the case with the AMI prOject. Therefore no law was broken. SEC normally does not rely on this informal rule, however, since we prefer to be completely upfront with our business with the PSC, we have filed an amendment with the work plan stating the intentions to install an AMI system. Additionally, P50 has, in recent years, been actively promoting installation of AMI meter technology by electric utilities due to the long-term cost savings, enhanced quality of service, and increased safety resulting from a AMI meter system. This is very obvious in the report, ike and ice issued by the P50 on November 19, 2009 that technological changes are expected by utilities to better report and restore power outages along with enhancing reliability. The AMI meter system will do just this for Shelby Energy members. These advantages were extensively discussed at the March 18, 2010 board meeting attended by Dr. Carlin Pippin, Ms. Sarah Jane Rankin, and Magistrate Betty Curtsinger. SEC's smart meter capital investment is entirely consistent with P80's policy on this matter.

Question 4:

What was the total amount given as end of year gifts for year ending 2009? Are there any gifts in the budget for year ending in 2010?

Responses:

a.

The term "gift" is not applicable in the traditional sense for this situation. The total amount paid at the end of 2009 to non-bargaining unit employees was \$12,750. This amount was based on two additional days of leave permitted to bargaining unit employees, a higher rate of pay provided bargaining-unit employees for regular hours of work during the ice storm in January, 2009 and expense allowances for bargaining unit employees in regards to apparel, tools and accessories that were not provided to non-bargaining unit employees in 2009.

Member's Information Request

Exhibit 5

Dated: August 19, 2010

Management considered two days of pay plus benefits for each non-management, non-bargaining unit employee to average \$750. The additional value of the ice storm pay and apparel, tool and accessory benefit was calculated to be approximately \$250. Management recommended to the Board for consideration of payment to each non-management, non-bargaining unit employee of \$1,000 and \$750 was approved by the Board.

b.

There were no funds budgeted in 2010 for this type of situation nor have any extraordinary events occurred that would warrant such.

Question 5:

Are copies of the 990 report for the last 5 years available to members? So, requested.

Response:

a.

The last 5 years of the IRS Form 990 are available on the website of Shelby Energy at www.shelbyenergy.com and may be viewed and/or printed by any interested parties. Prior to posting on the website, and consistent with federal law, the Form 990's were available for inspection at the Cooperative office by the public.

Question 6:

Will there be any consideration in the near foreseeable future given to changing the bylaws to prohibit proxy votes and to forbid any elected official from serving as a Director similar to the bylaws of Clark Energy and many other Cooperatives?

Response:

The board of directors began considering changes to the bylaws regarding the method of director elections prior to the most recent director elections but decided against any changes just prior to the Annual Meeting to avoid any appearance of an effort to affect the result of the elections. Several issues were being discussed; mail ballots, board of director qualifications, board of director education requirements along with a possible application process. The board of directors has the benefit of evaluating the bylaws of many different electrical cooperatives to evaluate whether the Shelby Energy bylaws are consistent to other member-owned cooperatives.

Shelby Energy has no plans to forbid elected officials to serve as a member of the Board. The Cooperative has found officials who have served on the Board, in the past and present, are well-informed, knowledgeable and valuable citizens within the community they serve and provide outstanding and dedicated service to our membership.

Member's Information Request
Dated: August 19, 2010

Exhibit 5

Question: 7

Why is the annual membership meeting not rotated among the 3 districts? Will it be rotated to Shelby or Trimble County next year?

Responses:

a.

The annual meeting of the members has been rotated among the three districts for many years.

b.

The cooperative has had scheduling difficulties in the past and made a decision, just this year, to hold it in Henry County at the Henry County High School for the future. This location provides a central location for all members.

Question 8:

You reported for the calendar year 2009 on form 990 that the salaries, other compensation employee benefits expense was 3,271,442 dollars and for the previous year it was 2,166,903 dollars---an increase of 1,104,531 dollars. How do you account for this difference?

Response:

Attached is a response from the cooperative's CPA, Alan Zumstein, and a revised Form 990 as filed with the IRS.

Question 9:

Why doesn't Shelby Energy use a ballot in the upcoming elections in the mailing? Clark County's elections are run by a disinterested Provost who mails the ballot directly to the members and is in charge of keeping the ballot box until the votes are counted.

Response:

Approximately half of the cooperatives in Kentucky elect directors by mail and the other half elect them at the member meeting as does Shelby Energy. Of the approximate half, some use proxies and some do not. Election of directors by the members at the meeting is a longtime custom originating from the democratic nature of cooperatives. Our director elections have been patterned after our country's local, state and national elections which are not conducted by mail. And, of course, it is a lot cheaper.

Mail ballots handled by a disinterested Provost will be considered along with other options at the time the bylaws are reviewed and revisions taken under consideration.

Member's Information Request
Dated: August 19, 2010

Exhibit 5

Shelby Energy's board has from time to time, in the past, discussed changing to a mail ballot system in order to potentially increase the number of members voting in the elections, but one of the reasons that the change has not occurred is the significant added cost to our members of a mail ballot system, estimated to run several thousands of dollars per election.

Question 10:

When will the BOD vacancy be filled? Is there any consideration for membership input for naming a candidate(s)?

Response:

a.

The Board is reviewing the process for appointing a member of the Board when a retirement or resignation takes place prior to the end of a board of directors term. The Board has plans to fill the position no later than the second quarter of 2011.

The Board will regard any candidate that resides in the appropriate district and who submits their name

Question 11:

Are there any other power resources besides East Ky Power Cooperative being considered for future wholesale energy purchases as advised by PSC?

Response:

The requirement in the past by Rural Utilities that each distribution cooperative, including Shelby Energy, sign long-term contracts agreeing to purchase all but 15% of their power from East Kentucky Power, and that those contracts be pledged to Rural Utilities as collateral for loans, is a significant legal hurdle to overcome any significant outside purchases until those contracts expire many years in the future, or even longer if Rural Utilities requires renewal of those contracts. PSC has been provided with copies of these contracts and mortgages. Shelby Energy Cooperative is participating in a process with all member cooperatives of East Kentucky Power that are reviewing other options and possibilities for the future.

Member's Information Request
Dated: August 19, 2010

Exhibit 5

Question 12:

Why are more VICE PRESIDENTS being hired and no linemen? Management seems heavy at the top: "FOUR VP'S for less than 40 employees" With so few linemen that are working so many hours DOESN'T THIS CONSTITUTE A SAFETY ISSUE?

Response:

The cooperative will have three vice president positions rather than four as stated in the question. These positions are as follows:

- Vice President of Engineering & Operations;
- Vice President of Customer Service & Marketing, and
- Vice President of Finance and Administration.

This revised organizational structure follows the PSC Management Audit recommendation and actually reduces the number of persons directly reporting to the CEO by one below the number recommended.

Shelby Energy hired four employees as Line Technicians (Linemen) in the operations area between late 2009 and early 2010. One of the four is no longer with the organization, but plans are to replace the position soon.

The cooperative has made tremendous advances in safety and continues to improve in this area. At no time is an employee asked to work in a situation that would place them in an unsafe position. Hours are reviewed and controlled by management employees along with the assistance from the actual employees performing the work. Only in emergency situations or extraordinary circumstances, which are few, would an employee be requested to work past the regular 16 hours-on and 8 hours-off schedule. As stated in our safety manual, should an employee find he/she is unable to work 18 hours due to safety reasons, accommodations will be arranged without a negative impact to the employee's work relationship with the Cooperative.

Shelby Energy answers its members

By Todd Martin

Shelby Energy Cooperative's board of directors met Thursday morning with a group of members who are concerned with how the co-op was spending money among other topics.

Customers are left tightening their belts as the country continues to suffer through a recession, but Shelby Energy is raising rates, renovating buildings and adding new technology.

On July 27 Shelby Energy received approval from the Kentucky Public Service Commission to raise rates to increase its annual revenue by \$1.9 million. It reported revenue in 2009 of nearly \$38 million.

The rate increase for a standard residential customer is about 2 percent, or about \$3 on a bill for an average customer using 1,522 kilowatt-hours per month, setting that monthly bill at about \$149.

The basic charge per customer also increased. The cost for regular customers went up nearly \$2 to \$9.75.

The basic cost for demand-control customers decreased about \$2.50 to the same rate of \$9.75, but it increased the cost of kilowatt-hours by about 12 percent. Demand-control customers are customers who have given Shelby Energy the right to control their energy consumption during peak hours, earning credits for scaling back.

A group of about eight showed to hear the board's answers to a list of questions that were submitted by customers on Aug. 19, some of which were addressed Wednesday in a letter published by The Sentinel-News.

Several out of the group questioned the timing of the repairs and the increase.

"In this economy, the timing of raising rates and spending money is not appropriate," said Carlen Pippin, the defacto speaker of the group.

Pippin was generally pleased with the responses after the meeting.

"It was good to see the questions and answers in writing," he said. "The whole idea was to get some transparency. This is our money they're spending, and we have right to weigh in on it."

However, not everyone was as pleased.

“I don’t know if anything was accomplished,” Irene Cornish said. “The answers were OK, but they just read them off the papers — they could’ve just mailed them to us.

“The main thing is the people of Kentucky and Shelby County aren’t getting raises, so we don’t need to be going overboard on our spending. They don’t need to be spending more than Shelby County can afford.”

Most of the questions addressed expenses and costs, along with the rate increase, including:

- The cost of the new Advanced Metering Infrastructure (AMI) or “smart meters,” and why a Certificate of Public Convenience and Necessity was not filed.
- The practice of giving “gifts” to office employees at the end of the year in 2009.
- A \$1.1 million increase on the company’s 990 form from 2008 to 2009.
- An office-remodeling budget that increased 173 percent over what was spent in 2009 and about 230 percent more than in 2008.

Other questions centered on the empty seat on the cooperative’s board of directors and proxy votes used for election to the board.

The board and CEO Debbie Martin provided written explanations for each question to all those that attended

New meters

A purchase order was submitted earlier this year for the new AMI meters, and almost 4,700 of the roughly 15,000 needed have been received.

Single-phase meters ranged from about \$100 to \$132, with installation costs of about \$13. The industrial load meters cost \$450 and another \$118 to install.

Martin said the company hopes to have all the new meters installed by mid-January.

Pippin and the group asked why a test area wasn't selected, to see if the technology would work in Shelby County.

"The technology has been around for many years, and there is no question that it will work. It is already being used in several other areas across the country," Martin said.

Once all the new meters are installed, the company can end a contract with a meter-reading service that costs between \$14,000 and \$18,000 a month. Meter readers are not needed with the new meters, which communicate electronically with the office.

As to why a Certificate of Public Convenience and Necessity was not filed with the PSC, Martin said one wasn't required.

She said her staff was told none was needed, and, also, she said there is a long standing informal rule with the PSC that if the total project is 10 percent or less than the total plant value and money is not being borrowed, a certificate is not necessary.

With revenues of about \$38 million in 2009, the \$3.1 million project fell under that rule.

Gifts for employees

Another area of concern was the act of giving "gifts" to employees at the end of the 2009-year and whether that practice would continue.

"It doesn't appear that these were performance based," Pippin said.

Martin and the board responded with an explanation and said that perhaps gifts were not the best way to word it.

Union workers received two paid days off for rest after the ice storm last year, and non-union workers, who still had to come to the office and put in long days had received no extra benefit for the time worked, Martin said.

“We couldn’t afford to split them up and not have them in the office for two days,” she said. “So we rewarded them with the pay of seven hundred and fifth dollars for the extra work put in during that storm. Managers did not receive the payment.”

So, Martin argued, though the payment did not seem, on the face, to be performance- based, it actually was.

\$1.1 million discrepancy on 990 form

The large increase on the 990 form, Martin said, was a simple mistake.

“You mean of all the people on this board and in this company that looked at this form, I’m the only one that caught that?” Pippin asked.

Said Martin: “We missed it.”

“Well somebody didn’t look at it,” Pippin replied.

Building remodeling

Martin explained that Shelby Energy’s building on Old Finchville Road is about 50 years old, and the co-op has gotten behind on upkeep.

Also the PSC recommended improvements to the dispatching station, including new equipment.

“This was done at less than the estimated cost of two hundred fifty thousand dollars from the PSC,” Martin added.

When Shelby Energy started renovating the basement where the contractors go in and out, it was discovered that mold had infiltrated much of the basement. Also, numerous pieces of furniture had to be replaced because of wear and tear.

Proxy votes

Outside of cost and consumption, the group’s other concern was with how members of the board are

elected. With one seat open, the board would get to pick the next member, and then with proxy voting it is nearly impossible to have a member changed.

Proxy voting allows for members who wish not to vote to give those votes to proxies who then vote in bulk.

Therefore, if a few hundred show up to the annual meeting, those voters could not out-vote the proxy.

“I don’t think a true member of this co-op could come out and get elected,” Pippin said. “Once they get the hundred names to get on the ballot, if only a few show up, it’s nearly impossible. Is there any thought to changing the proxy voting system?”

The written explanation said only that the board considered changing the bylaws pertaining to the election system before the previous meeting but declined to.

Martin would only say “it is still under consideration, and will be looked into further.”

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SHELBY ENERGY COOPERATIVE, INC
Shelbyville, Kentucky
Board of Directors' Meeting – November 21, 2012

Regular Meeting The following persons were present at 9:00 a.m. at Shelby Energy's headquarters on November 21, 2012:

Directors:

Ashley Chilton	Chairman
Randy Stevens	Vice-Chairman
Roger Taylor, Jr.	Secretary-Treasurer
Wayne Stratton	Director
Diana Arnold	Director
Pat Hargadon	Director

Also Present:

Debra Martin	President & CEO
Denise Hume	Manager, Accounting and Finance
Jason Ginn	VP, Operations & Engineering
Nick Morris	Engineering Manager
Donald Prather	Attorney
Gay Tennill	Vice President, Administrative & Office Services
Candi Waford	Manager, Member Services

Guests:

Mark Morrison

Call to Order The meeting was called to order by Chairman Chilton.

Board Policy – Director/Attorney Medical Insurance The directors and attorney met with Mark Morrison of Brown & Brown Insurance to consider amending Board policy 106 which governs director and attorney participation in Shelby Energy's major medical insurance policy. All directors elected after July 1, 1996 do not receive medical insurance from Shelby Energy. The two directors and attorney who were elected or hired prior to that date are grandfathered participants. The proposed change would eliminate their participation once they are eligible for Medicare. It would result in immediate cost savings of between \$10,352 and \$12,201 for Shelby Energy. Upon motion duly seconded the amended policy was adopted. The two affected directors abstained from voting.

Minutes The minutes of the October 23, 2012 Board of Directors meeting were approved.

Operations & Engineering Report Ginn presented the Operations & Engineering report. He introduced Nick Morris, the new engineering manager. The department continues to hook up new services consisting mostly of garages, barns and other buildings, although new home services are up from the same period in 2011. Security light repairs continue to gradually decline. Ginn expects this trend will continue as the new induction lights become more prevalent

Board of Directors Meeting – November 21, 2012

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throughout the system. The number of outages and number of members affected are up somewhat from last year mainly due to weather.

Safety Report Ginn reported the 17 safety crew inspections did not discover any violations. Shelby Energy crews have worked 46,206 hours since March 28, 2012, Elliott construction crews have worked 131,588 hours since September 1, 2008, and W.A. Kendall right-of-way crews have worked 40,654 hours since September 1, 2010, all without a lost-time accident.

KPI's – Operations and Engineering Ginn discussed the operations and engineering key performance indicators (KPI's) for the period of January through September of 2012. In the area of safety, Shelby Energy's incident and DART rate were 3.35, higher than the target rate of 2.74. These rates are calculated using estimated annual hours worked and should go down when the actual number of hours worked for the year is known.

In the reliability category, the 2,087 hours of unplanned outages during January through September, 2012 were higher than the 1,471 during the same period in 2011, as was the average outage time per affected member of 190 minutes in 2012 compared to 127 minutes in 2011. These figures are elevated due to a number of storms, particularly in July, and the fact that storm damage takes longer to repair than an ordinary equipment failure such as replacing a transformer.

The final KPI category relating to productivity measures both Shelby Energy and contractor projects by inspecting completed work orders, looking for anything performed incorrectly or not completed. The 18% average of return trips from January through September is well below the target rate of 20%, and is quite a bit less than the 23%, 31%, 34%, 21% and 21% rates during the same period of the years 2007 through 2011.

2013 – Work Plan and Budget - Operations and Engineering Ginn presented the proposed Operations and Engineering annual work plan and budget for calendar year 2013. One small bucket truck is budgeted for replacement, meaning that all small bucket trucks are now less than one year old. Three engineering/operation service trucks are being replaced, while one having mostly highway miles will be kept in service a while longer. The upgrade of the electric service at the office, a process which started last year, is scheduled to be completed in 2013. Ginn advised the directors the generator at the Shelby Energy office building would be upgraded to a three phase unit capable of keeping the entire office operational. The current system can only support very limited activities and would not be sufficient for any extended service outage. The meter testing equipment must be replaced to allow Shelby Energy to test solid state meters in order to comply with Public Service Commission requirements. Overall, capitalized expenditures will be down 18% and expensed expenditures will be down 16% in 2013.

Board of Directors Meeting – November 21, 2012

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A total of \$2,417,339 in line conversions and conductor replacements over 35.6 miles are being budgeted for 2013, of which \$1,044,489 are carry-over projects which were not completed in 2012.

After discussion, upon motion, duly seconded, the Operations and Engineering 2013 annual work plan and budget were approved as presented.

Billing and Customer Service Report	Tennill gave the Billing and Customer Service report for the month of October. The number of members paying their bills through the bank draft service, credit card, e-check, and Internet continues to increase. 101 members paid their bills through the Henry County Supply RPS. The Riverside Produce RPS in Trimble County has been a resounding success with 94 members using it to pay their bills in its first month of operation.
Capital Credits	Capital credits were paid to 7 estates during October. The 2012 general capital credit retirement to the members represented all of 1979 and one quarter of the 2011 capital credits.
Write-Offs	Tennill discussed the uncollectable accounts for August 2012 service dates. 49% of these uncollectable accounts are rental units. Write-offs for the year are running 0.30% of revenue. Upon motion, duly seconded, the write-offs were approved.
Major Medical Insurance	Tennill reported Shelby Energy's contributions into its self-funded major medical insurance plan continue to exceed payments made from the plan.
KPI's - Billing & Customer Service	Tennill discussed the Billing & Customer Service KPI's for the first nine months of 2012. Only two member concerns have been reported to PSC during 2012, which is within the zero to five member target range. Members using the bank draft service to pay their bills increased by 3.87% during January- September, 2012, which not only exceeds the target rate of 2.5% - 3% increase, but also exceeds the 3.33% increase for the same period in 2011. Write-offs of delinquent accounts for the first nine months of 2012 have averaged 0.3% of electric avenue, well below the PSC and Shelby Energy target rates of 0.5% - 0.8%.
2013 – Work Plan and Budget - Billing and Customer Service	Tennill discussed the proposed Billing and Customer Service annual work plan and budget for calendar year 2013. Five payment registers and receipt printers in the Shelbyville and Bedford offices must be replaced because the current equipment is obsolete and there will be no software support at the end of 2013. The department's budget includes funds to begin implementing a prepaid billing system, which other cooperatives have reported is beneficial to members, especially with renters since no deposit is required, and which tends to reduce write-offs for rental properties. The overall Billing and Customer Service department 2013 budget is 13% less than in 2012.

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Upon motion duly seconded, the Billing and Customer Service department 2013 annual work plan and budget were approved.

KPI's – Administrative and Human Resources	Tennill discussed the Administrative and Human Resource KPI's for the first nine months of 2012. The first relates to the employee absentee rate. The average hours of absence per employee during January through September was 56, which exceeds the target rate of 48 hours or less per employee per year. Tennill commented this target is extremely hard to meet if even one employee has surgery. The second KPI, related to employee development and training, has a target of two development/training courses per employee per year. Results will not be available for this annual goal until after the end of the year, but each department is on track to meet the goal.
2013 – Work Plan and Budget – Administrative and Human Resources	Tennill reviewed the proposed 2013 annual work plan and budget for the Administrative and Human Resources department. After discussion, upon motion, duly seconded, the proposed 2013 annual work plan and budget for the Administrative & Human Resources department were approved.
Member Services Report	<p>Waford reported her department is conducting quite a few energy audits, although members are sometimes reluctant to implement the suggestions. The new member surveys for October were mostly positive. She hopes to have the results from the annual member survey to present at next month's Board meeting. The co-op connections card is saving members an average of 39% of the cost of each prescription drug.</p> <p>Shelby Energy has contributed \$3,510.00 in 2012 within its service area to various charitable, educational and community improvement projects.</p>
KPI's - Member Services	Waford reported on the Member Services KPI's for January through September 2012. The 100% member satisfaction level from the monthly surveys continues to exceed the target rate of 90% - 97%. The ASCI score will not be available until the end of 2012. Participation in member-choice programs continues to be pretty much in line with 2011.
2013 – Work Plan and Budget – Member Services	Waford pointed out the biggest change in the 2013 annual work plan for the Member Services department is that energy conservation incentives, sponsored by EKPC, will be in 2013. She then discussed the proposed 2013 Member Services department budget. The amount for member energy audits has been increased. The cost for the Kentucky Living Magazine has increased slightly due to upcoming postage increases. The budget for the 2013 annual meeting has increased in case there is a contested director election in 2013. After discussion, upon motion, duly seconded, the Member Services 2013 work plan and budget were approved.

Board of Directors Meeting – November 21, 2012

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- Accounting & Finance Report** Hume presented the Accounting & Finance report. Due to milder weather and reduced electricity usage, Shelby Energy's year-to-date TIER has dropped to 1.163 and its operating TIER is now 1.089, both slightly below RUS requirements of 1.25 and 1.10, respectively. Shelby Energy has 36.64% of its assets as equity and its current ratio is 1.01, which meets the target rate of 1 or above. Overtime payroll decreased in September. Shelby Energy's rolling twelve-month average line loss is 3.6%, its rolling TIER is 2.44, and its rolling operating TIER is 1.13.
- Shelby Propane Plus Report** Shelby Propane Plus earned \$22,823.11 during October, and has earned \$60,229.60 year-to-date.
- KPI's – Accounting & Finance** Hume discussed the Accounting & Finance department's KPI's for the first nine months of 2012. The first relates to TIER and operating TIER, which measure the ability to earn sufficient income to cover interest on long-term debt. Shelby Energy's TIER for this time period was 1.163, which exceeds the RUS required level of 1.10 but is below Shelby Energy's target level of 1.25. The operating TIER for the first nine months was 1.089, again less than the RUS required level of 1.1 and Shelby Energy's target of 1.1. The second KPI of debt service coverage and modified debt service ratios will not be known until after the end of the year. The third KPI of equity ratio shows Shelby Energy's equity at 37%, well above the goal of 30% - 40%. The final KPI of current ratio, which measures cash flow stability and short-term solvency, is at 1%, which is within the target rate of 1% - 2%.
- 2013 -- Work Plan and Budget – Accounting & Finance** Hume reviewed the proposed 2013 annual work plan and budget for the Accounting & Finance department. The 2013 budget includes \$25,000 for a depreciation study required by PSC. After discussion, upon motion duly seconded, the Accounting & Finance department 2013 annual work plan and budget were approved.
- Board Policies** Tennill presented for consideration and approval the following Board policies, which have been reviewed by legal counsel:
- BP 105 – Reporting to Board on Key Performance Areas
 - BP 319 – Payroll processing
 - BP 320 – Outstanding checks
 - BP 321 – Refunds of Advance Payment for Access Line Extensions
 - BP 322 – Tax Collection and Remittance
 - BP 323 – Property Damage Reporting
 - BP 324 – Information Technology

Upon motion duly seconded, these policies were approved.

Board of Directors Meeting – November 21, 2012

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Section 125 Plan Tennill presented a Resolution for the adoption of the amendment and restatement to Shelby Energy's 125 Plan. After discussion, upon motion duly seconded, it was approved.

Executive Session The Board entered into an executive session with the attorney and Martin to discuss pending litigation and other matters. After emerging from the executive session, no action was taken.

KAEC Director Report Stevens reported KAEC has earned approximately \$207,000.00 thus far in 2012, which is a dramatic improvement.

EKPC Director Report Stratton presented the EKPC director report. EKPC is on target to earn a profit this year. EKPC's Board is expected to take action on joining PJM at its next meeting, with PSC likely to issue a ruling in the middle of 2013.

President & CEO's Report Martin presented the President & CEO's report, including distributing a draft of the new Rules & Regulations which she would like approved by the Board so they can be presented to PSC. Pursuant to a request from the Directors, Martin reported the PSC-mandated management audit has resulted in the hiring of seven additional employees at an annual cost to the members of approximately \$460,000. After discussion, the Board directed Martin and Prather to pursue the wholesale purchase of electricity on the open market to the extent permitted by Amendment 3 to the Wholesale Power Contract with EKPC.

There being no further business, the meeting was adjourned. The next regular Board meeting will be on December 20, 2012 at 9:00 a.m.

ROGER TAYLOR, JR., Secretary-Treasurer

Approved:

ASHLEY CHILTON, Chairman

SHELBY ENERGY COOPERATIVE, INC.
Shelbyville, Kentucky

POLICY NO. 312

PURCHASE AND USE OF COOPERATIVE VEHICLES

I. OBJECTIVES:

- A. To establish the approved policy and procedure for purchase and use of Cooperative Shelby Energy vehicles.
- B. To establish the requirements to care for vehicles that represents a significant investment by the Cooperative Shelby Energy.

II. CONTENT:

- A. Designated employees may be approved for automobile use expense.

Use and replacement of vehicles:

1. ~~The Cooperative~~ Shelby Energy does not purchase automobiles for use by employees.
2. The President and ~~Chief Executive Officer~~ CEO will be paid a car allowance for use of his/her personal vehicle, as approved by the Board of Directors, with the provision that the vehicle is maintained in good operating and physical condition and no older than ten years.
3. Vice Presidents/Managers and Executive Staff may be paid a car allowance for use of his/her personal vehicle as determined by the President and CEO with the provision the vehicle is maintained in good operating and physical condition and is no older than ten years.

- B. Purchase, Use and Replacement of Operating Vehicles

1. Construction, engineering and other miscellaneous vehicles shall be purchased and replaced as deemed necessary by the VP/Manager of Operations/Engineering Department and the President and ~~Chief Executive Officer~~ CEO.
2. During routine work days and under normal operating conditions, vehicles and equipment shall be used by employees for work-related assignments only.
3. Transportation while on ~~Cooperative~~ Shelby Energy business shall be in ~~Cooperative~~ Shelby Energy vehicles, whenever possible and practical.

4. Use of personal vehicles for work-related activities is subject to approval by the President and CEO.
5. When a personal vehicle is used for business purposes, the Internal Revenue Service Standard Mileage Rate shall be paid by the Cooperative Shelby Energy which shall be the total reimbursement including all insurance related costs.
6. All on-call service personnel shall be permitted to drive trucks to home from work and to work from home so the trucks will be available immediately for trouble calls.
7. The Department VP/Managers of Operations/Engineering and the Safety Supervisor will be provided with the use of a Cooperative truck vehicle in lieu of a car allowance.

C. Purchase of Non-Commercial Vehicles

1. Non-Commercial vehicles are those vehicles which do not require a Commercial Drivers License (“CDL”) to operate.
2. Purchase of a non-commercial vehicle shall require no less than ~~three~~ ^{two} (2) written bids. The VP /Manager of the department for which the vehicle is needed will handle the bid process and obtain the supporting documentation.
- ~~3. The bid process will be sealed. No bids may be opened until the designated time.~~
- ~~4. No discussion may occur between any representative of Shelby Energy and a business entity that has a bid in process.~~
5. The VP/Manager and President and CEO will review and evaluate ~~be present~~ ^{open} all bids.
 - ~~a. One additional staff person will be present to witness the bid openings.~~
 - b. In direct cooperation with the applicable VP/Manager, the President and CEO will designate the ~~winning~~ selected bid.
 - c. Should the recommended bid not be the lowest bidder, a written explanation providing justification for the purchase shall be documented and retained by the VP/Manager ~~the President and CEO.~~

d. The President and CEO shall have the final decision on the bid selection and must authorize the purchase by signing and dating the bid document for approval before the dealership is notified of the purchase.

~~e. The VP/Manager shall provide copies of the documentation (bid-related materials) to the President and CEO for submission with the monthly Board packet and the VP/Manager shall review at the next scheduled Board meeting.~~

D. Purchase of Commercial Vehicles

1. Commercial Vehicles are those vehicles that do require a Commercial Drivers License ("CDL") to operate.
2. Purchase of a commercial vehicle shall require no less than two (2) written bids.
3. ~~The bid process will be sealed.~~
4. ~~No discussion may occur between any representative of Shelby Energy and a business entity that has a bid in process.~~
5. The VP/Manager of the department for which the vehicle is needed will handle the bid process and obtain the supporting documentation.
6. In direct cooperation with the applicable VP/Manager, the President and CEO will designate the ~~winning~~ selected bid.
 - a. ~~One additional staff person will be present to witness the bid openings.~~
 - b. The President and CEO will designate the ~~winning~~ selected bid.
 - c. Should the recommended bid not be the lowest bidder, a written explanation providing justification for the purchase shall be documented and retained by the departmental VP/Manager ~~President and CEO.~~
 - d. The President and CEO shall have the final decision on the bid selection and must authorize the purchase by signing and dating the bid document before the dealership is notified of the purchase.

- ~~e. The VP/Manager shall provide copies of the documentation (all bid-related material) to the President and CEO for submission with the monthly Board packet and the Vice President/Manager shall review at the next Board meeting.~~

E. Passengers in Cooperative Vehicles

1. Only the following passengers may ride in a Shelby Energy Cooperative vehicle:
 - a. Employees
 - b. Family members in route to or attending business meetings or family members involved in community activities as authorized by the President and CEO.
 - c. Business associates/customers who have direct duties in conjunction with the employees' responsibilities.
 - d. Spouses may operate the vehicle when on Cooperative Shelby Energy business.
2. The driver and all passengers must wear a seatbelt.

F. Care of Cooperative Vehicles

1. All vehicles owned by the Cooperative Shelby Energy must be kept in good repair.
2. Damage and malfunction must be reported immediately to the VP/Manager.
3. The routine maintenance schedule established by the VP/Manager must be followed to assure the vehicle remains safe and in good condition.
4. The vehicle must be cleaned inside and out regularly.
5. No valuable personal property may be stored in a Cooperative Shelby Energy employee vehicle.
6. No objectionable materials may be stored in a Cooperative Shelby Energy vehicle.
7. No one may have drugs or alcohol in any Cooperative Shelby Energy vehicle.

III. RESPONSIBILITY:

The President and ~~Chief Executive Officer~~ CEO shall be responsible for the administration of this policy.

Adopted: October 26, 1972
Revised: August 29, 1985
May 26, 1989
November 18, 1999
August 19, 2010
September 20, 2012

SHELBY ENERGY COOPERATIVE, INC.
Shelbyville, Kentucky

POLICY NO. 313

PURCHASING OF GOODS AND SERVICES

I. OBJECTIVES:

- A. To establish a purchasing system that assures a uniform, prudent and effective procurement of goods and services for the efficient operation of Shelby Energy Cooperative (Shelby Energy).
- B. To secure the maximum total value for goods and services, consistent with the objective of delivering quality electric and other services to members and in accordance with any and all applicable regulatory and or lending agency requirements.
- C. To establish accounting procedures and internal control measures.
- D. To ensure that disbursements are supported by sufficient evidentiary matter.
- E. To determine that disbursements represent legitimate liabilities for goods and services received at agreed prices.

II. CONTENT:

- 1. The procurement of all goods and services shall be administered through designated employees who shall ensure that the most prudent, uniform, effective and professional methods are employed in obtaining maximum value for quality goods and services received.
- 2. Purchases equal to or greater than \$500.00, except as specified below, require a purchase order and the signature of a staff employee in order to authorize suppliers to provide Shelby Energy with specific goods and services at a stated price, and quantity and within a certain time frame. Such purchase orders shall be considered valid only after confirmed in written form and duly signed by the appropriate Shelby Energy personnel.

3. The procurement of certain goods and services and the associated disbursements do not require a purchase order. These goods and services include recurring ordinary course of business disbursements such as utility bills, Kentucky Living Magazine, postage, rental payments for leased equipment, construction and right-of-way work, janitorial, data processing, equipment, maintenance, legal and consulting, pole inspection, purchased power, etc. These items shall be reviewed and approved by the appropriate staff employee. Other items that do not normally require a purchase order are vehicle repairs, employee and director functions, annual meeting expenses, petty cash, outside services, dues and subscriptions, meals, travel and lodging, gas and oil, recurring items, loan payments, capital credit retirements, final bill refunds, taxes, insurance, association dues and company memberships.
4. Regardless of whether a purchase order was used or not, check disbursements shall not be made by the accounting department unless proper documentation of expenditures accompanies the request, i.e., delivery receipt, invoice or proper staff approval.
5. Field purchases without a purchase order or advance staff approval may be made under the following conditions:
 - a. The urgency of the needed goods prevents procurement through normal methods.
 - b. Procurement through normal methods by the department VP/Manager would yield no greater purchase value, i.e., lower price, better payment terms, etc.
 - c. The recipient vendor will extend open account credit status for such field purchases.
6. All Shelby Energy personnel who exercise any influence in procurement decisions, or otherwise are in routine contact with suppliers with whom Shelby Energy does business, shall be expected to exhibit the following conduct:
 - a. Consider first the interest of Shelby Energy.
 - b. Perform all procurement activities without prejudice, seeking to obtain maximum total value on behalf of Shelby Energy.

- c. Pursue honesty and objectivity in all procurement activities.
- d. Respect all obligations to suppliers and require that obligations of suppliers to Shelby Energy be fulfilled consistent with good business practices.
- e. Accord a prompt and courteous reception, so far as conditions permit, to all suppliers who solicit legitimate business activity with Shelby Energy.

III. RESPONSIBILITY:

The President and CEO shall be responsible for the administration of this policy.

Adopted: January 22, 2009
Revised: August 19, 2010
September 20, 2012



Gary Grubbs_arrest photo_October 19, 2012

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SITE SEARCH WEB SEARCH BY Google™



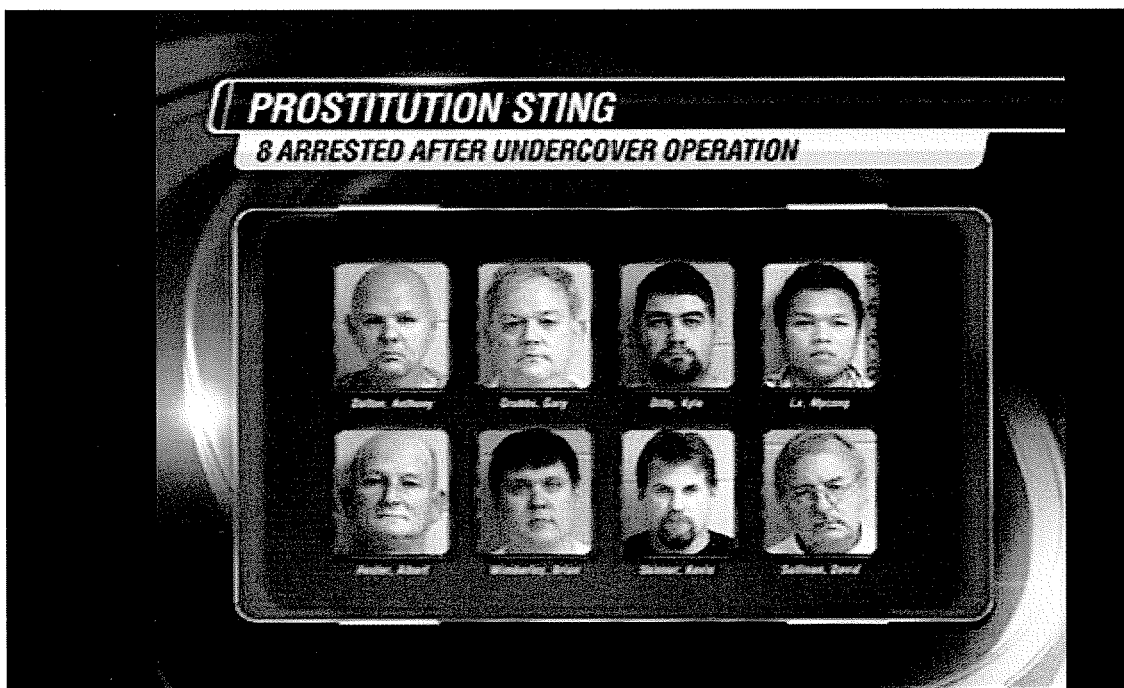
"Catch a John" sting operation nets eight

Recommend Sign Up to see what your friends recommend.

Posted: Oct 19, 2012 11:32 AM EDT

Updated: Oct 19, 2012 12:13 PM EDT

Steve Pobst - email



GRAVES COUNTY, KY (KFVS) - Eight men were arrested in a two day sting operation in Graves County titled "Catch a John".

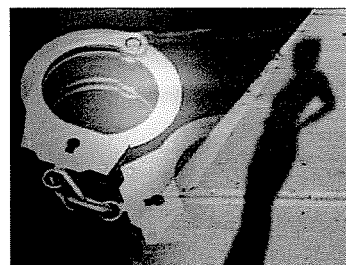
"Catch a John" was an operation conducted by the Graves County Sheriff's Department to highlight sex buyers as perpetrators and stop prostitution and sex trafficking in Western Kentucky.

The eight men were from the local area and other states.

Investigators began the operation on Wednesday October 18, 2012, by posting an ad on a well-known website.

The investigators immediately began receiving phone calls from males asking for sex in exchange for money.

A female detective, acting in an undercover capacity, spoke with the males and made arrangements to meet them at a local hotel.



Gary Grubbs_arrest photo_October 19, 2012

SHELBY ENERGY COOPERATIVE, INC
Shelbyville, Kentucky
Board of Directors' Meeting – April 21, 2011

Website

Regular Meeting The following persons were present at 9:00 a.m. at the Cooperative's headquarters on April 21, 2011

Directors:

Ashley Chilton	Vice-Chairman
Roger Taylor, Jr.	Secretary-Treasurer
Wayne Stratton	Director
Randy Stevens	Director
Dianna Arnold	Director

Also Present:

Debra Martin	President & CEO
Theresa Atha	Manager, Communications & Administrative
Jason Ginn	Safety & Risk Management Supervisor
David Graham	System Technical Engineer
Gary Grubbs	Consulting Engineer
Kim Hay	VP, Finance & Administration
Becky Jennings	Manager, Billing & Customer Service
Keith Miller	Manager, Operations
Brenden Simmons	Manager, Engineering
Gay Tennill	Staff & Executive Assistant
Donald Prather	Attorney

Member Guest:

Albert Moffett

Call to Order The meeting was called to order by Vice-Chairman Ashley Chilton. Martin introduced Brenden Simmons, the new Manager of Engineering.

Minutes The minutes of the Board of Directors special meeting on February 28, 2011 and regular meeting on March 17, 2011 were approved.

Safety Report Ginn presented the March safety report which showed there were no injuries or property damage accidents for the Shelby Energy, Elliott and Kendall crews. He singled out contractor Elliott for its excellent safety record. Elliott has worked on Shelby Energy's system for 2 ½ years without a single lost-time accident.

Board of Directors Meeting – April 21, 2011

Page 2

Ginn described the new “near miss” safety incentive program. In the past line technicians would openly discuss with each other “near miss” incidents but have been reluctant to disclose such incidents to management. This new program is designed to encourage reporting of near miss incidents so management can review the circumstances to see if anything can be changed to prevent a future occurrence. A free uniform t-shirt (\$30 value) is given to anyone who reports and discusses at a safety meeting any near miss situation. Any employee who reports and discusses at a safety meeting a near miss situation for the month will be eligible for a drawing to win an FR t-shirt (\$30 value) at the end of that month. All employees who reported and discussed a near miss situation throughout the year will also be eligible to participate in an annual drawing to win an FR sweatshirt (\$125 value).

Ginn summarized the topics which had been covered during the three safety training/meetings.

Key Account Report

Ginn presented the commercial and industrial key account report. Three Shelby County industries expect increased power usage due to anticipated business growth.

Operations Report

Miller presented the March 2011 operations department report, including March outages, right-of-way clearing progress, and construction project status. He also reported on three significant April outages resulting from storms. One was caused by a lightening arrestor and the other two were caused by trees located outside of the right-of-way falling and breaking power lines.

The air and ground inspection of the system has been completed and a report will be presented at the next Board meeting.

Another benefit of the AMI system was recently utilized. As repairs are occurring during an outage situation, the AMI system is being used to “ping” meters and verify power has been restored, which in turn eliminates employee “dry runs” to confirm power has been restored.

Engineering Report

Grubbs gave the Engineering department report. The new Engineering Manager Brenden Simmons is getting up to speed on the status of various projects. A new hire has brought the department back to the desired level of two staking technicians. The AMI system is running smoothly with a 98 or higher percentage of successful nightly meter readings. The department will now shift its focus over the next 6 months on improving system reliability.

Albert Moffett

Member Albert Moffett, who had been allocated 15 minutes to address the Board, spoke for over 45 minutes. In addition to several compliments, Moffett presented verbally and in writing a number of suggested changes to Shelby Energy's bylaws and procedures. At

Board of Directors Meeting – April 21, 2011

Page 3

the end of his presentation, Mr. Moffett was advised by Vice-Chairman Chilton that all of his suggestions would be considered by the Board. Mr. Moffett then departed the meeting.

- Distribution Reliability Report** Graham reviewed the 2010 Distribution Reliability Report for Shelby Energy, which has been filed with the Public Service Commission. This report provides PSC with information based upon the SAIFI (System Average Interruption Frequency Index), the SAIDA (System Average Interruption Duration Index), and the CAIDI (Customer Average Interruption Duration Index). The report also identifies the 10 most outage-prone parts of the system.
- Communications and Administration Report** Atha reported the newly implemented new member satisfaction survey is producing positive comments, gave the first quarter of 2011 donations by county, discussed current marketing programs, including incentives to replace inefficient resistance heat systems with heat pumps, and compared the premium costs with the benefits paid on claims of Shelby Energy's self-funded medical plan. This year's premium increase percentage was significantly less than the NRECA medical insurance plan. Employees are being educated regarding the value of their employment benefits.
- Board Policies** The following revised Board policies, having been reviewed by labor attorney Ruth Baxter and board attorney, Don Prather, were adopted:
- 921 – Employment discrimination
924 – Privacy policy for health plans
- Finance Accounting Report** Kim Hay presented the financial reports for February 2011, comparing actual versus budgeted revenues and expenses. The year-to-date financial results are very good. He reviewed the 2010 CFC annual certification which states Shelby Energy is a credit-worthy Cooperative. The 2010 IRS Form 990 was provided to the Board for examination prior to the meeting. Hay briefly discussed the Form 990 and offered to answer any questions the Board may have. Shelby Energy's 2010 form 990 tax return will be filed with the IRS now that the Board has had the opportunity to review.
- Billing and Customer Service Report** Jennings gave the billing and customer service report. The large number of revenue adjustments which were made from January through March 2011 resulted from the AMI meter change-out process. Adjustments should dramatically decrease with the AMI meter reading system.
- Capital Credits** Jennings reported capital credits were paid to 11 estates during March, 2011.
- Write-Offs** Jennings reported for January 2011 service date uncollectable accounts. Upon motion duly seconded, these accounts were written off.

Board of Directors Meeting – April 21, 2011

Page 4

Executive Session/	The Board entered an executive session with the attorney to discuss pending legal and other matters. After emerging from the executive session, no action was taken.
Attorney Engagement Letter	Prather presented a revised attorney engagement letter, which clarifies retainer versus hourly rate service categories, without any increase in hourly rates. Upon motion, duly seconded, the revised attorney engagement letter was approved.
KAEC Director Appointment	Vice-Chairman Chilton appointed Randy Stevens to serve as Shelby Energy's KAEC director. Upon motion, duly seconded, the appointment resolution attached to these minutes was adopted. A copy of the resolution will be submitted to KAEC to officially appoint Stevens.
EKPC Director Appointment	Vice-Chairman Chilton appointed R. Wayne Stratton as Shelby Energy's representative on the EKPC Board of Directors. Upon motion, duly seconded, the appointment resolution attached to these minutes was adopted.
EKPC Annual Meeting Representative	Vice-Chairman Chilton appointed Roger Taylor, Jr. as Shelby Energy's EKPC and Charleston Bottoms representative at the EKPC annual meeting. Randy Stevens was appointed as alternate representative .
Director Nominating Committee Report	Martin reported the nominating committee meeting was held April 5, 2011. The Committee members asked many direct and relevant questions. R. Wayne Stratton was nominated as a candidate for the District 1 director position and Ashley Chilton was nominated as a candidate for the District 2 director position.
KAEC Director Report	Martin gave a brief KAEC director report.
EKPC Director Report	Stratton reported ramifications from the management audit continue. The new director qualification requirements are in effect. Several incumbent directors will probably be replaced. The year-to-date operating margins look good.
President and CEO Report	Martin reported she is pleased with the recently-hired new employees.
Fresh Look Report Continued	Taylor reported all distribution cooperatives have now met with consultant Guernsey. Each representative was given a questionnaire to complete and return listing any specific concerns of that distribution cooperative.

Board of Directors Meeting – April 21, 2011
Page 5

There being no further business, the meeting was adjourned. The next regular meeting will be on May 16, 2011 at 1:00 p.m.

ROGER TAYLOR, JR., Secretary-Treasurer

Approved:

ASHLEY CHILTON, Vice-Chairman



Shelby Energy Cooperative


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Exhibit 12

October 29, 2010

Mr. Jeff Derouen, Executive Director
Kentucky Public Service Commission
PO Box 615
Frankfort, KY 40602

Re: Shelby Energy Cooperative's Application for Certificate of Public Convenience and
Necessity ("CPCN") **Case No. 2010-00244**

Dear Mr. Derouen:

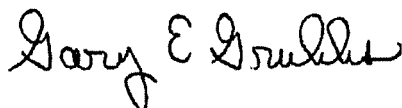
Shelby Energy Cooperative ("SEC") is submitting a Response to "The First Data Request of Commission Staff to Shelby Energy Coop, Inc." for Case No. 2010-00244 (a CPCN to construct distribution facilities according to its new four-year (4) 2010 ~ 2014 Construction Work Plan ("CWP") program). The Response and all supporting documentation are being filed using the procedures and guidelines of the Commission's electronic filing initiative. Commission staff has already signed the Application to Case No. 2010-00244 and assigned SEC a user ID and password.

The Application and all materials filed electronically in support of Case No. 2010-00244 are a true, accurate and complete representation of the original documents.

One (1) complete original Application in paper form will be filed with the Commission pursuant to the guidelines for electronic filing.

Please contact me should you have any questions or need additional information in regard to this filing.

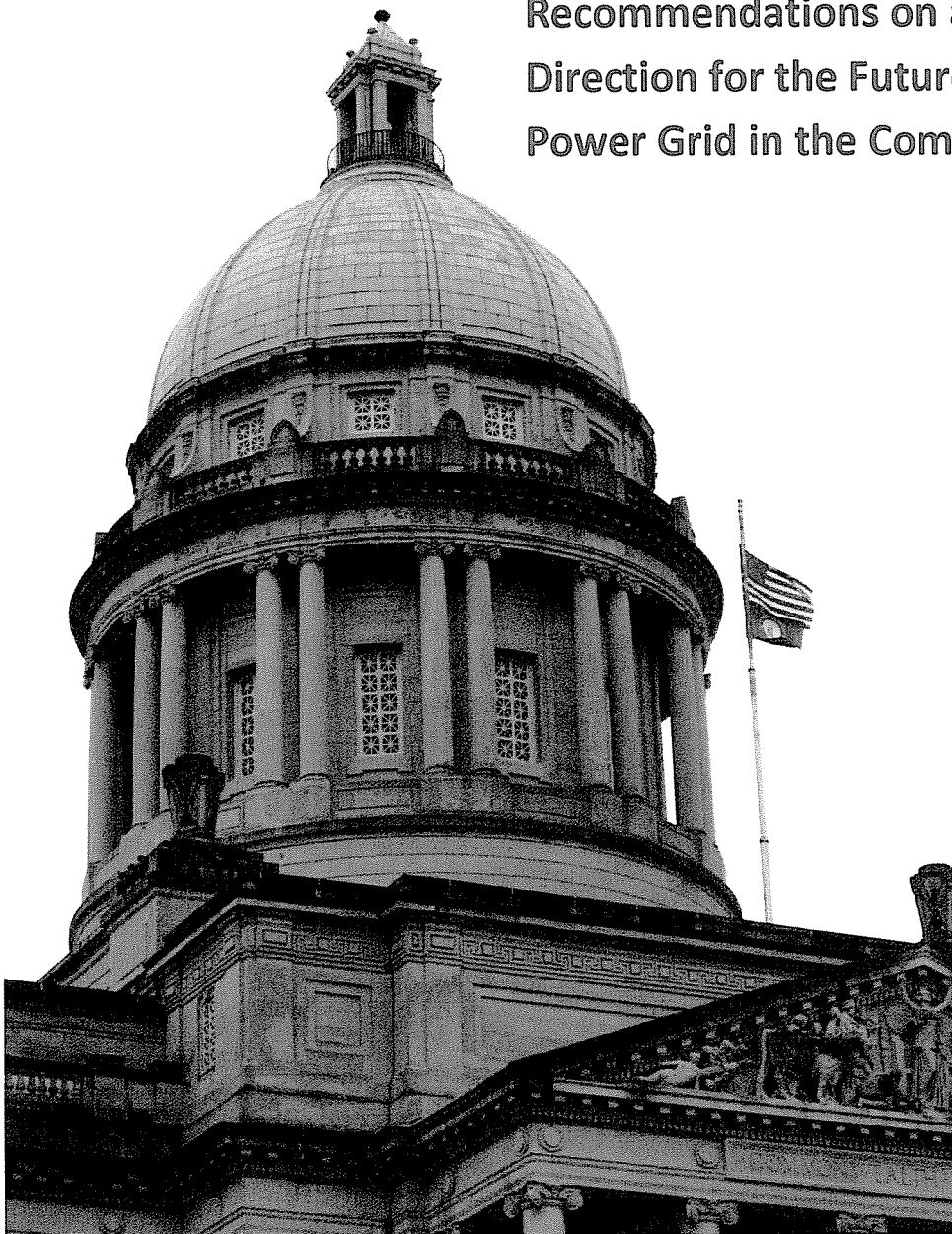
Respectfully,



Gary E Grubbs, P.E.
Interim Engineer
Shelby Energy

Kentucky's Smart Grid Roadmap

Recommendations on a Vision and
Direction for the Future of the Electric
Power Grid in the Commonwealth



The Kentucky Smart Grid Roadmap Initiative

Submitted to Kentucky Public Service Commission on 9/18/2012

PURPOSE

The Kentucky Smart Grid Roadmap Initiative (KSGRI) is an effort to identify a path towards electric grid modernization in the Commonwealth of Kentucky. The KSGRI includes inputs from academic, electric utility, governmental, and stakeholder representatives.

The KSGRI is led by the University of Louisville's Conn Center for Renewable Energy Research ("Conn Center") and the University of Kentucky's Power and Energy Institute of Kentucky ("PEIK"). The Conn Center and PEIK were engaged by the Kentucky Public Service Commission ("Kentucky Commission") to develop a technical roadmap for developing and deploying "Smart Grid" technology throughout the Commonwealth. Their efforts were monitored and reviewed by Staff from the Kentucky Commission; however, this report, its conclusions and recommendations do not reflect the opinion or position of the Staff of the Kentucky Commission or of the Commission, itself. The KSGRI has also brought together broad representation from the electric utility industry, state government, and other closely related industries for information and consultation.

The Kentucky Smart Grid Roadmap is the end result of a 2 year project by the KSGRI to analyze the existing power infrastructure in Kentucky and to develop recommendations for future grid modernization efforts. The goals of the Kentucky Smart Grid Roadmap are to facilitate the following outcomes:

1. Maintain Kentucky's energy security through prudent deployment of advanced Smart Grid technologies.
2. Improve electric energy efficiency, reliability, and safety of the Kentucky electric power system.
3. Facilitate academic, industrial, and governmental partnerships to position Kentucky at the forefront of Smart Grid analysis in the areas of technology development and deployment, and public policy.
4. Educate consumers, utility representatives, government representatives, and others on the benefits, risks, and barriers associated with Smart Grid technology deployments.

It is our belief that adoption of Smart Grid technologies will bring improvements to the Kentucky electrical grid in the areas of reliability, safety, security, price, environmental impacts, and efficiency.

CONTRIBUTORS

KY SMART GRID ROADMAP INITIATIVE COMMITTEE

Primary Authors

Mr. Yan Du - *Department of Electrical and Computer Engineering, University of Kentucky*
 Dr. Matthew Turner - *Conn Center for Renewable Energy Research, University of Louisville*

Contributing Authors

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KENTUCKY PUBLIC SERVICE COMMISSION ADVISORY PANEL

Ms. Kimra Cole - *Engineering Division, Kentucky Public Service Commission*
 Mr. Jeff Derouen, J.D. - *Executive Directors Office, Kentucky Public Service Commission*
 Mr. James Gardner, J.D. - *Vice Chairman, Kentucky Public Service Commission*
 Mr. Aaron Greenwell - *Executive Directors Office, Kentucky Public Service Commission*
 Dr. John Rogness - *Division of Financial Analysis, Kentucky Public Service Commission*

CONTRIBUTING UTILITY PARTNERS

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Tracy Bensley - <i>Jackson Purchase Energy Corporation</i>	Rick Lovekamp - <i>Louisville Gas & Electric and Kentucky Utilities, LLC</i>
James Bridge - <i>Owen Electric Cooperative</i>	Lila Munsey - <i>Kentucky Power</i>
Ken Cooper - <i>Bluegrass Energy Cooperative</i>	Jeff Myers - <i>Louisville Gas & Electric and Kentucky Utilities, LLC</i>
Rocco D'Ascenzo - <i>Duke Energy</i>	John Newland - <i>Kenergy Corp.</i>
Tim Duff - <i>Duke Energy</i>	John Patterson - <i>Taylor County RECC</i>
Paul Dollof - <i>East Kentucky Power Cooperative</i>	Todd Peyton - <i>Clark Energy Cooperative</i>
Mike French - <i>Meade County RECC</i>	Russ Pogue - <i>Big Rivers Electric Corporation</i>
David Graham - <i>Shelby Energy Cooperative, Inc.</i>	Brian Poling - <i>Grayson RECC</i>
Marvin Graham - <i>Inter-County Energy Cooperative</i>	Jeff Prater - <i>Big Sandy RECC</i>
Gary Grubbs - <i>Shelby Energy Cooperative, Inc.</i>	Mike Scaggs - <i>Taylor County RECC</i>
Greg Harrington - <i>Nolin RECC</i>	Isaac Scott - <i>East Kentucky Power Cooperative</i>
Roger Hickman - <i>Big Rivers Electric Corporation</i>	James See - <i>Owen Electric Cooperative</i>
Dennis Holt - <i>South Kentucky RECC</i>	

Shelby Energy Cooperative, Inc.

Your Touchstone Energy® Partner

BYLAWS OF SHELBY ENERGY COOPERATIVE, INC.
ESTABLISHED 1937
SHELBYVILLE, KENTUCKY

This Bylaws edition supersedes all previous issues 2012

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ARTICLE I MEMBERSHIP

Section 1.1 Requirements for Membership. Any natural person, partnership, association, corporation, limited liability company, body politic or subdivision thereof, or other legal entity will become a member of Shelby Energy Cooperative, Inc. (hereinafter called the "Cooperative"), provided that he, she, or it has first:

- (a) Made application for membership therein;
- (b) Agreed to purchase from the Cooperative electric energy as hereinafter specified, or gas or other energy if permitted by KRS 279.090(2) or other law;
- (c) Agreed to comply with and be bound by the Articles of Incorporation and Bylaws of the Cooperative and any rules and regulations adopted by the Board of Directors (hereinafter called the "Board");
- (d) Paid the Membership Fee, if any; and
- (e) Paid all debts owed to the Cooperative by the member, spouse, or any other person physically living in or deriving economic benefit from the premises to be served, plus accrued interest thereon from the date such debt became overdue until paid in full, compounded annually, at the Kentucky judgment legal rate.

The Membership Application shall be accompanied by any service security deposit, service connection deposit or fee, facility extension fee, or contribution in aid of construction that may be required by the Cooperative. With respect to any particular classification of service for which the Board shall require it, such application shall also be accompanied by a supplemental contract, executed by the applicant on such form as is provided by the Cooperative. No member shall have more than one membership in the Cooperative, and no membership shall be transferable, except as provided in these Bylaws.

Section 1.2 Membership Evidence. Membership in the Cooperative shall be evidenced in such form and shall contain such provisions as may be determined by the Board.

Section 1.3 Membership Fee and Other Deposits or Fees. The membership fee, if any, shall be fixed from time to time by the Board. Payment of the membership fee and any other deposits or fees required shall entitle the member to one service connection. A service connection deposit or fee in such amount as shall be prescribed by the Cooperative and any other deposits or fees required shall be paid by the member for each additional service connection.

Section 1.4 No Guarantee of Continuous Service; Purchase of Electric, Gas, or Other Energy; Power Production by Member; Application of Payments to Accounts. The Cooperative shall use reasonable diligence to furnish its members with adequate and dependable electric, gas, or other energy service, although it cannot and therefore does not guarantee a continuous and uninterrupted supply thereof. Production of electric, gas, or other energy on such premises, regardless of the source thereof, by means of facilities which shall be interconnected with Cooperative facilities, shall be subject to appropriate regulations as shall be fixed from time to time by the Board.

Each member, for so long as such premises are owned or directly occupied or used by him or her, shall purchase from the Cooperative and pay for all electric, gas, or other energy purchased for use on all premises to which electric, gas, or other service has been furnished by the Cooperative pursuant to his or her membership, unless and except to the extent that the Board may in writing waive such requirement, and shall pay therefore at the times and in accordance with the rules, regulations, rate classifications and rate schedules (including any monthly minimum amount that may be charged without regard to the amount of electric, gas, or other energy actually used) established by the Board and, if in effect, in accordance with the provisions of any supplemental contract. When the member has more than one service connection from the Cooperative, any payment by him for service from the Cooperative shall be allocated and credited at the Cooperative's sole discretion between his or her outstanding accounts for all such service connections, notwithstanding that the Cooperative's actual accounting procedures may not reflect such allocation.

Section 1.5 Termination of Membership.

(a) Any member may withdraw from membership upon compliance with such uniform terms and conditions as the Board may prescribe. The Board may, by the affirmative vote of not less than two-thirds (2/3) expel any member who fails to comply with any of the provisions of the Articles of Incorporation, Bylaws, or rules or regulations adopted by the Board, but only if such member shall have been given written notice by the Cooperative that such failure makes the member liable for expulsion and such failure shall have continued for at least ten (10) days after such notice was given. A hearing shall be held if requested by the member. Any expelled member may be reinstated by vote of the Board or by vote of the members at any annual or special meeting. The membership of a member who, for a period of six (6) months after service is available to him, has not purchased electric, gas, or other energy from the Cooperative, or of a member who has ceased to purchase energy from the Cooperative, may be canceled by resolution of the Board.

(b) Upon the withdrawal, death, cessation of existence or expulsion of a member, the membership of such member shall thereupon terminate. Termination of membership of any manner shall not release a member or his or her estate from any debts due the Cooperative.

(c) In case of withdrawal or termination of membership in any manner, the Cooperative shall repay to the member the amount of the membership fee paid by him or her, provided, however, that the Cooperative shall deduct from the amount of the membership fee and deposit, if any, the amount of any debts or obligations owed by the member to the Cooperative.

ARTICLE II RIGHTS, OBLIGATIONS, AND LIABILITIES OF MEMBERS

Section 2.1 Property Interest of Members. Upon dissolution, the remaining assets of the Cooperative shall be distributed among members as set forth in these Bylaws in Article 8, Section 8.2.

Section 2.2 Non-Liability for Debts of the Cooperative. Except for capital credits in the Cooperative, the private property of members shall be exempt from execution or other liability for the debts of the Cooperative and no member shall be personally liable or responsible for any debts or liabilities of the Cooperative.

Section 2.3 Wiring of Premises; Responsibility therefore; Responsibility for Meter Tampering or Bypassing and for Damage to Cooperative Properties; Extent of Cooperative Responsibility; Indemnification. Each member shall cause all premises receiving electric, gas, or other energy pursuant to his or her membership to become and to remain wired in accordance with the specifications of the National Electrical Code and any applicable state code or local government ordinances. Each member shall be responsible for and shall indemnify the Cooperative, its directors, officers, employees, agents and independent contractors against death, injury, loss or damage resulting from any defect in, or improper use or maintenance of, such premises and all wiring and apparatus connected thereto or used thereon. Each member shall make available to the Cooperative a suitable site, as determined by the Cooperative, whereon to place the Cooperative's physical facilities for furnishing and metering electric, gas, or other energy service and at all reasonable times shall permit the Cooperative's authorized employees, agents and independent contractors to have access thereto safely and without interference from hostile dogs or any other hostile source for reading, bill collecting and for inspection, maintenance, replacement, relocation, repair or disconnecting of such facilities. As partial consideration for service, each member shall be the Cooperative's bailee of such facilities and shall accordingly desist from interfering with, impairing the operation of, or causing damage to, such facilities, and shall use his or her best efforts to prevent others from doing so. In the event such facilities and their operation are interfered with, impaired or damaged by the member, or by any other person on the premises, the member shall indemnify the Cooperative, its directors, officers, employees, agents and independent contractors against death, injury, loss or damage resulting therefrom, including, but not limited to the Cooperative's cost of repairing, replacing or relocating such facilities and its loss, if any, of revenues resulting from the failure or defective functioning of its facilities. In no event shall the responsibility of the Cooperative for furnishing electricity, gas, or other energy extend beyond the point of delivery.

Section 2.4 Bylaws and Articles are Contract With The Cooperative. Each member of the Cooperative, by dealing with the Cooperative, acknowledges that the terms and provisions of the Articles of Incorporation, Bylaws, any special contract or any rules and regulations adopted by the Board, shall constitute and be a contract between the Cooperative and each member, and both the Cooperative and the member are bound by such contract, as fully as though each member had individually signed a separate instrument containing such terms and provisions.

Section 2.5 Attorney Fees. In the event a member fails to comply with any of the terms of these Bylaws, the Articles of Incorporation, any special contracts, or any other rules and regulations adopted by the Board, including but not limited to non-payment of debt, and if legal action is taken by the Cooperative to enforce such terms, the Cooperative shall be entitled to collect in such proceeding its reasonable attorney's fees and court costs.

Section 2.6 Access to Land and Premises. By virtue of becoming a member, and at no cost to the Cooperative, each member grants to the Cooperative a perpetual easement over, under, above, across, and through the land and premises of the member to erect, construct, place, locate, and build and thereafter use, operate, inspect, repair, maintain, service, replace, and move electric, communication, gas, or other energy distribution system facilities, including but not limited to, new or existing lines of any type, wires, poles, anchors, or other appurtenant parts thereof. Unless otherwise agreed in writing, the easement shall be 30' wide, and the centerline of the easement shall be the line or other facility as constructed. No swimming pool or other structure shall be placed within an applicable easement or under any power line in violation of national, state, or local electric codes. The Cooperative may at the member's cost relocate or raise the Cooperative's facilities or remove or require the member to remove any such structure. The above easement shall include, but shall not be limited to, the right to connect to and hook up to any existing service and/or service line and/ or service facility of any type that might be located on the member's land or premises for the purpose of providing and/ or extending electric, communication, gas, or other energy service to another member of the Cooperative. Unless otherwise agreed in writing, any new lines shall be constructed along existing exterior boundary lines, roads, and interior fence lines when physically and financially reasonable. The member further grants to the Cooperative the right and privilege to cut down, trim and/ or treat with herbicides any and all trees, vines, bushes and/ or landscaping, whether inside or outside the easement, which are of such height and/or such location in proximity to the Cooperative's line and/ or facilities that the trees, vines, bushes and/or landscaping, whether inside or outside the easement, may interfere with and/ or create a hazard to the operation of said lines and facilities. Upon request by the Cooperative, the member and the member's spouse, if any, shall at no cost to the Cooperative, execute a recordable easement incorporating the aforementioned easement rights. All service lines supplying the member with electric, communication, gas, or other energy and all switches, meters and equipment constructed or installed by the Cooperative on said land or premises, shall be the sole property of the Cooperative. The Cooperative shall have the right to remove its electric, gas, or other energy distribution system of any type and all appurtenant parts thereof upon discontinuance of service for any reason, provided, however, upon cancellation of the contract for electric, gas, or other energy service set forth herein, the perpetual easement granted by the provisions to this paragraph shall remain in full force and effect. The Board may expel from membership and/ or discontinue electric, gas, or other energy service to any member who fails or refuses to comply with the provisions of this Bylaw.

ARTICLE III MEETING OF MEMBERS

Section 3.1 Annual Meeting. The annual meeting of the members shall be held on a date after the first day of May and before the first day of October at such place within any of the counties served by the Cooperative and at such hour as may be selected by the Board, and which shall be designated in the notice of the meeting for the purpose of electing board members and transacting such other business as may come before the meeting. It shall be the responsibility of the Board to make adequate plans and preparations for the annual meeting. Failure to hold the annual meeting at the designated time shall not result in a forfeiture or dissolution of the Cooperative.

Section 3.2 Special Meetings. Special meetings of the members may be called upon request by any four board members, or by 10% or more of all members by filing with the Secretary the request in writing stating the purpose and signed by the requesting members, which request shall state the purpose of the special meeting. Upon

verification of the signatures of the members requesting a special meeting, it shall thereupon be the duty of the Secretary to cause notice of such meeting to be given as hereinafter provided. Special meetings by the members may be held at such time and at any place within one of the counties served by the Cooperative as designated by the Board and shall be specified in the notice of the special meeting.

Section 3.3 Notice of Members' Meeting. Written or printed notice stating the place, day and hour of the annual meeting, and in case of a special meeting or an annual meeting at which business requiring special notice is to be transacted the purpose or purposes for which the meeting is called, shall be delivered to each member not less than ten (10) days nor more than sixty (60) days before the date of the meeting, either personally, by mail, facsimile, other electronic transmission, or by publication at least one time in the newspapers of largest circulation in Henry, Shelby, and Trimble Counties, by or at the direction of the Secretary, or upon a default in duty by the Secretary, by the persons calling the meeting. Any such notice delivered by mail may be included with member service billings or as part of the Cooperative's monthly newsletter and/ or its monthly insert in *Kentucky Living*. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, addressed to the member at his or her address as it appears on the records of the Cooperative, with postage thereon prepaid. The failure of any member to receive notice of an annual or special meeting of the members shall not invalidate any action which may be taken by the members at any such meeting.

Section 3.4 Quorum. One-hundred (100) members present in person, or represented by properly signed and dated proxy, shall constitute a quorum for the transaction of business at all meetings of the members. If less than a quorum is present at any meeting, a majority of those present in person or represented by proxy may adjourn the meeting from time to time without further notice.

Section 3.5 Voting. Each member shall be entitled to only one vote upon each matter submitted to a vote at a meeting of the members. Members may not cumulate their votes. All questions shall be decided by a vote of a majority of the members voting thereon in person or by proxy except as otherwise provided by law, the Articles of Incorporation or these Bylaws. The vote of a member who is not a natural person, such as an association, corporation, limited liability company, partnership, or body politic, shall be cast by the highest ranking officer of such member present at the meeting, unless such member shall have designated in writing another person to represent it at such meeting. Such officer or representative shall at said meeting present at the registration desk either credentials of his or her authority or sign a statement that he or she is the authorized officer or representative.

The Board shall, prior to any meeting of the members at which directors are to be elected, appoint such number of assistant secretaries as it deems advisable for the purpose of checking registrations. Should the Board fail to appoint a sufficient number of assistant secretaries or should it develop that the number appointed is for any reason insufficient, then the secretary may, at or before said meeting, appoint such number of assistant secretaries as he or she may deem necessary from among the employees of the Cooperative. Should the secretary be absent or fail to act, then the Board Chairman or President may in like manner appoint assistant secretaries.

Section 3.6 Proxies. At all meetings of members, a member may vote by proxy executed in writing by the member. Such proxy shall be received at the Cooperative headquarters office at least seven (7) days before the date of the meeting. No proxy shall be voted at any meeting of the members unless it shall designate the particular meeting at which it is to be voted and no proxy shall be voted at any meeting other than the one so designated, or at any adjournment of such meeting. Other than the Secretary of the Cooperative (or in his or her absence the Board Chairman or the President), who shall vote at the direction of the Board, no member shall vote as proxy for more than three (3) members at any meeting of the members except where such person is exercising a proxy in connection with the borrowing of funds. No proxy shall be valid after sixty (60) days from the date of its execution. The presence of a member at a meeting of the members shall revoke the proxy theretofore executed by him or her and such member shall be entitled to vote at such meeting in the same manner and with the same effect as if he or she had not executed a proxy. A proxy may be unlimited as to the matters on which it may be voted or it may be restricted; a proxy containing no restriction shall be deemed to be unlimited. In the event a member executes two (2) or more proxies for the same meeting, the most recently dated proxy shall revoke all others; if such proxies carry the same date and are held by different persons, none of them will be valid or recognized.

Section 3.7 Credentials and Election Committee. The Board shall, not less than eighty (80) days nor more than one hundred forty (140) days before the annual meeting of the members, appoint a Credentials and Election Committee. The Committee shall consist of an uneven number of Cooperative members, not less than five (5) nor more than nine (9), who are not members of the Nominating Committee or existing Cooperative employees, agents, officers, directors or known candidates for director, and who are not close relatives as defined in Article IV, Section 4.1, or members of the same household thereof. In appointing the Committee, the Board shall have regard for the equitable representation of the several areas served by the Cooperative. The Committee shall elect its own chairman and secretary prior to the member meeting. If a petition or petitions are received on behalf of a candidate for inclusion on the ballot, other than candidates nominated by the Nominating Committee, then the Credentials and Election Committee shall meet at least thirty (30) days prior to the annual meeting to certify signatures on the petition and to determine the eligibility of such person to serve if elected. It shall be the Committee's responsibility to establish or approve the manner of conducting member registration and any ballot or other voting, to pass upon all questions that may arise with respect to the registration of members in person, to count all ballots or other votes cast in any election or in any other matter, to rule upon the effect of any ballots or other vote irregularly or indecisively marked or cast, to rule upon all other questions that may arise relating to member voting and the election of directors (including but not limited to the validity of petitions of nomination or the qualifications of candidates and the regularity of the nomination and election of directors), and to pass upon any protest or objection filed with respect to any election or to conduct affecting the results of any election. In the exercise of its responsibility, the Committee shall have available to it the advice of counsel provided by the Cooperative. Any nominee or anyone designated in writing by such nominee may be present in the counting room. No other person shall be present in the counting room except the Cooperative attorney who may be present at any part of the election process. In the event a protest or objection is filed concerning any election, such protest or objection shall be filed with the chairman of the Credentials and Election Committee or at the headquarters office of the Cooperative during, or within three (3) business days following the adjournment of, the meeting in which the voting is conducted. The Committee shall thereupon be reconvened, upon notice from its chairman, not less than thirty (30) days after such protest or objection is filed. The Committee shall hear such evidence as is presented by the protestor(s) or objector(s) who may be heard in person, by counsel, or both, and any opposing evidence; and the Committee, by a vote of a majority of those present and voting, shall, within a reasonable time but not later than thirty (30) days after such hearing, render its decision, the result of which may be to affirm the election, to change the outcome thereof, or to set it aside. The Committee may not affirmatively act on any matter unless a majority of the Committee is present. The Committee's decision (as reflected by a majority of those actually present and voting) on all matters covered by this section shall be final. Any action challenging the Committee's decision must be filed in a court of competent jurisdiction within thirty (30) days after the minutes reflecting the Committee's decision are approved by the Committee. The Committee shall be appointed for a one (1) year term and the Cooperative may compensate them for their services.

Section 3.8 Agenda. No proposal shall be voted upon or board action taken upon any matter at the annual meeting, unless it has been placed on the agenda by the Board at least forty (40) days prior to such meeting. Any agenda item proposed by anyone other than the Board shall be submitted to the headquarters office of the Cooperative or to the Secretary at least seventy (70) days prior to the annual meeting by filing with the Secretary a request in writing stating the purpose of the agenda item proposed, that it be submitted to the annual meeting for consideration and signed by not less than one hundred (100) requesting members. A proposal must be determined to be legitimate by the Board in order to be placed on the agenda of the member's annual meeting.

Section 3.9 Order of Business. The order of business at the annual meeting of the members, as established by the Board, and so far as possible, at all other meetings of the members, shall be essentially as follows:

- (a) Report on the number of members present in person or by valid proxy, in order to determine the existence of a quorum;
- (b) Reading of the notice of the meeting and proof of the due publication or mailing thereof, or the waiver or waivers of notice of the meeting, as the case may be;
- (c) Reading of unapproved minutes of the previous meeting of the members, and the taking of necessary action thereon;

- (d) Presentation and consideration of reports of officers, directors, and committees;
- (e) Election of, or report on election of, board members;
- (f) Other agenda items, if any, and
- (g) Adjournment.

ARTICLE IV DIRECTORS

Section 4.1 Number, Duties and General Powers. The business and affairs of the Cooperative shall be managed by a board (the Board) of six (6) directors. The Board shall exercise all the powers of the Cooperative except such as are by law or by the Articles of Incorporation or these Bylaws conferred upon or reserved to the members. A director shall discharge his duties as a director:

- (a) In good faith;
- (b) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
- (c) In a manner he reasonably believes to be in the best interest of the Cooperative. A director may not act in his self-interest and should not vote in a matter in which he has a direct personal interest.

Section 4.2 Districts. The Cooperative shall be divided into three (3) territorial districts and all directors or nominees for the office of director shall be members and shall be residents of their respective districts. The boundaries of said districts shall be as follows:

District 1 shall include all of Shelby County and those portions of Anderson, Franklin, Jefferson, and Spencer Counties served by the Cooperative.

District 2 shall include all of Henry County and that portion of Owen County served by the Cooperative.

District 3 shall include all of Trimble County and those portions of Carroll and Oldham Counties which are served by the Cooperative.

Section 4.3 Election and Tenure. Each Director on the Board as of September 25, 1997, shall continue in office until the expiration of his or her current term. At the annual meeting of members for the year 1998, one director shall be elected from District 2 and one director shall be elected from District 3 for regular three (3) year terms. At the annual meeting of members for the year 1999, one director shall be elected from District 1 and one director shall be elected from District 2 for regular three (3) year terms. At the annual meeting of members for the year 2000, one director shall be elected from District 1 and one director shall be elected from District 3 for regular three (3) year terms. Thereafter, two directors to fill the offices, the terms of which are then expiring, shall be elected at each annual meeting of members, and the term of each shall be three (3) years or until his or her successor shall have been elected and qualified.

Directors shall be elected by a majority of the votes cast. Each member shall be eligible to cast one (1) vote per director elected. Cumulative voting for directors is not allowed. In case of any tie votes, drawing by lot by the candidate shall resolve any tie votes. The entire membership shall retain the right to vote for directors in all districts. All contested elections shall be by secret ballot.

The Secretary shall mail with the notice of the meeting a statement of the number of directors to be elected and showing separately the nominations made by the Nominating Committee and nominations made by petition, if any. If the election of directors shall not be held on the day designated herein for the annual meeting, or at any adjournment thereof, a special meeting of the members shall be held for the purpose of electing directors within a reasonable time thereafter.

Section 4.4 Qualifications. To be eligible to become or remain a director of the Cooperative a person shall:

- (a) Be a member of the Cooperative whose permanent, principal residence is presently located and has been located during the past 60 months in the district served by the Cooperative where the vacancy exists;
- (b) Not be an employee of or financially interested in (i) a competing enterprise, other than indirect and minimal ownership through a mutual stock or bond fund or similar investment entity, or (ii) an entity which sells goods or services to the Cooperative, if the entity derives more than 1% of its annual gross income from sales to the Cooperative;
- (c) Have the capacity to enter into legally binding contracts;
- (d) Before becoming a director, graduate from high school or earn an equivalent degree or certification;
- (e) Not be an employee of, retired employee of, nor have been employed by the Cooperative during the past 60 months, nor be the spouse of such a person;
- (f) Not be a close relative of an active employee, director or attorney of the Cooperative;
- (g) Not have entered a plea of guilty to, or no contest to, or have been convicted of, a felony, or while a director and prior to becoming a director, not have a final judgment entered against them involving civil fraud, ethical violations, discrimination and/or acts of harassment;
- (h) While a director, and during the eighty-four (84) months immediately before becoming a director, not have been discharged of debt in a federal bankruptcy proceeding or have had as a debtor a final order entered against them in a similar proceeding under applicable state law such as insolvency, liquidation, receivership reorganization, or assignment for the benefit of creditors;
- (i) While a director, and during the eighty-four (84) months immediately before becoming a director, not have been a party to a foreclosure or other proceeding (judicial or non-judicial), which resulted in an involuntary sale of any of the director's property which proceeding is or was instituted because of the the director's default on indebtedness;
- (j) Except as otherwise provided by the Board of Directors for good cause shown, receive a Credentialed Cooperative Director designation, Director's Certificate, or similar designation or certification from the National Rural Electric Cooperative Association within thirty-six (36) months of becoming a Shelby Energy Director and after becoming a Director, participate in and complete additional director training as may be required by the Board of Directors;
- (k) Except as otherwise provided by the Board of Directors for good cause shown, attend at least ninety (90%) percent of all properly noticed regular and special board meetings, committee meetings and Board telephone/video conference meetings during each twelve (12) month rolling period.
- (l) Except as otherwise provided by the Board of Directors for good cause shown, shall not miss more than two (2) consecutive properly noticed regular Board meetings;
- (m) While a director, not breach the director's fiduciary duties to the Cooperative, violate confidences, or engage in illegal activity under the color of authority as a director;
- (n) While a director, provide a "Disclosure and Authorization" form which may be used for obtaining a periodic background check based on employment purposes;
- (o) Comply with any other reasonable qualifications determined, made adopted, amended, and/or disseminated in policies or rules of the Cooperative, not inconsistent with law, the Articles of Incorporation regulations, or these Bylaws.

(p) While a director, and during the thirty-six (36) months immediately before becoming a director, not be an employee of an entity of which the Cooperative is a member or owns an interest;

(q) While a director, and during the thirty-six (36) months immediately before becoming a director, not have been a director, officer, employee or agent of a union or other entity representing, or seeking to represent, Cooperative employees regarding the terms and conditions of employment with the Cooperative;

Notwithstanding any of the foregoing provisions, no incumbent director shall lose eligibility to remain a director or be re-elected as a director if he or she becomes a close relative of another incumbent director, a Cooperative employee, or a Cooperative attorney because of a marriage to which he or she was not a party.

As used in these bylaws "close relative" is defined as a person who by blood or marriage, including half, foster, step and adoptive kin is either a spouse, child, grandchild, parent, grandparent, brother, sister, aunt, uncle, nephew, or niece of the principal.

Upon establishing the fact that a director is holding the office in violation of any of the foregoing provisions, unless the violation is corrected promptly and to the complete satisfaction of the Board, the Board shall remove such director from office. Nothing contained in this section shall affect the validity of any action taken at any meeting of the Board.

Section 4.5 Nominations. It will be the duty of the Board to appoint, not less than eighty (80) days nor more than one hundred forty (140) days before the date of the meeting of the members at which directors are to be elected, a nominating committee consisting of not less than two (2) nor more than six (6) members, who shall be selected so that at least one member from each district from which a director is to be elected will serve on the nominating committee. No officer or director shall be on such committee. The committee shall prepare and post at the principal office of the Cooperative at least seventy (70) days before the meeting a list of nominations for directors.

Any nomination by members shall be submitted to the headquarters office of the Cooperative or to the Secretary at least sixty (60) days prior to the annual meeting by filing with the Secretary a petition calling for the nomination signed by at least one hundred (100) members who reside in the same district as the person who is being nominated. Each page of the petition shall contain a verbatim statement of such nominations(s). The petition shall be signed by each member in the same name as he or she is billed by the Cooperative and shall state the signatory's address as the same appears on such billings.

The Secretary shall mail with the notice of the meeting a statement of the number of directors to be elected from each district and showing separately the nominations made by the nominating committee and the nominations made by petition, if any. No nominations may be made from the floor. Notwithstanding the provisions contained in this section, failure to comply with any of such provisions shall not affect in any manner whatsoever the validity of any action taken by the Board after the election of directors.

Section 4.6 Removal of Directors by Members. Any member may bring one or more charges for cause against any director and may request the removal of such director at a special or regular meeting by filing with the Secretary such charges in writing signed by said member, together with a petition signed by not less than ten percent (10%) of all the members. For the purpose of this section, "cause" means an act or omission adversely affecting the Cooperative which amounts to gross negligence, fraud, or criminal conduct. Charges must be against the individual director rather than the Board as a whole. If the petition is to be heard at the annual member meeting, the petition shall be filed at the cooperative's principal business office in the format set forth above at least seventy (70) days prior to such annual meeting. The petition shall be added to the agenda of the annual meeting if all the requirements for filing are met.

The petition shall be signed by each member and state the name and address of the each member using the same name and address as the member is billed by the Cooperative filing such charges, and each page shall contain a verbatim statement of such charges and the name of the director against whom the charges are being made. A statement of such charges verbatim, the name of the director against whom the charges have been

made, the purpose of the meeting, and the name of the member filing the charges shall be contained in the notice of the meeting. Such director shall be informed in writing of the charges after they have been validly filed and at least thirty (30) days prior to the meeting of the members at which the charges are to be considered, and shall have an opportunity at the meeting to be heard in person, by witnesses, by counsel or any combination of such, and to present evidence in respect to the charges; and the person bringing the charges shall have the same opportunity, but must be heard first. The question of the removal of such director shall, separately for each if more than one has been charged, be considered and voted upon at such meeting; PROVIDED, that the question of the removal of a director shall not be voted upon at all unless some evidence in support of the charges against him or her shall have been presented during the meeting through oral statements, documents, or otherwise, with the ruling concerning same to be made by the chairman of the special meeting. Removal shall be by the affirmative vote of a majority of those members present. The chairman of said meeting shall be a licensed attorney appointed by the attorney to the Board, and the cooperative shall compensate him or her for such services.

Section 4.7 Vacancies. Vacancies occurring in the Board shall be filled by the affirmative vote of a majority of the remaining directors for the unexpired portion of the term. The appointed director shall be from the same district as was the director whose office was vacated.

Section 4.8 Compensation and Expenses. Directors shall not receive any salary for their services as such, except that the Board may authorize insurance coverage and/ or a fixed sum for each day or portion thereof spent on Cooperative business, such as attendance at meetings, conferences and training programs, or performing committee assignments when authorized by the Board. If authorized by the Board, directors may also be reimbursed for expenses actually and necessarily incurred in carrying out Cooperative business or granted a reasonable per diem allowance by the Board in lieu of detailed accounting for these expenses. No director shall receive compensation for serving the Cooperative in any other capacity, nor shall any close relative of a director receive compensation for serving the Cooperative, unless the payment and amount of compensation shall be specifically authorized by a vote of the members, or the service by the director or his or her close relative shall have been certified by the Board as an emergency measure.

Section 4.9 Amendments to Article IV. Notwithstanding anything in these Bylaws to the contrary, this Article IV, Sections 1, 2, 3, 4, 5, and 6 may not be amended without the affirmative vote of at least two-thirds of the members of the Board.

ARTICLE V MEETINGS OF THE BOARD

Section 5.1 Regular Meetings. Regular meetings of the Board shall generally be held monthly at such time and place within one of the counties served by the Cooperative as designated by the Board. Such regular monthly meetings may be held without notice other than such resolution fixing the time and place thereof. The regular meeting will normally not be held during the month within which falls the Cooperative's annual meeting.

Section 5.2 Special Meetings. Special meetings of the Board may be called by the Chairman or by any three board members, and it shall thereupon be the duty of the Secretary to cause notice of such meeting to be given as hereinafter provided. The Chairman or board members calling the meeting shall fix the time and place for the holding of the meeting, within the Cooperative area, unless all directors consent to its being held in some other place in Kentucky or elsewhere.

Section 5.3 Notice of Directors' Meetings. Notice of the date, time, place, and purpose of any special meeting of the Board shall be delivered to each director, if personally or by facsimile, email, or other electronic method, at least 24 hours before the date set for the meeting, if by reputable overnight delivery service at least 48 hours before the date set for the meeting, or if by mail at least five (5) days before the date set for the meeting, all by or at the direction of the Secretary, or upon a default in duty by the Secretary, by the Chairman or the Director calling the meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States Mail, addressed to the Director at his or her address as it appears on the records of the Cooperative, with postage thereon prepaid.

Section 5.4 Quorum. A majority of the Board shall constitute a quorum, provided that if less than such majority of the Board is present at said meeting, a majority of the Board present may adjourn the meeting from time to time, and provided further, that the Secretary shall notify any absent board members of the time and place of such adjourned meeting. The act of a majority of the Board members present at a meeting at which a quorum is present shall be the act of the Board, except as otherwise provided in these Bylaws.

ARTICLE VI OFFICERS

Section 6.1 Number. The officers of the Cooperative shall be a Chairman, Vice-Chairman, Secretary and Treasurer, each of whom shall be a director and shall be elected by the Board. Such other officers and assistant officers, including the President and Chief Executive Officer (CEO), as may be deemed necessary may be elected or appointed by the Board. The offices of Secretary and Treasurer may be held by the same person. The offices of President and Secretary may not be held by the same person.

Section 6.2 Election and Term of Office. The elected officers of the Cooperative shall be elected annually at the first regular meeting of the Board after the annual meeting of the members. If the election of officers shall not be held at such meeting, such election shall be held as soon thereafter as conveniently may be. Each officer shall hold office until the first meeting of the Board following the next succeeding annual meeting of the members or until his or her successor shall have been elected and qualified.

Section 6.3 Removal. Any officer, agent, or employee elected or appointed by the Board may be removed by the Board whenever, in its judgment, the best interests of the Cooperative will be served thereby. The principal against whom such charges have been brought shall be informed in writing of the charges at least ten (10) days prior to the Board meeting at which the charges are to be considered and shall have an opportunity at the meeting to be heard in person or by counsel and to present evidence in respect of the charges; and the person or persons bringing the charges against him or her shall have the same opportunity.

Section 6.4 Vacancies. A vacancy in any office elected or appointed by the Board shall be filled by the Board for the unexpired portion of the term.

Section 6.5 Chairman of the Board. The Chairman of the Board shall:

- (a) Unless otherwise determined by the Board, preside or designate some other individual to preside at all meetings of the members and the Board and, with the assistance of the President and CEO, formulate and prepare the agendas for such meetings;
- (b) In general perform all duties incident to the office of Chairman and such other duties as may be prescribed by the Board from time to time.

Section 6.6 Vice-Chairman. In the absence of the Chairman, or in the event of his or her inability or refusal to act, the Vice-Chairman shall perform the duties of the Chairman, and when so acting shall have all the powers of and be subject to all the restrictions upon the Chairman. The Vice-Chairman shall also perform such other duties as from time to time may be assigned to him or her by the Board.

Section 6.7 Secretary. The Secretary shall be responsible for:

- (a) Keeping, or causing to be kept, the minutes of the members and of the Board in books provided for that purpose;
- (b) Seeing that all notices are duly given in accordance with these Bylaws or as required by law;
- (c) The safekeeping of the corporate books and records and the seal of the Cooperative, and affixing the seal of the Cooperative to all documents, the execution of which on behalf of the Cooperative under its seal is duly authorized in accordance with the provisions of these Bylaws;

- (d) Keeping, or causing to be kept, a register of the names and post office addresses of all members;
- (e) Keeping on file at all times a complete copy of the current Articles of Incorporation, Bylaws, and rules and regulations of the Cooperative (which copies shall always be open to the inspection of any member) and furnishing a copy of the current Bylaws to each member upon request therefore; and
- (f) In general performing all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him or her by the Board.

Section 6.8 Treasurer. The Treasurer shall be responsible for:

- (a) Custody of all funds and securities of the Cooperative;
- (b) The receipt of and the issuance of receipts for all monies due and payable to the Cooperative and for the deposit and investment of all such monies in the name of the Cooperative in such financial institution(s) as may be selected in accordance with the provisions of these Bylaws; and
- (c) The general performance of all the duties incident to the office of Treasurer, and such other duties as from time to time may be assigned to him or her by the Board.

Section 6.9 Delegation of Secretary's and Treasurer's Responsibilities. Notwithstanding the duties, responsibilities and authorities of the Secretary and of the Treasurer hereinbefore provided in Sections 6.7 and 6.8, the Board may, except as otherwise limited by law, delegate wholly or in part, the responsibility and authority for, and the regular or routine administration of, one or more of each such officer's duties to one or more agents, other officers or employees of the Cooperative who are not directors. To the extent that the Board does so delegate with respect to the Secretary or Treasurer, that officer shall be released from such duties, responsibilities and authorities except as may be otherwise provided in these Bylaws.

Section 6.10 President and CEO. The Board shall appoint a President and CEO who may or may not be a member of the Cooperative, and need not be a director. The President and CEO shall be the principle Executive and operating officer of the Cooperative and shall:

- (a) Sign deeds, mortgages, notes, bonds, contracts or other instruments authorized by the Board to be executed, except in cases in which the signing and execution thereof shall be delegated by the Board or by these Bylaws to some other officer or agent of the Cooperative, or shall be required by law to be otherwise signed or executed.
- (b) In general perform all duties incident to the office of President and CEO and such other duties as may be prescribed by the Board from time to time.

Section 6.11 Bonds of Officers. The Treasurer and any other officer or agent of the Cooperative charged with responsibility for the custody of any of its funds or property shall be bonded or insured in such sum and with such surety as the Board shall determine. The Board in its discretion may also require any other officer, agent or employee of the Cooperative to be bonded or insured in such amount and with such surety as it shall determine.

Section 6.12 Indemnification of Officers, Directors, Employees and Agents.

- (a) Suit by Third Parties. The Cooperative shall indemnify any person who was or is a party, or is threatened to be made a party to, any threatened, pending or completed action, suit, or proceeding, whether civil, criminal, administrative or investigative (other than an action by, or in the right of, the Cooperative), by reason of the fact that such person is or was a director, officer, employee, committee member, or agent of the Cooperative, or who is or was serving at the request of the Cooperative as a director, officer, employee, committee member, or agent of another cooperative, association, corporation, partnership, joint venture, trust or other enterprise, against expenses (including reasonable attorney's fees), judgments, fines and amounts paid in settlement actually and

reasonably incurred by such person in connection with such action, suit or proceeding, if such person acted in good faith and in a manner such person reasonably believed to be in, or not opposed to, the best interests of the Cooperative, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the conduct of such person was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not of itself, create a presumption that the person did not act in good faith or in a manner which such person reasonably believed to be in, or not opposed to, the best interests of the Cooperative, and with respect to any criminal action or proceeding, had reasonable cause to believe that the conduct of such person was unlawful.

(b) Suit by Cooperative. The Cooperative shall indemnify any person who was or is a party, or is threatened to be made a party to, any threatened, pending or completed action or suit by, or in the right of, the Cooperative to procure a judgment in its favor by reason of the fact that such person is, or was, a director, officer, employee, committee member or agent of the Cooperative, or is, or was, serving at the request of the Cooperative as a director, officer, employee, committee member, or agent of another cooperative, association, corporation, partnership, joint venture, trust or other enterprise, against expenses, (including attorney's fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit, if such person acted in good faith and in a manner such person reasonably believed to be in, or not opposed to the best interests of the Cooperative, and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable for negligence or misconduct in the performance of the duty of such person to the Cooperative, unless and only to the extent that the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability, but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity of such expenses as the court shall deem proper. The Board may determine whether such reimbursement shall be made at the final conclusion or during the pendency of the action, suit or proceeding.

To the extent that a director, officer, employee or agent of the Cooperative has been successful, on the merits or otherwise, in the defense of any action, suit or proceeding referred to in paragraph (a) or (b) of this section, in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorney's fees) actually and reasonably incurred by such person in connection therewith.

Any indemnification under paragraph (a) or (b) of this section (unless ordered by a court) shall be made by the Cooperative only as authorized in the specific case, upon a determination that indemnification of the director, officer, employee, committee member, or agent is proper in the circumstances because such person has met the applicable standard of conduct set forth in paragraph (a) or (b) of this section and that the expenses claimed are reasonable. Such determination shall be made (1) by the Board by a majority vote of a quorum consisting of directors who were not parties to such action, suit or proceeding or (2) if such a quorum is not obtainable, or even if obtainable, a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or (3) by the members.

In order for any person to receive indemnification under this bylaw, he shall vigorously assert and pursue any and all defenses to those claims, charges or proceedings covered hereby which are reasonable and legally available and shall fully cooperate with the Cooperative or any attorneys involved in the defense of any such claim, charges, or proceedings.

Expenses incurred in defending a civil or criminal action, suit or proceeding may be paid by the Cooperative in advance of the final disposition of such action, suit or proceeding, as authorized by the Board in the specific case, upon receipt of an undertaking by or on behalf of the director, officer, employee, committee member or agent to repay such amount, unless it shall ultimately be determined that he or she is entitled to be indemnified by the Cooperative as authorized in this bylaw.

The indemnification provided by this bylaw shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of members or disinterested directors, or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding such

office, and shall continue as to a person who has ceased to be a director, officer, employee, committee member, or agent, and shall inure to the benefit of the heirs, executors and administrators of such a person.

The Cooperative may purchase and maintain insurance on behalf of any person who is or was a director, officer, employee, committee member, or agent of the Cooperative, or who is or was serving at the request of the Cooperative as a director, officer, employee, committee member, or agent of another cooperative, association, corporation, partnership, joint venture, trust or other enterprise, against any liability asserted against such person and incurred by such person in any such capacity, or arising out of the status of such person as such, whether or not the Cooperative would have the power to indemnify such person against such liability under the provisions of this Bylaw.

Section 6.13 Compensation. The powers, duties and compensation of officers, agents, committee members, and employees shall be fixed by the Board subject to the provisions of these Bylaws with respect to compensation for a Board Member and close relatives of a Board Member.

Section 6.14 Reports. The officers of the Cooperative shall submit at each annual meeting of the members reports covering the business of the Cooperative for the previous fiscal year. Such reports shall set forth the condition of the Cooperative at the close of such fiscal year.

ARTICLE VII NON-PROFIT OPERATION

Section 7.1 Interest or Dividends on Capital Prohibited. The Cooperative shall at all times be operated on a cooperative non-profit basis for the mutual benefit of its members. No interest or dividends shall be paid or payable by the Cooperative on any capital furnished by its members.

Section 7.2 Patronage Capital. In the furnishing of energy, the Cooperative's operations shall be so conducted that all members will, through their patronage, furnish capital for the Cooperative. In order to induce patronage and to assure that the Cooperative will operate on a non-profit basis, the Cooperative is obligated to account on a patronage basis to all its members for all amounts received and receivable from the furnishing of energy in excess of operating costs and expenses. All such amounts in excess of operating costs and expenses at the moment of receipt by the Cooperative are received with the understanding that they are furnished by the members as capital. The Cooperative is obligated to pay, by credits to a capital account for each member, all such amounts in excess of operating costs and expenses. The books and records of the Cooperative shall be set up and kept in such a manner that at the end of each fiscal year the amount of capital, if any, so furnished by each member is clearly reflected and credited in an appropriate record to the capital account of each member.

All such amounts credited to the capital account of any member shall have the same status as though they had been paid to the member in cash in pursuance of a legal obligation to do so and the member had then furnished the Cooperative corresponding amounts for capital.

All other amounts received by the Cooperative from its operation in excess of costs and expenses shall, insofar as permitted by law, be (a) used to offset any losses incurred during the current or any prior fiscal year and (b) to the extent not needed for that purpose, allocated to its members on a patronage basis and any amount so allocated shall be included as part of the capital credited to the accounts of members, as herein provided.

In the event of dissolution or liquidation of the Cooperative, after all outstanding indebtedness of the Cooperative shall have been paid, outstanding capital credits shall be retired without priority on a pro rata basis, before any payments are made on account of property rights of members. If, at any time prior to dissolution or liquidation, the Board shall determine that the financial condition of the Cooperative will not be impaired thereby, the capital then credited to members' accounts may be retired in full or in part. After December 31, 1992, the Board shall determine the method, basis, priority and order of retirement, if any, for all amounts heretofore and hereafter furnished as capital.

Capital credited to the account of each member shall be assignable only on the books of the Cooperative pursuant to written instruction from the assignor and only the successors in interest or successors in occupancy in all or part of such member's premises served by the Cooperative unless the Board, acting under policies of general application, shall determine otherwise.

Notwithstanding any other provision of the Bylaws, the Board at its discretion shall have the power at any time upon the death of any member, who was a natural person, if the legal representative of his or her estate shall request that the capital credited to any such member be retired prior to the time such capital would otherwise be retired under the provisions of these Bylaws, to retire capital credited to any such member immediately upon such terms and conditions as the Board, acting under policies of general application, and the legal representatives of such member's estate shall agree upon, including without limitation the option to receive an immediate cash payment in a reduced amount representing the value of those capital credits discounted to their present value; provided, however, that the financial condition of the Cooperative will not be impaired thereby; and provided, further, that no payment of capital credits to the estate of a deceased member shall be made except to the extent said credits represent margins earned by the Cooperative from its own operations and amounts received in cash from margins distributed by organizations or other cooperatives of which this Cooperative is a member. This shall be construed to exclude capital credits assigned, but not paid in cash, by such other cooperatives. Separate records shall be kept of patronage capital received and receivable.

The Cooperative, before retiring any capital credits to any member's account, shall deduct therefrom any amount owing by such member to the Cooperative, together with interest thereon at the Kentucky legal rate on judgments in effect when such amount became due, compounded annually, and such member hereby grants the Cooperative a security interest against such capital credits for such amounts owed.

ARTICLE VIII DISPOSITION AND PLEDGING OF PROPERTIES AND BORROWING MONEY; DISTRIBUTION OF SURPLUS ASSETS ON DISSOLUTION

Section 8.1 Disposition and Pledging of Property and Incurring Debt. The Cooperative may not sell, lease or otherwise dispose of all or any substantial portion of its property (including but not limited to merger, consolidation or dissolution) unless such sale, lease or other disposition is authorized by a vote of not less than three-fourths of all of the directors and at a meeting of the members thereof by the affirmative vote of not less than the majority of all of the members of the Cooperative, and unless the notice of such proposed sale, lease or other disposition shall have been contained in the notice of the meeting; provided, however, that notwithstanding anything herein contained, the Board of the Cooperative, without authorization by the members thereof shall have full power and authority to authorize the execution and delivery of a mortgage or mortgages or a deed or deeds of trust upon, or the pledging or encumbering of any or all of the property, assets, rights, privileges, licenses, franchises and permits of the Cooperative, whether acquired or to be acquired, and wherever situated, as well as the revenues and income therefrom, all upon such terms and conditions as the Board shall determine, to secure any indebtedness of the Cooperative; provided further that the Board may upon the authorization of a majority of those members of the Cooperative present at a meeting of the members thereof sell lease or otherwise dispose of all or a substantial portion of its property to another Cooperative or foreign corporation doing business in this State pursuant to the Act under which this Cooperative is incorporated.

No sale, lease, lease-sale, exchange, transfer or other disposition of all or substantially all of the Cooperative's property shall be authorized except in conformity with the following:

(a) If the Board looks with favor upon any proposal for such sale, lease, lease-sale, exchange, transfer or other disposition, it shall first cause three (3) independent, non-affiliated appraisers, expert in such matters, to render their individual opinions as to the value of the Cooperative with respect to such a sale, lease, lease-sale, exchange, transfer or other disposition and as to any other terms and conditions which should be considered. The three (3) such appraisers shall be designated by the Circuit Court Judge for the Judicial District in Kentucky in which the Cooperative's headquarters are located. If such judge refuses to make such designations, they shall be made by the Board.

(b) If the Board, after receiving such appraisals (and other terms and conditions which are submitted, if any), determines that the proposal should be submitted for consideration by the members, and after satisfaction of any option to purchase or rights of first refusal which may have been granted, it shall first give every other cooperative organized under KRS Chapter 279 (which has not made such an offer for such sale, lease, lease-sale, exchange, transfer or other disposition) an opportunity to submit competing proposals. Such opportunity shall be in the form of a written notice to such other cooperatives, which notice shall be attached to a copy of the proposal which the Cooperative has already received and copies of the respective reports of the three (3) appraisers. Such other cooperatives shall be given not less than thirty (30) days during which to submit competing proposals, and the actual minimum period within which proposals are to be submitted shall be stated in the written notice given to them.

(c) If the Board then determines that favorable consideration should be given to the initial or any subsequent proposal which has been submitted to it, it shall first adopt by the affirmative vote of the three-fourths of all directors a resolution recommending the sale and directing the submission of the proposal to a vote of the members at a duly held member meeting, and shall call a special meeting of the members for consideration thereof and action thereon, which meeting shall be held not sooner than ninety (90) days after the giving of such notice to the members; PROVIDED, that consideration and action by the members may be given at the next annual member meeting if the Board so determines, and if such annual meeting is held not sooner than ninety (90) days after the giving of such notice.

(d) Anyone hundred (100) or more members, by so petitioning the Board not less than forty (40) days prior to the date of such special or annual meeting, may cause the Cooperative, with the cost to be borne by the Cooperative, to mail to all members any opposing or alternative positions which they may have to the proposals that have been submitted or any recommendations that the Board has made.

(e) In connection with the exercise of its judgment in determining what is in the best interest of the Cooperative and its members when evaluating any proposal for dissolution, merger, consolidation, sale of assets, lease, transfer, or other disposition of all or substantially all of the Cooperative's assets, the Board shall consider all of the following factors and other factors which it deems relevant:

1. The long-term as well as short-term interest of the Cooperative and its members, including the possibility that those interests may be best served by the continued existence of the Cooperative;
2. The societal and economic impact of the transaction upon the community and service territories; and
3. The societal and economic effects of the transaction upon the Cooperative's employees.

Notwithstanding anything in these Bylaws to the contrary, this Article VIII, Section 8.1, may not be amended without the affirmative vote of at least three-fourths of the members of the Board.

Section 8.2 Distribution of Surplus Assets on Dissolution. Upon dissolution, after all debts and liabilities of the Cooperative shall have been paid, and all capital furnished through total un-retired patronage shall have been retired as provided in these Bylaws, the remaining property and assets of the Cooperative shall, to the extent practicable as determined by the Board, be distributed among the members and former members in the proportion which the aggregate patronage of each bears to the total patronage of all such members during the period beginning with the oldest unretired patronage capital and ending with the date of the filing of the certificate of dissolution;

PROVIDED HOWEVER, that, if in the judgment of the Board, the amount of such surplus is too small to justify the expense of making such distribution, the Board may, in lieu thereof, donate or provide for the donation of such surplus to one or more non-profit charitable or educational organizations that are exempt from Federal income taxation.

ARTICLE IX FINANCIAL TRANSACTIONS

Section 9.1 *Contracts.* Except as otherwise provided in these Bylaws, the Board may authorize any officer or officers, agent or agents to enter into any contract to execute and deliver any instrument in the name and on behalf of the Cooperative, and such authority may be general or confined to specific instances.

Section 9.2 *Checks, Drafts, etc.* All checks, drafts or other orders for the payment of money and all notes, bonds or other evidences of indebtedness issued in the name of the Cooperative, shall be signed and/ or countersigned by such officer or officers, agent or agents, employee or employees of the Cooperative and in such manner as shall from time to time be determined by resolution of the Board.

Section 9.3 *Deposits, Investments.* All funds of the Cooperative shall be deposited or invested from time to time to the credit of the Cooperative in such bank or banks or in such financial securities or institutions as the Board may select.

Section 9.4 *Change in Rates.* All rate changes shall be submitted to the Public Service Commission, other applicable regulatory agencies, and lenders as required.

Section 9.5 *Fiscal Year.* The fiscal year of the Cooperative shall begin on the first day of January of each year and shall end on the thirty-first day of December of the same year.

ARTICLE X MISCELLANEOUS

Section 10.1 *Waiver of Notice.* Any member or board member may waive in writing any notice of a meeting required to be given by these Bylaws. The attendance of a member or board member to any meeting shall constitute a waiver of notice of such meeting by such member or board member, except in the case a member or board member shall attend a meeting for the express purpose of objecting to the transaction of any business on the grounds that the meeting has not been lawfully called or convened.

Section 10.2 *Policies, Rules and Regulations.* The Board shall have power to make, amend, and adopt such policies, rules and regulations, not inconsistent with law, the Articles of Incorporation or these Bylaws, as it may deem advisable for the management of the business and affairs of the Cooperative.

Section 10.3 *Accounting System and Reports.* The Board shall cause to be established and maintained a complete accounting system which, among other things, and subject to applicable laws and rules and regulations of any regulatory body, shall conform to such accounting system as may from time to time be designated by the Administrator of the Rural Utilities Service of the United States of America or its successor entity. The Board shall also, after the close of each fiscal year, cause to be made by certified public accountant a full and complete audit of the accounts, books and financial condition of the Cooperative as of the end of such fiscal year.

Section 10.4 *Area Coverage.* The Board shall make diligent effort to see that energy service is extended to all un-served persons within the Cooperative serviced area who (a) desire such service, and (b) meet all reasonable requirements established by the Cooperative as a condition of such service.

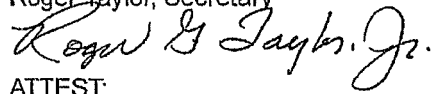
Section 10.5 *Computation of Time.* In computing any period of time prescribed or allowed by these Bylaws, the day of the act or event after which the designated period of time begins to run is not to be included. The last day of the period so computed is to be included, unless it is a Saturday, a Sunday, or a legal holiday, in which event the period runs until the end of the next day which is not a Saturday, a Sunday, or a legal holiday. When the period of time prescribed or allowed is less than seven (7) days, intermediate Saturdays, Sundays, and legal holidays shall be excluded in the computation period.

Section 10.6 Amendments. These Bylaws may be altered, amended, or repealed only by a two-thirds vote of the all of Cooperative's directors, except as otherwise provided in Article IV, Section 4.10 and Article VIII, Section 8.1. The notice of the meeting shall contain a copy of the proposed alteration, amendment or repeal or an accurate summary explanation thereof. If the Bylaws have been altered, amended or repealed, a copy of same shall be delivered to any member upon request by that member within a reasonable time after such action has been taken.

Section 10.7. Rules of Order. Parliamentary procedure at all meetings of the members, of the Board, of any committee provided for in these Bylaws, and of any other committee of the members or Board which may from time to time be duly established, shall be governed by the most recent edition of Robert's Rules of Order, except to the extent such procedure is otherwise determined by law or by the Cooperative's Articles of Incorporation or Bylaws.

ADOPTED by unanimous vote of the Board of Directors on February 16, 2012.

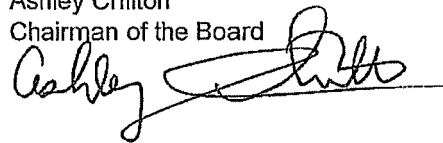
Roger Taylor, Secretary



ATTEST:

Ashley Chilton

Chairman of the Board



SHELBY ENERGY COOPERATIVE, INC
Shelbyville, Kentucky
Board of Directors' Special Meeting – June 22, 2012

Regular Meeting The following persons were present at 6:00 p.m. at the Henry County High School in New Castle, Kentucky on June 22, 2012 for a special called meeting:

Directors:

Ashley Chilton	Chairman
Roger Taylor, Jr.	Secretary-Treasurer
Wayne Stratton	Director
Diana Arnold	Director
Pat Hargadon	Director

Also Present:

Donald Prather	Attorney
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Absent:

Randy Stevens

Proxy Votes Attorney Prather reported that the Credentials & Election Committee had certified 947 proxies as complying with the Bylaw requirements. 938 of these proxies granted Shelby Energy's Secretary the right to cast those members' votes. 8 proxies indicated an intention that those votes be cast for Sonia McElroy. There was great concern expressed that some of them directed the Secretary to vote in favor of Ms. McElroy, which is the same as mail voting and is not allowed by the bylaws. Nevertheless, it was agreed that in the spirit of conducting a fair election the desires of those members will be honored. Accordingly, upon motion duly seconded the Board directed the Secretary to cast 938 proxy votes in favor of Randy Stevens and 8 proxy votes in favor of Sonia McElroy. This is a one-time only accommodation. In the future, proxies designating the secretary will be voted at the discretion of the Board as specified in the bylaws and despite any written notation directing that vote be cast for a particular candidate. Any change in this policy will require and be consistent with a change in the bylaws.

There being no further business, the meeting was adjourned. The next regular meeting of the Board of Directors will take place on July 19, 2012.

ROGER TAYLOR, JR., Secretary-Treasurer

Approved:

ASHLEY CHILTON, Chairman

From: Betsy Bennett

Sent: Sunday, June 24, 2012 8:12 PM

Subject: Shelby Energy Election Report Election Report

June 20, 2012

The live voting was conducted at Henry County High School from 4:30-6:30 p.m. Sonia and her opponent, the incumbent, Trimble County Judge Exec. Randy Stevens were allowed to stand in the foyer out front and campaign as voters walked in the front door to register. Sonia was terrific. She was shaking hands and smiling as fast as she could.

The vote total at 6:30 p.m. was 84 for Randy and 75 for Sonia. Apparently some people who thought they could vote were not named on the account for the family, but it was clear that Sonia has a lot of friends in the area. (I've already suggested that she probably needs to run for a seat in the legislature where election procedures are a little more fair/ transparent). I was permitted to watch the read-out of the voting machine with the Credentials Committee on Sonia's behalf and was given a copy of the totals.

Unbeknownst to the general public (and to us), the COOP board, minus Randy, met privately at 5:30 p.m. - while the voting was going on - and counted proxies. Apparently Randy received 940 votes by proxies mailed in and Sonia received 8 by proxies delivered that night, so the final total was 1024 to 83.

Following the board's current election process, it would clearly be impossible for anyone not nominated by the existing board to do any better than Sonia; in fact, she did an amazing job in a poor situation.

Betsy

2011 Shelby Energy Proxy

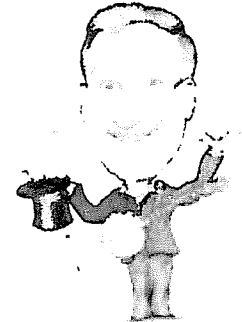
Shelby Energy Cooperative's



74th Annual Meeting

Tuesday, June 21st
Henry County High School
New Castle, Ky

Registration: 4:30 p.m.
Business meeting: 6:30 p.m.



Dave Cottrell
Magician

*food*safety demonstrations*free health screenings*door prizes*caricaturist*energy efficiency tips*

PROXY FOR THE ANNUAL MEETING OF SHELBY ENERGY COOPERATIVE, INC. SHELBYVILLE, KENTUCKY

You are welcome and invited to attend your Annual Meeting June 21, 2011 at Henry County High School. If you are unable to attend, please sign and return this proxy when paying your current bill.



Shelby Energy Cooperative, Inc.
P.O. Box 309
Shelbyville, KY 40066-0309

PRINT NAME

SIGNATURE OF MEMBER

ACCOUNT NUMBER

DATE

The above signed member of SHELBY ENERGY COOPERATIVE, INC., hereby constitutes and appoints the Secretary of the Corporation, their proxy to attend and vote on their behalf at the Annual Meeting of the Members of the Cooperative to be held at Henry Co. High School on June 21, 2011 or at any adjournment thereof, upon all business which may properly come before the meeting, including election of directors of the Cooperative.

2010 Shelby Energy Proxy

**PROXY FOR THE ANNUAL MEETING OF
SHELBY ENERGY COOPERATIVE, INC.
SHELBYVILLE, KENTUCKY**

You are welcome and invited to attend your Annual Meeting June 24, 2010 at Henry County High School. If you are unable to attend, please sign and return when paying your current bill.



Shelby Energy Cooperative, Inc.
P.O. Box 309
Shelbyville, KY 40066-0309

PRINT MEMBER NAME AS LISTED ON ACCOUNT

SIGNATURE OF MEMBER AS LISTED ON ACCOUNT

ACCOUNT NUMBER

DATE

The above signed member of SHELBY ENERGY COOPERATIVE, INC., hereby constitutes and appoints the Board Chairman of the Corporation, their proxy to attend and vote on their behalf at the Annual Meeting of the Members of the Cooperative to be held at New Castle, KY on June 24, 2010 or at any adjournment thereof, upon all business which may properly come before the meeting, including election of directors of the Cooperative.



Part 7. Rulings and Agreements

Chapter 25. Exempt Organizations Determinations Manual

Section 12. Organizations Exempt Under IRC 501(c)(12)

7.25.12 Organizations Exempt Under IRC 501(c)(12)

- 7.25.12.1 [Technical Overview](#)
- 7.25.12.2 [Regulatory Overview](#)
- 7.25.12.3 [Requirements for Exemption Under IRC 501\(c\)\(12\)](#)
- 7.25.12.4 [Requirements for Benevolent Life Insurance Associations](#)
- 7.25.12.5 [Requirements for Mutual Ditch, Irrigation, Cooperative Telephone or Electric Companies, and "Like Organizations"](#)
- 7.25.12.6 ["Like Organizations"](#)
- 7.25.12.7 [Unrelated Business Income Tax](#)
- 7.25.12.8 [The 85-Percent Member Income Test](#)
- 7.25.12.9 [Current Issues](#)

7.25.12.1 (08-09-2006)

Technical Overview

- 1 IRC 501(c)(12) exempts the following organizations from federal income tax:
 - benevolent life insurance associations of a purely local character
 - mutual ditch or irrigation companies
 - mutual or cooperative telephone companies
 - mutual or cooperative electric companies
 - "like organizations"
- 2 The phrase "of a purely local character" applies only to benevolent life insurance associations and organizations like them
- 3 To qualify for and maintain exemption under IRC 501(c)(12), all of the organizations described in (1) above must receive 85 percent or more of their income from members for the sole purpose of meeting losses and expenses each year
- 4 Organizations that meet the requirements of IRC 501(c)(12) may apply for exemption from federal income tax on Form 1024
- 5 Contributions to organizations that are exempt under IRC 501(c)(12) are not deductible as charitable contributions on the donor's income tax return
- 6 For more information regarding examination issues, see IRM 4.76.20

7.25.12.1.1 (08-09-2006)

Legislative History

- 1 In 1916, Congress established exemption from federal income tax for mutual ditch or irrigation companies, mutual or cooperative telephone companies, and like organizations 1916 Revenue Act, P L. 64-271, sec. 11(a)(10), 39 Stat 766 (1916)
- 2 In 1924, Congress extended exemption from federal income tax to benevolent life insurance associations of a purely local character and reduced the member income from 100 percent to 85 percent Revenue Act of 1924, ch. 234, sec. 231(10), 43 Stat. 283 (1924)
- 3 In passing the Miscellaneous Revenue Act of 1980, Congress added IRC 501(c)(12)(C), which specifically listed electric cooperatives as exempt under this Code section for the first time and permitted them to exclude qualified pole rentals from the 85-percent member income test Miscellaneous Revenue Act of 1980, P L. 96-605, section 106(a), 94 Stat. 3523 (1980)
- 4 In 1988, Congress permitted mutual or cooperative telephone and electric companies to exclude income derived from the prepayment of a loan under sections 306A, 306B, or 311 of the Rural Electrification Act of 1936 from the 85-percent member income test Technical Miscellaneous Revenue Act of 1988, P L. 100-647, section 2003(a)(2)(C)(ii), 102 Stat. 3598 (1988)
- 5 Effective for taxable years beginning after October 22, 2004, and before January 1, 2007, Congress amended IRC 501(c)(12) to exclude income received by a mutual or cooperative rural electric company from any open access transaction, any nuclear decommissioning transaction, or any asset exchange or conversion transaction, for purposes of determining whether such cooperative meets the income test for tax-exempt status (i.e., 85 percent of income collected from members of cooperatives for the sole purpose of meeting losses and expenses of providing services to members) American Jobs Creation Act of 2004, P L. 108-357, sections 319(a),(b), 118 Stat. 1470 (2004)
- 6 Congress passed the Energy Policy Act of 2005, eff. Aug. 8, 2005, P L. 109-58, Title XIII, Subtitle A, sections 1304(a),(b), 119 Stat. 997, eliminating the January 1, 2007, sunset provision for treatment of income derived from open access and nuclear decommissioning transactions and income from load loss transactions, thereby making the income-exclusion provision described above in paragraph (5) permanent.

7.25.12.2 (08-09-2006)

Regulatory Overview

- 1 State and federal agencies regulate mutual or cooperative telephone or electric companies Recordkeeping and reporting requirements vary

Exhibit 18

- A The Federal Communications Commission regulates and oversees interstate and international communications by radio, television, wire, satellite, and cable. More information is available at <http://www.fcc.gov/aboutus.html>
- B The Federal Energy Regulatory Commission (FERC) regulates interstate transmission of electricity, natural gas, and oil. It reviews rates for wholesale sales, examines proposed mergers and acquisitions, and seeks to ensure the integrity of electrical power grids. More information is available at <http://www.ferc.gov/default.asp>.
- C State public utility commissions regulate in-state services and rates. The National Association of Regulatory Utility Commissioners has links to state regulators at <http://www.naruc.org/displaycommon.cfm?an=7>
- D The Department of Agriculture's Rural Utilities Service (RUS) provides financing for utility plants, expansion, and updating technology in rural areas. More information is available at: <http://www.usda.gov/rus/index2/aboutus.htm>
The RUS implementing regulations are in 7 CFR, Chapter 17, section 1710

7.25.12.3 (08-09-2006)**Requirements for Exemption Under IRC 501(c)(12)**

- 1 In order to qualify for exemption under IRC 501(c)(12), an organization must:
 - Meet the organizational and operational requirements that apply to one of the types of organizations described in the Code, regulations derived thereof and revenue rulings, and
 - Receive 85 percent or more of its income from members for the sole purpose of meeting losses and expenses

7.25.12.4 (08-09-2006)**Requirements for Benevolent Life Insurance Associations**

- 1 The phrase "of a purely local character" applies only to benevolent life insurance associations and organizations that are similar to them. An organization of purely local character is one that confines its business activities to a particular community, place, or district, irrespective of political subdivisions. *Treas. Reg. 1.501(c)(12)-1(b)*
- 2 The organization must confine its operations to a single identifiable locality. In 1928, the Court of Claims held that a reciprocal or interinsurance exchange that operated in 27 states was not an organization of a purely local character. *Hardware Underwriters v. United States*, 65 Ct. Cl. 267 (1928), *cert. den.*, 278 US 645 (1928)
- 3 An organization is not purely local in character if only the borders of a state limit its activities. *Treas. Reg. 1.501(c)(12)-1(b)*. A life insurance organization that operated under a state permit that empowered it to do business in any county within 75 miles of its home office, but also issued policies to residents outside that area, did not qualify as an exempt organization. *Rev. Rul. 64-193, 1964-2 C.B. 151*.
- 4 The requirement that business activities must be purely local is satisfied if members reside in the local area at the time of application. In 1983, the Service ruled that a benevolent life insurance company that did not terminate members' life insurance coverage when they moved out of the local area was tax-exempt. *Rev. Rul. 83-43 1983-1 C.B. 108*

7.25.12.5 (08-09-2006)**Requirements for Mutual Ditch, Irrigation, Cooperative Telephone or Electric Companies, and "Like Organizations"**

- 1 Ditch and irrigation companies, telephone companies, electric companies, and "like organizations" that seek exemption under IRC 501(c)(12) must be organized and operated as mutual or cooperative organizations. The terms "mutual" and "cooperative" have no legal distinction for purposes of section 501(c)(12). The U.S. Tax Court defined "cooperative" as follows:
"A cooperative is an organization established by individuals to provide themselves with goods and services or to produce and dispose of the products of their labor. The means of production and distribution are those owned in common and the earnings revert to the members, not on the basis of their investment in the enterprise, but in proportion to their patronage or personal participation in it."
Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305 (1966), *acq.* 1966-2 C.B. 6
- 2 The court described the organizational and operational cooperative principles as follows:
 - A **Democratic Control.** The organization must periodically hold democratically conducted meetings with members. Election of officers must be on a one member, one vote basis. Meetings must have a quorum of members in attendance or voting by proxy.
 - B **Operation at Cost.** The organization must allocate all excess operating revenues (excess of revenue over expenses) among the members.
 - C **Subordination of Capital.** The organization must ensure that those who contribute capital neither control the operations nor receive most of the pecuniary benefits. The organization will meet this requirement by ensuring that the members control and own the savings or monetary benefits rather than the shareholders or equity investors.
- 3 The Service sets out additional organizational and operational cooperative requirements that an organization must meet for exemption under IRC 501(c)(12). *Rev. Rul. 72-36, 1972-1 C.B. 151*. These requirements are:
 - A The organization must keep adequate records of each member's rights and interests in its assets.
 - B The organization must distribute any savings to members in proportion to the amount of business done with them based on the "operation at cost" principle.
 - C The organization must not retain more funds than it needs to meet current losses and expenses.
 - D The organization cannot forfeit a member's right and interest in the organization upon termination of membership.
 - E Upon dissolution, the organization must distribute the gains from the sale of any appreciated assets to all persons who were members during the period that the organization owned the assets, in proportion to the amount of business done by the members during that period.

7.25.12.5.1 (08-09-2006)**Mutual or Cooperative Characteristics—Examples**

- 1 An association organized and operated on a cooperative basis to produce and market the worker-members' products and to allocate profits to the worker-members was found to be exempt. *Puget Sound Plywood, Inc. v. Commissioner*, *supra*
- 2 A mutual water company's articles of organization required its members, in the event of dissolution, to turn over their total interests without charge to the local government. This requirement is consistent with the principles of mutual operation and does not preclude exemption under IRC 501(c)(12). *Rev. Rul. 73-453, 1973-2 C.B. 185*

Exhibit 18

- 3 In 1978, the Service announced that it would not follow the Ninth Circuit's decision in Peninsula Light Co., Inc. v. U.S., 552 F.2d 878 (9th Cir. 1977). The decision recognized an organization that never operated on a patronage basis as exempt under IRC 501(c)(12). Its charter provided each member with an equal share in the organization's assets and, upon dissolution, divided its assets equally among the current members. Rev. Rul. 78-238, 1978-1 C.B. 161.
- 4 A mutual ditch company operated in a manner that was consistent with the provisions of state law before Congress enacted legislation that provided for exemption from federal income tax. It qualified for exemption even though it did not satisfy all the requirements in Rev. Rul. 72-36. Since there were no major changes in the applicable federal tax provisions in the intervening years, the Service believed that Congress intended that mutual ditch and irrigation companies that operate in such a manner would qualify for exemption. Rev. Rul. 81-109, 1981-1 C.B. 347.
- 5 The fact that all of its members may be exempt under IRC 501(c)(12) does not alone qualify an organization for exemption. Consumers Credit Rural Electric Cooperative Corp. v. Commissioner, 37 T.C. 136 (1961), *aff'd on exemption issue*, 319 F.2d 475 (6th Cir. 1963).

7.25.12.6 (08-09-2006) "Like Organizations"

- 1 The Code provides that an organization may qualify for exemption from federal income tax under IRC 501(c)(12) if it is "like" a benevolent life insurance association, a mutual ditch or irrigation company, or a telephone or electric company.
- 2 "Like organizations" engage in activities similar in nature to organizations listed in IRM 7.25.12.4 and IRM 7.25.12.5. Rev. Rul. 65-201, 1965-2 C.B. 170.

7.25.12.6.1 (08-09-2006) Examples of "Like Organization" Activities

- 1 "**Like**" **Benevolent Life Insurance Associations.** An activity that is similar to providing life insurance is providing cash benefit for burial and funeral expenses. Thompson v. White River Burial Association, 178 F.2d 954 (8th Cir. 1950).
- 2 "**Like**" **Electric Cooperatives.** Activities or services that are similar to providing electricity to members include:
 - water and sewer services (see Rev. Rul. 67-265, 1967-2 C.B. 205, *updating and restating* I.T. 1671, II-1 C.B. 158 (1923), and Rev. Rul. 2002-54, 2002-2 C.B. 527)
 - cable television service (see Rev. Rul. 83-170, 1983-2 C.B. 97)
 - natural gas service (see Rev. Rul. 2002-54, *supra*)
The rationale is that these services are public utility-type services that have been traditionally regulated by a state, political division, public utility commission, or other similar body of a state, or an agency or instrumentality of the United States. Such services also require extensive delivery infrastructure, the construction of which necessitates large capital investment. See Rev. Rul. 2002-54, *supra*.
- 3 "**Like**" **Telephone Cooperatives.** Activities or services that are similar to providing telephone service include:
 - a two-way radio service for the use of members (see Rev. Rul. 57-420, 1957-2 C.B. 308)
The rationale is that these services, like telephone service, allow members to communicate with others. See Rev. Rul. 57-420, *supra*.
- 4 "**Like**" **Ditch and Irrigation Cooperatives.** An activity that is similar to providing ditch and irrigation services is constructing and maintaining structures to prevent erosion of river banks. Rev. Rul. 68-564, 1968-2 C.B. 221.

7.25.12.6.2 (08-09-2006) Activities Not Within the Meaning of "Like Organization"

- 1 Providing bus services is an activity not exempt under IRC 501(c)(12). Rev. Rul. 55-311, 1955-1 C.B. 72.
- 2 Promoting automobile safety and furnishing road side and trip planning services are activities not exempt under IRC 501(c)(12). New Jersey Automobile Club v. United States, 181 F.Supp. 259 (Ct. Cl. 1960), *cert. den.*, 366 U.S. 964 (1961).
- 3 Financing the purchase of appliances and equipment is an activity not exempt under IRC 501(c)(12). Consumers Credit Rural Electric Cooperative Corp. v. Commissioner, *supra*.
- 4 Selling electrical materials, equipment, and supplies, and furnishing equipment for manufacturing, repair, testing, and other services are not activities exempt under IRC 501(c)(12). Rev. Rul. 65-201, 1965-2 C.B. 170.
- 5 Selling tanked propane is not an activity exempt under IRC 501(c)(12). Rev. Rul. 2002-54, 2002-2 C.B. 527.

7.25.12.7 (08-09-2006) Unrelated Business Income Tax

- 1 IRC 511(a)(1) imposes a tax on unrelated business income earned by organizations described in IRC 501(c)(12), except as described in (2) below. The criteria to determine whether an activity conducted by a section 501(c)(12) organization is an unrelated business are in section 511 *et seq.* These criteria are whether the activity is a trade or business, whether it is regularly carried on, and whether it is unrelated within the meaning of IRC 513.
- 2 Income earned by electric cooperatives from activities described in IRC 501(c)(12)(H) is excluded from the definition of unrelated business taxable income. See IRC 512(b)(18).
- 3 Interest earned on debt-financed income is subject to tax under section 511. Southwest Tex. Elec. Coop. v. Commissioner, T.C. Memo 1994-363 (1994).

7.25.12.8 (08-09-2006) The 85-Percent Member Income Test

- 1 A cooperative exempt under IRC 501(c)(12) must receive 85 percent or more of its income from members. The 85-percent member income test requires that the income be
 - derived from members and
 - used to pay for services listed in IRC 501(c)(12)
Rev. Rul. 2002-55, 2002-2 C.B. 529; see Rev. Rul. 2002-54, *supra*, Treas. Reg. 1.501(c)(12)-1(a), and Credit Rural Electric Cooperative Corp. v. Commissioner, *supra*.

Exhibit 18

- 2 The 85-percent member income test is computed each tax year. If in any year the member income falls below 85 percent of the total income received that year, the organization is no longer exempt under IRC 501(c)(12) for that tax year and must file a corporate tax return. Rev. Rul. 65-99, 1965-1 C.B. 242.
- 3 When an organization uses the accrual method of accounting, it will use the same method to compute the 85-percent member income test. Rev. Rul. 68-18, 1968-1 C.B. 271.
- 4 Electric cooperatives do not have to subtract the cost of goods sold from gross sales to calculate the 85-percent member income test. Prior to 1998, the Service's position was that an electric cooperative must deduct the cost of goods sold for purposes of calculating the 85-percent member income test. See Rev. Rul. 80-86, 1980-1 C.B. 118. This position was proposed for formal adoption in Prop. Treas. Reg. 1.501(c)(12)-2 (49 Fed. Reg. 1244, 1984). The proposed regulation was withdrawn. See 58 Fed. Reg. 25587 (April 27, 1993). Under the safe harbor guidelines, electric cooperatives may continue to use the method they have consistently used in the past. Ann. 96-24, 1996 I.R.B. 35, (12)22 3(b).
- 5 A benevolent life insurance company is not entitled to exemption if it issues policies for stipulated cash premiums, or requires advance deposits to cover the cost of the insurance and maintains investments from which it gets more than 15 percent of its income. However, if an organization makes advance assessments for the sole purpose of meeting future losses and expenses, and retains the balance of the assessments remaining at the end of the year to meet losses and expenses or returns it to members, it may be entitled to exemption. Treas. Reg. 1.501(c)(12)-1(a). The Court of Claims has held that:

" [T]he income of the association did not consist solely of assessments, dues, and fees collected from members. It had income from large investments in certificates of deposits and United States bonds, and this income, as stated, was deposited and commingled with the general fund of the association in the bank and used for paying expenses. It was income derived from investments. Certainly there is at least a grave doubt as to whether the plaintiffs come within the exemption, and it must be held that they are not entitled to be exempted."

Hardware Underwriters v. United States, supra

7.25.12.8.1 (08-09-2006)**Included Income, Excluded Income, and Non-Income Items**

- 1 A cooperative must take income from all sources (except as provided below) for computation under the 85-percent member income test, including capital gains from the sale of assets where the gain arises from an incidental disposition of assets upon dissolution. Mountain Water Co. of La Crescenta v. Commissioner, 35 T.C. 418 (1960), *acquiescence on other issues*, 1961-2 C.B. 5; Cate Ditch Co. v. U.S., 194 F.Supp. 688 (D. Cal. 1961).
- 2 When an electric cooperative leases power facilities to a nonmember power company, and the nonmember power company furnishes electric energy to the cooperative members, the payments are not an "interchange of power." Rather, they are rental payments that the cooperative must include in income to determine whether it meets the 85-percent member income requirement for exemption from federal tax. Rev. Rul. 65-174, 1965-2 C.B. 169.
- 3 A government grant is not income and is treated as nonshareholder contribution to capital. Hence, such a grant is not included as income for purposes of computation under the 85-percent member income. In order to be treated as a grant, the income:
 - must become a permanent part of the transferee's working capital structure,
 - may not be compensation, such as a direct payment for a specific, quantifiable service provided for the transferor by the transferee,
 - must be bargained for,
 - must result in benefit to the transferee in an amount commensurate with its value, and
 - must ordinarily, if not always, be used in or contribute to the production of additional income and its value assured in that respect. United States v. Chicago, Burlington & Quincy R.R., 412 U.S. 401 (1973); Rev. Rul. 93-16, 1993-8 C.B. 26.
- 4 Telephone cooperatives will apply the 85-percent income test without taking into account any income received or accrued from:
 - Another telephone company for the performance of communication services involving the completion of long distance calls to, from, or between members of the IRC 501(c)(12) telephone company. IRC 501(c)(12)(B)(i).

Example:

In one year, a cooperative telephone company receives \$85X from its members for telephone calls, \$15X interest income, and \$20X in credits. Other long distance telephone companies give the credits, under long distance interconnection agreements, for the performance of communication services involving the completion of long distance calls to, from, or between the cooperative members (whether the credits may be offset, in whole or in part, by amounts due the other companies under the interconnection agreements). The cooperative telephone company will calculate the member income fraction without taking into account, either in the numerator or the denominator, the \$20X credits received from the other telephone companies. Treas. Reg. 1.501(c)(12)-1(c); Rev. Rul. 81-291, 1981-2 C.B. 131.

- Qualified pole rentals. IRC 501(c)(12)(B)(ii).
 - The sale of display listings in a directory furnished to members of the mutual or cooperative telephone company. IRC 501(c)(12)(B)(iii).
 - The prepayment of a loan under section 306A, 306B, or 311 of the Rural Electrification Act of 1936. IRC 501(c)(12)(B)(iv).
 - Charging third parties such as inter-exchange carriers, local exchange carriers, or other exchange carriers for billing and collecting intrastate, interstate, or international revenues. FSA 199906034 (1999). This Field Service Advice changed the Service's position and reflected its acquiescence to the U.S. Tax Court's decision in Golden Belt Telephone Association, Inc. v. Commissioner, 108 T.C. 498 (1997). See AOD 1998-18 I.R.B. 4 (1998); see also, Notice 92-33, 1992-2 C.B. 363.
- 5 Electric cooperatives will apply the 85-percent income test without taking into account any income received or accrued from:
 - **Qualified pole rentals.** IRC 501(c)(12)(C)(i).
 - **Nondiscriminatory open access transactions** (other than income received or accrued directly or indirectly from a member) such as the provision or sale of electric energy transmission services or ancillary services under an open access transmission tariff approved or accepted by FERC, or under an independent transmission provider agreement approved or accepted by FERC. See IRC 501(c)(12)(C)(ii),(iii).
 - **Nuclear decommissioning transactions.** IRC 501(c)(12)(C)(iv). The term "nuclear decommissioning transaction" is defined as any transfer into a trust, fund, or instrument established to pay any nuclear decommissioning costs if the transfer is in connection with the transfer of the cooperative's interest in a nuclear power plant or nuclear power plant unit, or any distribution from a trust, fund, or instrument established to pay any nuclear decommissioning costs, or any earnings from a trust, fund, or instrument established to pay any nuclear decommissioning costs. IRC 501(c)(12)(F).
 - **Asset exchange or conversion transactions.** IRC 501(c)(12)(C)(v). The term "asset exchange or conversion transaction" means any voluntary exchange or involuntary conversion of any property related to generating, transmitting, distributing, or selling electric energy by a mutual or cooperative electric company, the gain from which qualifies for deferred recognition under IRC 1031 or IRC 1033, but only if the replacement property acquired by the company constitutes property which is used or to be used for generating, transmitting, distributing, or selling electric energy or natural gas. IRC 501(c)(12)(G).

7.25.12.8.2 (08-09-2006)

Exhibit 18

Member vs. Nonmember

- 1 Members are those who have the rights to elect the governing board of the cooperative and be involved in the operations of the organization. Many kinds of entities and individuals may be members of organizations exempt under IRC 501(c)(12). Government agencies may be members of IRC 501(c)(12) organizations. Rev. Rul. 68-75, 1968-1 C.B. 169. An organization that is exempt under section 501(c)(12) may have members that are exempt under that section. See e.g., Consumers Credit Rural Electric Cooperative Corp. v. Commissioner, supra.
- 2 Below are some examples of types of member income or nonmember income for purposes of the 85-percent member income test:
 - A. Income from the sale and service of appliances to nonmembers who do not purchase electricity from the cooperative is nonmember income, whether the sale is made through a third party or subsidiary. Treas. Reg. 1.513-1(a), (d).
 - B. Interest income from the sale of an office building is nonmember income. Rev. Rul. 65-99, 1965-2 C.B. 242.

**7.25.12.9 (08-09-2006)
Current Issues**

- 1 Some current issues are described below.

**7.25.12.9.1 (08-09-2006)
Redemption of Capital Credit Accounts at a Discount**

- 1 Many cooperatives keep savings in reserve for improvements, expansion, and unexpected expenses. They create capital credit accounts that show pro-rata savings per member. When finances permit, cooperatives may redeem these accounts. Some cooperatives have asked to redeem the accounts at a discount rather than face value. Discounted redemption programs raise two issues:
 - A. Whether the difference between the face value and the discounted amount is income for purposes of the 85-percent member income test—The difference is treated as income for purposes of the 85-percent member income test.
 - B. Whether discount redemption programs violate any cooperative principles—A capital credit redemption program may jeopardize two cooperative principles: (1) a member's rights and interest in the assets of the cooperative cannot be forfeited if his or her membership ends; and (2) on dissolution, a cooperative must distribute any gains from the sale of its assets to all members while the cooperative owned the assets. The Office of Exempt Organizations, Rulings and Agreements, in coordination with the Office of Chief Counsel, has issued multiple private letter rulings to the effect that an electric cooperative's program that creates capital accounts and retires capital credit accounts at a discount does not violate cooperative principles.

**7.25.12.9.2 (08-09-2006)
New Services**

- 1 Below is a list of activities that the Service has determined administratively to be exempt under IRC 501(c)(12). See IRM 7.25.12.6.1, above.
 - A. **Telecommunications.** Many telephone cooperatives are offering new telecommunications services such as:
 - wireless or cellular phone services
 - Internet access
 - paging
 - home security monitoring
 - medical alert and environmental monitoring services
 The rationale is that providing a communications capability to members on a cooperative basis is an exempt activity similar to a two-way radio system. See Rev. Rul. 57-420, 1957-2 C.B. 308.
 - B. **Direct Satellite Television.** The Service has determined that this service is an activity exempt under IRC 501(c)(12). The rationale is that, like cable television, it is regulated to some extent by state governmental units.

**7.25.12.9.3 (08-09-2006)
Other Issues**

- 1 For information on the following issues—
 - Providing multiple services, see IRM 4.76.20.8(1);
 - Issuance of shares of non-voting, interest-bearing stock, see IRM 4.76.20.8(2).

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SHELBY ENERGY COOPERATIVE, INC
Shelbyville, Kentucky
Board of Directors' Meeting – September 20, 2012

Regular Meeting	<p>The following persons were present at 9:00 a.m. at Shelby Energy's headquarters on September 20, 2012:</p> <p><u>Directors:</u></p> <table border="0"> <tr> <td>Ashley Chilton</td> <td>Chairman</td> </tr> <tr> <td>Randy Stevens</td> <td>Vice-Chairman</td> </tr> <tr> <td>Roger Taylor, Jr.</td> <td>Secretary-Treasurer</td> </tr> <tr> <td>Wayne Stratton</td> <td>Director</td> </tr> <tr> <td>Diana Arnold</td> <td>Director</td> </tr> <tr> <td>Pat Hargadon</td> <td>Director</td> </tr> </table> <p><u>Also Present:</u></p> <table border="0"> <tr> <td>Jason Ginn</td> <td>Vice-President, Operations & Engineering</td> </tr> <tr> <td>Denise Hume</td> <td>Manager, Accounting and Finance</td> </tr> <tr> <td>Debra Martin</td> <td>President & CEO</td> </tr> <tr> <td>Gay Tennill</td> <td>Executive Assistant</td> </tr> <tr> <td>Candi Waford</td> <td>Manager, Member Services</td> </tr> <tr> <td>Donald Prather</td> <td>Attorney</td> </tr> </table> <p><u>Guests:</u></p> <table border="0"> <tr> <td>Rod Crile</td> <td></td> </tr> <tr> <td>Nancy Combs</td> <td></td> </tr> </table>	Ashley Chilton	Chairman	Randy Stevens	Vice-Chairman	Roger Taylor, Jr.	Secretary-Treasurer	Wayne Stratton	Director	Diana Arnold	Director	Pat Hargadon	Director	Jason Ginn	Vice-President, Operations & Engineering	Denise Hume	Manager, Accounting and Finance	Debra Martin	President & CEO	Gay Tennill	Executive Assistant	Candi Waford	Manager, Member Services	Donald Prather	Attorney	Rod Crile		Nancy Combs	
Ashley Chilton	Chairman																												
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Gay Tennill	Executive Assistant																												
Candi Waford	Manager, Member Services																												
Donald Prather	Attorney																												
Rod Crile																													
Nancy Combs																													
Call to Order	The meeting was called to order by Chairman Chilton.																												
Minutes	The minutes of the August 16, 2012 Board of Directors meeting were approved.																												
Key Ratio Trend Analysis	<p>Chairman Chilton welcomed Rod Crile, Regional Vice President of the Cooperative Finance Corporation (“CFC”) to review and discuss the 2011 Key Ratio Trend Analysis (“KRTA”) for Shelby Energy. CFC's KRTA develops 145 financial operating criteria ratios from surveys of 815 electric cooperatives throughout the country. Each ratio is based upon median figures and therefore is a true midpoint, as opposed to average figures which can be distorted by a few extremely high or extremely low figures. KRTAs give a true peer group comparison. His report focused on the KRTAs for the 16 other cooperatives who purchase power from East Kentucky Cooperative, because he considered that the most relevant comparison, and the 815 nationwide cooperative KRTAs which are calculated from the largest pool and therefore are the most accurate median comparisons. Other KRTAs on which he did not focus compares Shelby Energy to the other 26 cooperatives in the state, the other 92 cooperatives nationwide with between 15,000 and 19,999 customers, and those 162 national cooperatives with a</p>																												

Board of Directors Meeting – September 20, 2012

Page 2

similar growth rate of between 5% and 6%. Approximately 600 out of the 815 cooperatives nationwide have fewer than 15,000 customers.

There are three core drivers of the ratios: the number of customers, the number of employees, and the annual electric sales which are heavily influenced by weather. There are also a number of factors can affect the ratios: system demographics such as the number of customers per mile of line, the terrain (flat versus hilly) and revenue mix (residential versus industrial customers), major storms and natural disasters, accounting differences, the type of utility plant (underground, which is prevalent around cities, versus overhead), whether the cooperative owns the substations or not, and strategic initiatives.

Of these factors, Shelby Energy only has significant control over the number and type of employees. He emphasized a difference between Shelby Energy's KRTAs and those of other EKPC or national cooperatives does not automatically mean there is a problem, it simply indicates a difference. The Board must look at Shelby Energy's individual circumstances to determine if being average is right for Shelby Energy.

Crile chose to concentrate on five types of ratios he considers most relevant: (1) demographics; (2) financial ratios (loan covenants); (3) plant investments; (4) capital credits; and (5) revenue/expenses/margins.

With respect to demographics, he considers three ratios especially significant. Shelby Energy sells more mwh per mile of line than both the national and EKPC median. Shelby Energy also sells fewer residential kwh per total kwh sales than EKPC and national medians. These two ratios are due to Shelby Energy's relatively higher concentration of industrial customers. While a higher ratio of industrial customers can help keep rates lower during good economic times, it can be a problem when the economy turns bad.

The final demographic ratio is the average customers per mile. Shelby Energy's average is a little over seven customers per mile, which is between the national median of six and the EKPC median of nearly nine. A higher number of customers per mile is helpful in keeping rates lower.

He discussed five financial ratios. The first is Times Interest Earned Ratio ("TIER"), which measures the ability to generate margins to cover long-term interest expense. Shelby Energy is above the RUS minimum of 1.25 with a 5-year average TIER that is above the national median and somewhat below the EKPC median. Next is the Operating Times Interest Earned Ratio ("OTIER"), which measures the ability to generate operating margins to cover long-term interest expense. This is the hardest of the financial ratios to meet. Shelby Energy is again above the RUS minimum of 1.10.

Board of Directors Meeting – September 20, 2012

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The third ratio of Modified Debt Service Coverage (“MDSC”) measures the ability to generate cash to cover debt service. Shelby Energy's 5-year average has exceeded the CFC minimum of 1.35. The fourth financial ratio is Equity as a Percent of Assets, which is its total equity divided by its total assets. Shelby Energy has for the last five years exceeded the EKPC median, as well as the 20% CFC minimum and 30% RUS minimum to permit capital credit retirement to members. The higher this ratio, the more the cooperative is being financed by member-owned equity; the lower this ratio, the more money must be borrowed and therefore additional interest expense incurred. The final financial ratio is Distribution Equity, which excludes equity in associated organizations such as EKPC. Shelby Energy's 5-year median is above the EKPC and below the national medians.

Crile next discussed plant investment ratios. Shelby Energy's annual percentage growth in total utility plant was significantly above both the national and EKPC medians in both 2010 and 2011, largely because of the installation of the AMI system. Its percentage growth in the number of customers has, consistent with the economy, decreased over the last several years and is on par with other EKPC cooperatives. Shelby Energy's total utility plant investment per consumer is higher than the EKPC median largely due to Shelby Energy having fewer customers per mile of line.

Shelby Energy's capital credit ratios look good. The percent of total equity retired annually by Shelby Energy as capital credits is ahead of the EKPC median. The cumulative amount of patronage capital retired as a percentage of total patronage capital is equal to the EKPC median.

Shelby Energy's rates have for the last five years been lower than the EKPC median and significantly lower than the national median. Its cost of purchased power is approximately equal to both the national and EKPC medians. Shelby Energy's amount of depreciation per consumer is between the EKPC and national medians. Shelby Energy's long term interest cost per consumer is higher than both the EKPC and national medians, largely due to Shelby Energy's past reliance upon fixed rate loans to protect its customers against interest rate fluctuation. This discrepancy will disappear when interest rates invariably rise. Martin commented Shelby Energy had recently been taking advantage of the ability to borrow money at a variable interest rate but with the ability to quickly convert to a fixed rate if interest rates begin to rise. Shelby Energy's total margins per consumer are above the national and EKPC medians. Its operating margins per consumer are above the EKPC median but below the national median.

Crile also discussed the ratio for total controllable expenses per customer. This is the amount of expenses that can actually be controlled by a cooperative. Shelby Energy's controllable expenses per consumer are below the US median. They are a little above the EKPC median, which he would expect due to fewer customers per mile. Martin commented this ratio has been significantly and negatively impacted in the last several years by complying with the management audit recommendations which required an

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increase from 31 to 38 full-time employees. The cost of these additional employees, as well as the \$150,000 to \$200,000 cost of the management audit itself, have significantly contributed to the likely need for a rate increase in the near future.

In summary, Crile stated that Shelby Energy's challenges, due to its revenue mix and system demographics, are greater than the medians. The fact that most cooperatives are PSC regulated in Kentucky, as compared to many states where cooperatives are not regulated, significantly contributes to the relatively weak OTIER and MDSC margins of regulated Kentucky cooperatives. All in all, however, Shelby Energy's overall position looks good. After Crile's presentation concluded, he departed the meeting.

Executive Session	The Board entered into an executive session with the attorney and Nancy Combs, President of HR Enterprises, Inc. After emerging from the executive session, upon motion duly seconded, the Directors unanimously approved the President & CEO's 2013 compensation.
George Busey Resolution	Prather presented a draft resolution honoring the recently deceased, long-time Chairman and member of the Board, George M. Busey. Upon motion duly seconded, the Board approved the resolution which will be presented to Mr. Busey's son.
Operations & Engineering Report	Ginn presented the Operations & Engineering report for August. New construction continues to be down, resulting in employee concentration on maintenance work. There were 59 outages in August 2012 as compared to 117 in August 2011, which Ginn believes especially good considering the number of small storms in August of this year.
Safety Report	An Elliott Construction crew was discovered performing work on energized lines without proper truck grounding. The crew was directed to immediately ground the truck. This crew is no longer working with Shelby Energy's system. Shelby Energy crews have worked 33,950.55 hours since March 28, 2012 without a lost-time accident. Elliott construction crews have worked 127,969 hours since September 1, 2008 without a lost-time accident. W.A. Kendall right-of-way crews have worked 37,719.50 hours since September 1, 2010 without a lost-time accident.
EKPC Annual Operations Meeting	Ginn reported that double locks were installed on August 20, 2012 with LG&E at Long Run, concluding a long process first discussed with LG&E on April 18, 2002. Also, KU has given permission to use its KU Florence substation for back-feeding the Shelby Energy Bedford and Milton substations. This should significantly help with the problems at those substations. Discussions continue with EKPC regarding the need for EKPC to upgrade its Long Run substation, which would be 20% overloaded if Shelby Energy had not continued to shift loads from that substation to surrounding substations. It will be difficult for Shelby Energy to shift any more load from the Long Run substation, and an upgrade would permit Shelby Energy to improve its back-feed capability from that substation. Finally, Ginn discussed the continuing efforts to convince EKPC to replace the nearly 60-year-old conductor on its line feeding the Clay

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Village and New Castle substations. EKPC had a rebuild of this line section scheduled in 2011, but deferred it to 2012 for budgetary reasons and the project has now been put on further hold. Some breakers have been added and poles changed which will improve the situation.

EKPC Load Forecast Ginn discussed the load forecast prepared by EKPC which projects Shelby Energy's power requirements in the future. The forecast indicates that Shelby Energy customers through 2032 will increase an average of 1.4% per year and energy sales will increase an average of 1.6% per year, both up considerably from the 0.6% and 0.5% respective average growth over the last five years. The winter and summer peaks are expected to increase an average of 1.5% per year. Although residential energy sales grew by an average of 2.6% per year during the last five years, the load forecast it projects only 1.4% per year during the next five years, with the additional growth instead being in the commercial and industrial energy sales. The substation forecast information confirms Shelby Energy's experience that EKPC needs to upgrade the Long Run substation.

After discussion concluded, upon motion duly seconded, the Board adopted the Power Requirements Study Resolution.

Billing and Customer Service Report Tennill discussed the Billing and Customer Service Report for the month of August 2012. There being no questions from the Directors regarding the written information, she moved to the Capital Credit report.

Capital Credits Capital credits were paid to 6 estates during August.

Write-Offs Tennill reported uncollectable accounts totaling \$14,066.73 from June 2012 service dates. While this is slightly more than during June 2011, the total write-offs from January through June of 2012 are \$93,050.58, much less than the \$127,175.75 written off during the same period in 2011. Write-offs for the year are running 0.28% of revenue, well below the PSC and Shelby Energy target rate of 0.5% - 0.8% of revenue.

Farmers Bank Of Milton Tennill presented for consideration resolutions authorizing all of the Directors and Martin, Tennill, Waford and Cox as authorized signees on the bank account at Farmers Deposit Bank in Milton which will be used to process transactions from the remote payment center at Riverside Produce in Milton. Upon motion duly seconded, both resolutions, copies of which are attached to these minutes, were approved.

Member Services Report Waford reported the new member survey results for August continue to show a good satisfaction rate and the comments were mostly good. The annual member survey is being prepared and is expected to go out on September 25, 2012. A real effort has been

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made to develop questions for that survey which will provide information that can be used to improve member service. Waford reported a total of 26 individuals are scheduled to participate in the October 6 World War II veteran honor flight to Washington, DC. Shelby Energy's representative J.W. Miles is looking forward to the trip.

Accounting & Finance Report	Hume presented the Accounting & Finance report. The RUS Form 7 shows Shelby Energy's financial status is essentially unchanged. Shelby Energy's year-to-date TIER is 1.32 and its year-to-date Operating TIER is 1.25, both of which exceed RUS minimum requirements of 1.25 and 1.10 respectively. Shelby Energy has 36.23% of its assets as equity. Overtime payroll was up in July due to several small storms. A very positive development is that more employees are taking advantage of the wellness program. Shelby Energy's cumulative 12-month average line loss of 3.38%, TIER of 2.66 and Operating TIER of 1.32 all show Shelby Energy remains in good shape.
Shelby Propane Plus Report	Hume reported that Shelby Propane Plus had a small loss during the month of August 2012, but has still made money for the year.
Insurance Deductibles	Hume reported Director Hargadon has been assisting her in investigating whether it would be advantageous for Shelby Energy to increase various deductibles on its insurance policy. The analysis uses Shelby Energy's actual claim history for the past five years to determine whether the additional out-of-pocket expense that would have been paid by Shelby Energy if it had a higher deductible would have been more or less than the premium cost savings from having that larger deductible. For instance, on automobile insurance, the preliminary results seem to indicate the out-of-pocket expenses would be more than the premium savings.
FEMA Update	Hume reported Shelby Energy is still owed \$113,441.11 in FEMA approved reimbursement for the January 2009 ice storm.
Audit Proposal	Hume discussed the proposal from Allen Zumstein to perform the 2012 audits. After discussion, upon motion duly seconded, the Board approved his proposal to perform the audit for Shelby Energy at a cost of \$8,200 and for Shelby Energy Service Corporation at a cost of \$3,200.
Board Policies	Tennill presented for consideration and approval the following Board policies, which have been reviewed by legal counsel: <ul style="list-style-type: none"> BP 911 – Conduct of Employees (revised based on input from previous meeting) BP 305 – Rural Economic Development Assistance BP 310 – Inventory Control BP 311 – Financial Planning BP 312 – Purchase and Use of Cooperative Vehicles

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BP 313 – Purchasing of Goods and Services
 BP 316 – Accounts Receivables and Receipts
 BP 317 – Disposal of Scrap Metal
 BP 318 – Collections and Write-offs of Bad Debts

Upon motion, duly seconded these policies were approved.

401k Plan Tennill explained that NRECA requires a resolution every five years authorizing the amendment and reinstatement of the 401k pension plan. She presented two proposed resolutions to the Board. Upon motion duly seconded, both resolutions were approved and copies are attached to these minutes.

Economic Development Fund Tennill reviewed an application from the Kentucky Little River Watershed for a loan from Shelby Energy under the Economic Development Fund. This fund consists of money originally provided to Shelby Energy for use as a revolving loan fund for rural economic projects. As each loan is repaid, the principal and accrued interest is re-deposited into that fund. The fund can only be used for economic development projects.

The Little Kentucky River Watershed is a taxing district in Henry County. It has requested a \$50,000 loan to repair weather-related damage. The proposed payback will be over five years. Martin recommended a 1% interest rate due to the shorter term and smaller amount of the loan, along with collateral of two certificates of deposit covering the entire balance of the loan, therefore there is almost no risk associated with the repayment of this loan. After discussion, upon motion duly seconded, the loan was approved on these terms.

Director Taylor, being a member of the Watershed's Board, abstained from the discussion except for answering factual questions, and abstained from voting on the loan.

2012 General Capital Credit Retirement Martin recommended the Board retire 100% of the 1979 capital credits and 25% of the 2011 capital credits, for a total general capital credit payment to the members of \$366,953.21, to be paid later this year. This is approximately \$30,000 more than was paid last year. After discussion, upon motion duly seconded, the proposal was approved.

Executive Session The Board entered into an executive session with the attorney and Martin to discuss employee and district office matters. After emerging from the executive session, the Board authorized the renewal of the existing lease on the Bedford office for five years, at a monthly rate of \$525, with the Landlord paying the utilities.

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KAEC Director Report Stevens reported the aggressive cost-cutting measures implemented by KAEC are starting to take effect and have produced a very strong turn around in its financial condition. The budget had predicted an \$800,000 loss, whereas KAEC has instead posted a \$70,000 profit so far this year.

EKPC Director Report Martin presented the EKPC Director report in Stratton's absence, who had previously departed the meeting due to another pressing commitment. Discussion continues regarding whether, and upon what terms, distribution cooperatives will be permitted to purchase power from suppliers other than EKPC. EKPC continues to work to comply with the management audit recommendations.

President & CEO's Report Martin presented the President & CEO's report. Among other topics, she mentioned the possibility Shelby Energy may wish to resume contributing to the CFC Territorial Integrity Fund, which it has done in the past. This fund exists to assist cooperatives who are forced into legal confrontations to prevent incursions by neighboring utilities into their service territory.

There being no further business, the meeting was adjourned. The next regular Board meeting will be on October 23, 2012 at 9:00 a.m.

ROGER TAYLOR, JR., Secretary-Treasurer

Approved:

ASHLEY CHILTON, Chairman

**SHELBY ENERGY COOPERATIVE, INC.
Shelbyville, Kentucky**

POLICY NO. 900

EMPLOYMENT OF PERSONNEL

I. OBJECTIVE

It is the commitment of Shelby Energy Cooperative to ensure fair and equal treatment for everyone in our employ. We believe employment, training, promotion, discipline, compensation, and all other decisions related to employment should be made without regard to race, age, religion, gender, color, national origin, creed, disability, or military status.

Our selection, training, promotion, and other employment practices are based on job-related qualifications. We strive to comply with all federal, state, and local laws that regulate employment practices.

Shelby Energy Cooperative is committed to compliance with laws that address the employment of qualified persons with a disability. To this end, we conduct all recruitment in an ethical, professional, and non-discriminatory manner. Those requiring assistance in completing an application form or accommodation to participate in employment interviews, because of disability, will be accommodated. Efforts are made to accommodate those who can perform the essential functions of the job to enjoy employment opportunities with Shelby Energy.

II. CONTENT

- A. This policy covers all employment practices including, but not limited to: hiring, upgrading, demotion, transfer, recruitment, termination or other forms of compensation and selection for training programs.
- B. A "full time," "regular," and/or "active" employee, as those terms are used in these policies, is defined as a person who is scheduled for a work week of not less than forty (40) hours for a period of fifty-two (52) weeks per year, and is eligible for the employee benefit plans.
- C. A "close relative" of Shelby Energy employees or directors shall not be employed by the Cooperative on a permanent basis. "Close relative" shall be defined as a person who by blood or in-law, including half, foster, step and adoptive kin is either a spouse, child, grandchild, parent, grandparent, brother, sister, aunt, uncle, nephew, or niece of the employee or Board Member.
- D. Approval from the President and Chief Executive Officer is required to create a new position or fill a vacant position. A written job description must accompany the request.

- E. The minimum educational and experience requirements will be stated in the written job description.
- F. When an existing position becomes vacant, or a new position is created, this position will be announced inside and outside the Cooperative. It will be posted internally on bulletin boards and/or in the Cooperative Intranet, accessible to employees. Internal and external candidates will receive equal consideration.

External sources used may include schools, state employment services, specialized training facilities, www.E3ky.gov job bank, other Internet sites, newspapers, job fairs, employment recruiters, and other recruiting sources within the recruiting area.

- G. The selection of employee(s) to fill a position will be the responsibility of the hiring manager, with guidance and approval of the President and Chief Executive Officer and human resource representative.
- H. All candidates must complete and sign a Shelby Energy Cooperative application form. Those who refuse to sign an application form may not be considered.
- I. The employment interview procedure must be structured and comply with the *Guidelines for Selection* established by the Equal Employment Opportunity Commission.
- J. Pre-employment testing may be requested for candidates who meet the minimum requirements and who are considered active candidates for employment, after the interview is complete.
- J. Candidates for whom an employment offer will be made are required to have a pre-employment drug/alcohol screening test. Prospective employees will be required to disclose any prescribed medication and other medicines used, when such information is requested by the Medical Review Officer, prior to the screening procedure. A positive drug screen will be an immediate disqualification for employment.
- K. The employment offer will be made in writing after conferring with the President and Chief Executive Officer.
- L. Certain positions require the completion of a post-offer physical examination to determine if the candidate can perform the essential functions of the position. The physician conducting the examination will be the final authority regarding physical ability. At the recommendation of the physician, the employment offer may be withdrawn.

- M. Each new employee will be provided with *New Employee Orientation Training* at which time the employee benefit program will be explained. Participation in specified Shelby Energy benefit programs is available to all employees, based on employment status.
- N. All regular employees are considered in training for the first six months of employment. Employees may be dismissed at any time during or after the training period unless termination is covered by a contract.
- O. Should two (2) employees marry after becoming employed at Shelby Energy, only one of the employees will be allowed to continue their employment with the Cooperative. If the affected employees cannot decide which of them will terminate, the employee with the least service to the Cooperative will be terminated.
- P. A non-bargaining unit employee, who left the Cooperative in good standing and was rehired, may receive credit for previous years of service toward vacation, provided the period of previous service was greater than the period of time between the date the employee left the Cooperative and was rehired. The decision to grant previous vacation credit will be at the sole discretion of the President and CEO.
- Q. A non-bargaining unit new hire with more than five years of service to a utility similar to Shelby Energy Cooperative, may be granted paid vacation credit as a condition of employment at a rate greater than other new hires. The level of benefit granted will be at the sole discretion of the President and CEO and must be approved prior to the time the offer letter is delivered to the prospective employee.

III. RESPONSIBILITY

The President and Chief Executive Officer is responsible for the administration of this Policy.

Adopted: May 27, 1965
Revised: March 25, 1976
June 23, 1988
April 26, 1990
May 27, 1999
July 26, 2001
May 17, 2007
September 22, 2009

SHELBY ENERGY COOPERATIVE, INC.
Responses to January 21, 2011 Member Questions

Question 1: Who requested and approved the use of two SE employees and a bucket truck to install Christmas lights at the Trimble County Courthouse during regular working hours on November 22, 2010 (2 ¼ hours)? Will this expense be reimbursed to SEC?

Question 1 Response: The Trimble County Judge Executive made this request.

A community leader or community organization representative may contact the Cooperative with a request for assistance. Any management employee has the authority to consider and approve a minor request based on coordination with the appropriate department, its management staff, and the availability of the required employees and equipment.

No, the expense won't be reimbursed. Shelby Energy Cooperative doesn't charge communities or community organizations for minor assistance of this type.

Listed below are some of the activities, but not all, where employees participate and equipment is provided by the Cooperative:

- High voltage demonstrations for schools
- High voltage demonstrations for state highway departments
- Various presentations at emergency management meetings
- Presentations at the Cattleman's Association meetings regarding farm safety
- Presentations and demonstrations for fire and EMS departments
- Participation of employees and equipment displays at Career Day held at the Shelby County Fairgrounds
- Participation in the Community Showcase at Shelby County High School
- Employee participation with Rotary in Shelby, Henry & Trimble counties, Leadership Shelby, Shelby County Professional Women, etc.
- Employees hanging flag ropes on flag poles at various organizations and schools in the communities
- Repair of lights for various parks and schools for athletic and other functions
- Hanging quilts for participants involved in the program supported by the extension offices
- Participation in the Shelby County Christmas parade
- Setting poles for the Ruritan Club horse show facility

Shelby Energy is an advocate for community involvement. We are proud to support the communities we've served for more than seventy years without charging for our participation or assistance. Shelby Energy has no plans to charge for these minor activities in the future.

Question 2: Has a woman or minority member ever been appointed to the Board of Directors? Why not? How many applications were filed for the current Board vacancy? Are any women or minority members being considered for the vacancy or if the appointment has been made were women or minorities a part of the selection criteria?

Question 2 Response: No woman or minority member has in the past applied for or served on the Board of Directors for Shelby Energy Cooperative. All members expressing an interest in a board position have been and will be considered.

The Cooperative received eleven (11) applications for the District III board position. All members who submitted an application will be given equal consideration regardless of their race, religion, political affiliation or gender.

Question 3: What is the Board's policy concerning DUI convictions of employees, counsel, subcontractors and Board of Directors? Is there a zero tolerance for such behavior?

Question 3 Response: Board policies concerning alcohol and drug use in the workplace for employees and others working on the Cooperative distribution system were provided with the responses issued for the November 18, 2010 questions. This information referenced the Department of Transportation and those who hold commercial drivers licenses (CDL). Shelby Energy follows these policies.

Other than these policies there are no specific policies concerning DUI convictions. The bylaws state no person who has been convicted of a felony can serve as a director. There are no such prohibitions regarding misdemeanor traffic offenses, including DUI convictions. Shelby Energy follows the guidelines referenced above.

Question 4: Does SE have a local contract for its heating and air conditioning maintenance requirements? Is this a contract that is put out for bidding? The Shelby Energy website has recently listed requests for bidding on lawn mowing/Landscaping services with grounds maintenance, excavating bulldozing work and stump grinding/removal. Was the heating/AC bidding contract left off for a reason? Is there a conflict of interest with the current contractor?

Question 4 Response: Yes, Shelby Energy has a local contract for its heating and air maintenance.

Yes, three proposals were received from local contractors in late 2009 for (1) a maintenance contract and (2) the replacement of heating and

and air equipment that was no longer functional. The current contractor replaced the equipment for significantly less money than the other contractors. The current maintenance contract with that same contractor has also resulted in significant savings compared to the other proposals.

The maintenance contract is reviewed annually. Should an increase be applied to the contract that reduces the savings to within the range of the other proposals or service is not satisfactory, the bid process will be initiated. Otherwise, the regular bid process will be initiated five (5) years from the January 15, 2010 date of the current maintenance contract.

No, a conflict of interest doesn't exist with the current contractor. Prior to voting on the contract, full disclosure was provided to the Board of Directors that the recommended contractor was a spouse of a current employee. The contractor's knowledge of the heating and air systems as initially installed many years ago and the savings recognized on behalf of the Cooperative was considered before the recommendation of using this contractor was approved by the Board.

Question 5: In answering "Member's information request dated August 19, 2010", you stated that during the remodeling process "significant mold was found spread over the entire floor beneath the carpet when it was pulled up. That was not healthy for our employees". What safety precautions were taken by the workers and for the employees using the area involved to prevent the inhalation of damaging mold spores? Did the bid contractor have liability insurance?

Question 5 Response: The contractor employees used masks during the remodeling project as determined necessary by the contractor. Of course, the contractor that performed the work had liability insurance.

Question 6: How do you justify the use of SE crews for routine replacing security light bulbs on an overtime basis (time and one-half)?

Question 6 Response: Shelby Energy places great emphasis upon, and makes no apologies for, the safety of our members.

When the normal work schedule prevents completion of outdoor lighting repairs in a timely manner, work may be performed after regular business hours to meet the needs of our members, especially where lighting is considered a security factor. Repairs to outdoor lighting after regular work hours occurs infrequently and isn't "routine".

Question 7: How do you justify the submission of a \$333,301.00 error to FSC (Case # 2010-00244) in calculating the anticipated annual cost of operation after completion of all Current Work Projects (2010-2014)?

Question 7 Response: The consulting engineer was dealing with a significant amount of data and information. He inadvertently listed the wrong amount in the application. However, supporting schedules were attached that reflected the correct amount which allowed for the PSC to recognize the difference.

Shelby Energy performs daily functions on the power of its employees, contractors and consultants who perform their jobs well and with dedication and commitment. They are human and honest mistakes occur.

Question 8: Since weather conditions did not permit the attendance of members at the December 16, 2010 monthly meeting, it is requested that Chairman Busey put in writing his answer to question 4 from the "member information request, dated November 18, 2010". The question was "When member-customers attend monthly meetings, they are referred to as guests. However, they are not provided an agenda of the meeting or any other handout information that is presented. Why not?".

Question 8 Response: A response was provided in the November 18, 2010 set of answers to questions for why guests/members are not provided information: "The meeting is a meeting of the Board of Directors. Employees in attendance are referred to as Management and Staff and all others are referred to as guests." "A cooperative member is, in many ways, similar to a shareholder of a public corporation: shareholders who attend board meetings as guests are not provided the written information given to the board members."

Your question contains an honest mistake. A member was present at the December 16, 2010 meeting. Chairman Busey offered an apology for the unintended offense of members being referred to as guests in the past and assured the member attending the December 16, 2010 meeting that he would make a sincere effort to introduce members as members or as member-guests in the future.

Question 9: In your response to "Member's Information Request, dated August 19, 2010" you stated that the Coop will have 3 VP positions; VP of Finance and Administration, VP of Customer Service and Marketing and VP of Engineering and Operations, You are advertising for a Manager of Engineering and not a VP of Operations and Engineering; Does that indicate that you now have two positions, a Manager of Operations and a Manager of Engineering? Has the Manager of Operations been filled on a temporary or permanent basis? Is the VP for Customer Service and Marketing position vacant? Was this position re-advertised when the vacancy occurred?

Question 9 Response: Yes, Shelby Energy Cooperative is advertising for a Manager of Engineering. It is the Cooperative's goal to hire an electrical engineer who is or will become registered as a professional engineer in the Commonwealth of Kentucky. The Cooperative will have two permanent positions of management; one for Engineering and one for Operations. There are plans at this time, at a later date, to have the two departments combined into one department, Engineering and

Operations. This department will be under the direction of the VP of Engineering and Operations.

The VP of Customer Service and Marketing position is currently vacant. The vacancy was not advertised. The Cooperative is re-evaluating the organizational structure at this time as a potential cost-saving matter.

Business organizations are dynamic and do not stand still as current employees grow and progress and new employees with other talents and skills join a company. As various developments take place within the electric utility industry for the future, employees and the organizational structure will be assessed to meet those changing needs.

Question 10: Is there a permanent or temporary position titled "Field Supervisor" now at SEC? Is it filled?

Question 10 Response: The Field Supervisor position has been a permanent position since October 1, 2009 but became vacant when the employee holding the job moved to another position. It was filled effective 11/8/10.

Question 11: Were any gifts, bonuses or longevity awards given to any Employees, Board Member, Subcontractor, Counsel or any other associate of Shelby Energy during 2010?

Question 11 Response: Yes. Decade awards for every 10 years worked with the Cooperative have for many, many years been presented to any eligible employee, director and attorney on an annual basis.

Question 12: On January 14, 2011 PSC approved another average residential rate increase of \$5.85 per month for SE member-customers. Why was our increase the most of the Cooperatives served by EKPC? When will we expect to find this pass through rate increase from EKPC on our bill? It appears that we can expect more rate increases from EKPC in the near future. Any ideas for our planning purposes?

Question 12 Response: Shelby Energy had a larger increase because the average consumption of Shelby Energy's residential members is higher than the other cooperatives in the EKPC system. The average for all systems served by EKPC was approximately 1,170 kWh with Shelby's average kWh use by a residential member being approximately 1,476. Higher usage results in a higher dollar-amount rate increase. The increase will show on bills that have energy usage reflecting the PSC approval date of January 14, 2011.

It appears future increases in the cost of the fuels needed to produce electricity are inevitable, but the timing and amount is impossible to predict. The future cost increases to comply with ever-increasing stringent environmental standards is also impossible to accurately predict. The recent general rate increase obtained by Shelby Energy

was the first in more than two decades. Shelby Energy will continue to do everything possible to restrain future rate increases as it has done in the past.

Should future increases take place at the power-supply level, Shelby Energy will notify its members in as timely manner as possible. Normally, notice is provided no less than six months prior to the date of the effective increase.

Member Information Request

Dated: November 18, 2010

Question 1 (a) What is the status of the Board of Directors vacancy?

Response 1 (a) The Board plans to have the vacant board of director position for District III filled no later than the regular board meeting scheduled for March 17, 2011.

Question 1(b) What are the specific requirements for member nominations?

Response 1(b) We assume you are inquiring about the current board vacancy, rather than a regular board of director election. Any candidates must meet the qualifications set forth in Section 4.4 of the By-Laws.

The notice provided below has been placed in the newspapers and posted at the Shelbyville and Bedford offices, and will be listed on the Cooperative website as of December 1, 2010.

Shelby Energy Director Position

The Board of Directors for Shelby Energy Cooperative, Inc. is preparing to fill an open director position for District III which includes all of Trimble County and those portions of Carroll and Oldham Counties served by the Cooperative.

Interested members of District III who meet the qualifications as provided in Article IV, Section 4.4 of the Bylaws must provide the following information to be considered as a candidate for the position:

1. A cover letter stating their interest and contributions towards serving the membership as a Board member;
2. A fully completed Shelby Energy Application.

A copy of the Bylaws and the Application may be obtained from the Shelby Energy Cooperative web site at www.shelbyenergy.com or by contacting Gay Tennill at 1-800-292-6585.

Applications must be submitted to Shelby Energy Cooperative no later than January 10, 2011 and marked to the attention of Gay Tennill at Shelby Energy Cooperative, 620 Old Finchville Road, Shelbyville, KY 40065.

As stated in the August 19, 2010 response to Question 10, the Board will regard any candidate that resides in the appropriate district and who submits their name along with the information provided above.

Member Information Request
Dated: November 18, 2010

Additional part of Question 1 This information was previously requested at the August 19, 2010 special meeting?

Additional Response to Question 1 Your statement this information was previously requested is not accurate and implies the question which were asked were not answered. Here are the August 19, 2010 questions and the answers given:

Question 10: When will the BOD vacancy be filled? Is there any consideration for membership input for naming a candidate(s)?

Response: a. The Board is reviewing the process for appointing a member of the Board when a retirement or resignation takes place prior to the end of a board of director's term. The Board has plans to fill the position no later than the second quarter of 2011.

b. The Board will regard any candidate that resides in the appropriate district and who submits their name.

Question 2 (a) Is the Kentucky Ratio Trend Analysis for 2009 available to members customers?

Response 2 (a) We are unable to provide the information at this time. We are currently seeking authorization from the author of the analysis report.

Question 2(b) Is the report that was presented at the August 19, 2010 meeting available for member-customers to review?

Response 2(b) Refer to Response 2 (a)

Question 3

Why not publish the member customer questions that have been submitted along with your answers in the Kentucky Living Magazine and include the same on the Shelby Energy information website?

Member Information Request
Dated: November 18, 2010

Response 3

The Kentucky Living Magazine is not devoted exclusively to the members of Shelby Energy Cooperative or any special interest group. It is inappropriate to use the space designated to Shelby Energy as a forum for responses to any specific group. Our goal is to provide information that will be of interest to the broad base of Cooperative members and focus on a variety of topics concerning energy, safety, conservation and other mandatory notifications.

Your suggestion the responses be posted to the website will be referred to the Board of Directors at its December meetings.

Question 4

When member-customers attend monthly Board of Director's meetings, they are referred to as guests. However, they are not provided an agenda of the meeting or any other handout information that is presented. Why not?

Response 4

The meeting is a meeting of the Board of Directors. Employees in attendance are referred to as Management and Staff and all others are referred to as guests. One reason handout information is not shared with guests is the often confidential information is contained in those handouts. Another reason is that board members consider in its entirety a great deal of information in making their decisions. Distributing voluminous information would allow the use of isolated bits of information out Of context, which mis-information would in turn require extensive cooperative resources to correctly explain. This is a standard business protocol for board meetings and not exclusively a Shelby Energy Cooperative practice.

A cooperative member is, in many ways, similar to a shareholder of a public corporation: shareholders who attend board meetings as guests are not provided the written information given to the board members. Shareholders elect Directors who run the corporation, not the other way around. A member's role of a cooperative is similar to that of a shareholder. Members can contact any of the Board members regarding their concerns and are free to attend Board meetings, unlike corporate shareholders. Members are free to run for office as a Director and express their preference in all Board elections by voting.

Mr. George Busey, Chairman, will address the question of providing agendas to guests at the next regular board meeting scheduled for December 16, 2010.

Member Information Request
Dated: November 18, 2010

Question 5

Why is the Monthly Board meeting agenda not published on the S B informational website?

Response 5

Publishing the monthly agenda is currently being considered by the Board of Directors.

Question 6

When four employees were playing golf (Sponsored by S B on August 27, 2010) while on the member customers' payroll was is it considered work or entertainment?

Response 6

This was a business function as answered in the September 16, 2010 response to Question 1 as follows:

Question 1: Were four Shelby Energy staff members paid to play golf on Friday August 27, 2010? Was this a local or an out-of-town event? What was the expense of this outing and how did this benefit the members customers in lowering our electrical bill?

Response: The four employees who participated in the golf event on Friday August 27, 2010 were paid their regular salary. Three of the four are salaried employees who receive a fixed paycheck no matter how many hours they work, including emergencies. The fourth employee did not work any extra hours. The event was sponsored by another utility company, held near Lexington and focused on economic development and key accounts. Shelby Energy paid \$100.00 to participate. This event helped our employees observe first-hand an outstanding system of strengthening relations with key business accounts (who help keep rates low through large consumption). Finally, it helped build relationships with employees of other utilities, on whom we depend for backup during disasters.

Question 7

At the June 2, 2010, P S C public hearing in Frankfort, you told the Commissioners that the A I M project was being funded by OUR LOAN PLAN? Was this a R U S loan?

Response 7

Yes. The AMI project is being funded by drawing the unused portion of a prior RUS loan. The Cooperative had already completed construction of distribution plant for which the unused

Member Information Request
Dated: November 18, 2010

portion of the loan had been intended, using customer bill payment revenue rather than borrowed money to reduce interest expense. The amount of the unused portion could be drawn at any time based on the needs of the Cooperative.

Electric cooperatives have access to loans provided exclusively for cooperative use by the US Government, as provided by law. You may research the RUS loan program. Here is a web site to visit: <http://www.usda.gov/rus/electric/loanS.htm>
It will assist you in understanding how the RUS program works.

Question 8

Shelby Energy was one of seven Energy Cooperatives selected to receive (\$264,000) as a grant from the Department for Energy Development and Independence and the ONLY ONE TO REJECT THE OFFER. Two DEDI officials stated that they were surprised by the rejection. It appears as a lost opportunity to save members customers monies through a project designed to create jobs, reduce the peak load on utilities' grids, improve overall system reliability and reduce carbon dioxide emissions. Was a P S C "certificate of public convenience and necessity" for the AMI Project required to meet the grant's qualification?

Response 8

The decision to participate in available grant opportunities is based on whether the overall outcome will benefit cooperative members. This means considering how many staff resources will be needed, and whether the return on staff, time and money invested in the grant will provide a return that makes sense. With only 15,000 members, Shelby Energy is a small cooperative which cannot expend the resources other cooperatives have available. Our decision was that it was unwise to engage in any project (including those that look like they are giving away "free money") when the grant would cost the Cooperative more than the scope of the grant and detract from the basic responsibilities of the paid staff. We are most interested in using our staff resources towards providing continuous, uninterrupted and reliable energy to our members.

Since Shelby Energy did not have sufficient existing staff to handle the extensive custom record keeping and reporting requirements of the grant, either an additional employee would have been hired or the work contracted out. A contractor was projected to cost the same or more than the grant. Hiring a new employee with the required expertise would in the long run have also cost more than the grant.

Shelby Energy is one of at least two cooperatives that have withdrawn from a DEDI grant. No, a Certificate of Public Convenience and Necessity was not required as a qualification.

Member Information Request
Dated: November 18, 2010

-
- Question 9 (a) How long is the probation period for newly hired employees?
Response 9 (a) Shelby Energy has a six month training period for newly hired employees.
Question 9 (b) Is it six month for all administrative and field employees?
Response 9 (b) The six month training period is applicable to administrative/office and field employees.
Question 9 (c) During the probation period are these new employees allowed any paid vacation time?

Response 9 (c) No paid vacation time is permitted during the six month training period for administrative/office or field employees.

Question 10

Have there been any reported cases of unauthorized use of a Shelby Energy credit card in the last six months?

Response 10

No. If anyone is aware of any unauthorized use of a Cooperative credit card, the Board and management would appreciate receiving that information to investigate and take the appropriate action.

Question 11 (a) How often are employees tested for drugs and alcohol use while on the job?

Response 11(a) Shelby Energy Cooperative complies with the Drug Free workplace Act of 1988. Employees in safety sensitive positions, as described in the law, are mandated to have four separate types of drug/alcohol testing. To comply with both the Drug Free Workplace Act and the Department of Transportation drug and alcohol testing, all employees are tested as provided below:

1. Pre-employment testing is mandated and a positive outcome is an immediate disqualification of employment.

Member Information Request
Dated: November 18, 2010

Response 12 (a) Yes, The Civil Rights Act of 1964 and the complementary laws in Kentucky mandate equal opportunity employment for private employers, such as Shelby Energy Cooperative.

Question 12 (b) Please provide a copy of the rules and regulations provided employees.

Response 12 (b) A copy of the following Board Policies governs employment processes and procedures:

- 900 — Employment of Personnel
 - 901 — Employment Practices
 - 902 — Wage & Salary Administration
-

Question 12 (c) Are bargaining unit employees allowed to apply for management positions when they meet job qualifications?

Response 12(c) Yes.

Question 12(d) What are your hiring policies and where are they recorded? Please attach a copy.

Response 12(d) Hiring policies are recorded as Board Policies. Refer to Item b.

Question 12 (e) Are all open positions that are to be filled announced to current employees?

Response 12 (e) Yes.

During the test year (for rate making purposes; June 2008-2009) Shelby Energy paid seven directors fees and expenses totaling \$89,234.00. The P S C excluded \$43,602.00 of this expense which was for life insurance premiums, per dimes and annual meeting expenses. It was for directors who were not delegates or alternate delegates to the Ky. Association of Electrical Cooperatives (K-ABC) and BK-PC annual meetings that were included on this tab.

Question 13 (a) Who were the seven directors and who were the official delegates?

**Member Information Request
Dated: November 18, 2010**

Response 13 (a) The seven directors and official representatives during the test year (August, 2008 through July, 2009) are listed below as provided in Exhibit 10 of the rate application. In addition, a list of delegates and alternate delegates for the test year are provided.

President/Chairman

George Busey	4390 Vigo Road	Bagdad, KY 40003
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Vice President/Vice Chairman

Ashley Chilton	6041 Castle Highway	Pleasureville, KY 40057
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Secretary-Treasurer

Roger Taylor, Jr.	177 Lake Jericho Road	Smithfield, KY 40068
Joe Butler	10664 Hwy 421 N.	Milton, KY 40045
R. Wayne Stratton	115 Bluebird Drive	Shelbyville, KY 40065
Randy Stevens	849 New Hope Road	Bedford, KY 40006
RickRand*	P. O. Box273	Bedford, KY 40006

*retired and was replaced by Randy Stevens in April, 2009

East Kentucky Power Cooperative representative

R. Wayne Stratton

KAEC representative

George N. Busey

NRECA representative

Ashley Chilton

Test Year Delegates and Alternate Delegates

<i>Organization</i>	<i>Delegate</i>	<i>Alternate Delegate</i>
East Kentucky Power (2008)	Rick Rand	Roger Taylor
NRECA	Wayne Stratton	Debra Martin
CFC	Debra Martin	Wayne Stratton
Federated	Debra Martin	Wayne Stratton
NRTC	Debra Martin	Wayne Stratton
KAEC	George Busey	Joe Butler
East Kentucky Power (2009)	Ashley Chilton	Roger Taylor

Question 13 (b) What is the Boards' justification for this unnecessary expense?

Response 13 (b) Answers to this inquiry were provided in prior responses dated March 18, 2010 and September 16, 2010 for questions 15 and 7 respectively.

**Member Information Request
Dated: November 18, 2010**

Response 13 (c) Yes.

Question 14

How did Shelby Energy estimate legal fees related to administration of issues resulting from the bargaining unit contract to cost \$8,500.00 annually?

Response 14

The estimate of legal fees was based on the number of union grievances that have been processed for the calendar year of 2010 along with those that have been considered for arbitration during the same period. Having a contract is something very new for Shelby Energy union employees and management, so there has been a period of adjustment, particularly with respect to the number of filed grievances. We expect the costs to stabilize when the level of understanding the terms of the agreement increases for those who represent the employees and those who manage the contract on behalf of Shelby Energy.

Question 15 (a) Does the P S C include promotional advertising, SPONSORSHIP, employee picnic and nominating committee expenses for rate making purposes?

Response 15 (a) Not knowing the specific expenses as referenced in the question as “SPONSORSHIP”, the response below includes expenses for newspaper, radio and bill insert communications and advertising along with the youth tour program, scholarships, community events, donations to *WinterCare*, educational and other miscellaneous activities.

Promotional advertising is included for rate making purposes when safety is incorporated as part of the message; the same criteria would apply to other sponsorships supported by Shelby Energy; the employee picnic would not be included as part of rate making; the nominating committee expenses would be included as part of rate making.

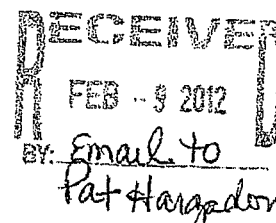
<u>Question 15 (b)</u>	How much was spent for these items in	2009?
<u>Response 15 (b)</u>	<u>2009 Actual</u>	<u>Amount</u>
	Promotional advertising	10,181
	Sponsorship*	24,475
	Employee picnic	1,362
	Nominating committee	<u>119</u>
		\$36,137

*Scholarships in the amount of \$5,000 were not issued by year-end

Member Information Request
Dated: November 18, 2010

Question 15 (c) How much was budgeted for these items in 2010?

<u>Response 15 (c)</u>	<u>2010 Budget</u>	
Promotional advertising		11,000
Sponsorship		30,350
Employee picnic		1,500
Nominating committee		<u>150</u>
		\$43,000



February 16, 2012 Questions for S E Board of Directors

In response to questions submitted on August 19, 2010 the following amounts were reported spent for repairs, office renovation and furnishings at the main office location.

2008- \$38,533.98

2009- \$48,723.53

2010- \$99,611.48-through 08/27/10

What was the total amount spent for 2010?

What was budgeted for 2011 and what was the total amount spent?

What was the total cost plus installation of the 2 new heating and AC units that were installed in 2011?

Was the lowest bid accepted? If not explain. What are the warranties of these units? What is the energy efficiency rating of these new units?

What was spent for exterior painting in 2011? Was this a bid project? Was the low bid accepted?

What was spent for repair and repaving of parking lots and driveways surfaces at the main office location in 2011? Was the low bid accepted?

In response to November 16, 2011 Question 1; it was stated that contractors are selected by competitive bidding process?

Is there an open bidding process? Are bidders invited to be present at the bid opening?

Who does the engineering on construction projects?

Who decides which projects will be done by Shelby Energy employees, and which projects are to be contracted out?

Who at Shelby Energy is responsible for oversight of the construction work that the Coop contracts out? (Such as Heating and A C replacement and maintenance, Paving of parking lots, Painting , Right of way clearing and electrical sub contractors).

Did any employee receive a performance bonus or gift in 2011?

What amount has been budgeted for the Annual Membership Meeting that is to be held in June 2012 in Henry County?

Since over 5,400 members live in Shelby County; Why is the annual meetings not rotated among the three districts? Henry County maybe somewhat geographically located but NOT centrally located by membership numbers. Henry County meetings require 8800 members to travel out of their districts. Shelby County meetings would only require 6550 members to travel out of their districts. Thimble County meetings would require 8700 members to travel out of their districts. Shelby County has many facilities to choose from for an annual meeting so I have been informed.

Is there any consideration for redistricting the 10 county territory? District 1 has 2 directors representing approximately 5500 members. District 2 has 3350 members with 2 directors. District 3 has 2 directors representing 3200 members. Should District 1 have another director?

In your reply to the August 19, 2010 member questions it was stated that " the board of directors began considering changes to the bylaws regarding the method of director elections but decided against any changes just prior to the Annual Meeting to avoid any appearance of an effort to affect the result of the election". Again we ask will there be any consideration in the near foreseeable future given to changing the bylaws to prohibit proxy votes?

Is a current staffing chart with the duties of employees available to members?

Can any member obtain a list of Shelby Energy Member-customers upon request by agreeing to pay for the cost of printing?

SHELBY ENERGY COOPERATIVE, INC.
Responses to February 16, 2012 Member Questions

Question 1: What was the total amount spent for 2010 for repairs, office renovation and furnishings at the main office location?

Question 1 Response: \$106,443.00

Question 2: What was budgeted for 2011 and what was the total amount spent?

Question 2 Response: Budgeted amount: \$123,419.00; Amount spent: \$83,733.00.

Question 3: What was the total cost plus installation of the 2 new heating and AC units that were installed in 2011?

Question 3 Response: Total installation costs: \$28,602.00.

Question 4a: Was the lowest bid accepted? If not, explain.

Question 4a Response: The middle of the three bids was accepted as the lowest and best bid based on various factors as follows:

1. Bid amount;
2. Reasonableness of bid;
3. Stability of vendor;
4. Dependability of vendor;
5. Prior experience with vendor (including cost and effectiveness of prior repair efforts);
6. Service quality of work;
7. Support of completed work;
8. Maintenance of equipment;
9. Other factors that may apply to specific projects or jobs

Question 4b: What are the warranties of these units?

Question 4b Response: 5 years on the compressor, with 1 year on parts and labor.

Question 4c: What is the energy efficiency rating of these new units?

Question 4c Response: SEER 11.15. Higher efficiency units were not chosen because of the space limitations of the location where they needed to be installed and because of the higher installation cost.

Question 5: What was spent for exterior painting in 2011? Was this a bid project? Was the low bid accepted?

Question 5 Response: \$7,558.00. It was a bid project. Three bids were obtained. The lowest and best bid was accepted based upon the applicable factors listed in the Response to Question 3 above.

Question 6: What was spent for repair and repaving of the parking lot and driveway surfaces at the main office location in 2011? Was the low bid accepted?

Question 6 Response: \$43,810.00. Three bids were obtained. The lowest and best bid was accepted based upon the applicable factors listed in Response to Question 3 above.

Question 7: Is there an open bidding process? Are bidders invited to be present at the bid opening?

Question 7 Response: The competitive bidding process is an informal process that involves more than just the lowest bid price in the evaluation and selection of the vendor. Generally, bids from three area contractors are obtained. Some potential bidders are not requested to submit bids due to concerns about their safety practices. Since the lowest bid amount is not the only factor determining selection of the bid, those bidders are not present at the opening of bids.

Question 8: Who does the engineering on construction projects?

Question 8 Response: Sometimes it is performed by Shelby Energy employees and sometimes it is performed by outside contractors, depending upon the circumstances.

Question 9: Who decides which projects will be done by Shelby Energy employees, and which projects are to be contracted out?

Question 9 Response: Electric distribution construction projects are assigned to contractors or cooperative employees based on the scope of the job along with the equipment and labor needed to perform the

project in the safest and most cost effective manner for the cooperative and its members.

Question 10: Who at Shelby Energy is reasonable for oversight of the construction work that the Co-op contracts out? (Such as Heating and AC replacement and maintenance, paving of parking lots, painting, right-of-way clearing and electrical subcontractors.)

Question 10 Response: Oversight of electric distribution construction work is primarily performed by the VP of Operations & Engineering in conjunction with the assistance of the Manager of Field Support Services and the Field Supervisor in regards to construction site evaluation and necessary right-of-way clearing for the job.

Oversight of the maintaining right-of-way work on Shelby's system is primarily performed by the Field Supervisor.

Oversight of other contracted work varies, depending upon the nature of that work.

Question 11: Did any employee receive a performance bonus or gift in 2011?

Question 11 Response: No performance bonuses or gifts were paid in 2011.

Question 12: What amount has been budgeted for the Annual Membership Meeting that is to be held in June 2012 in Henry County?

Question 12 Response: \$30,350.00.

Question 13: Since over 5,400 members live in Shelby County, why is (sic) the annual meetings not rotated among the three districts?

Question 13 Response: Shelby Energy used to rotate its annual meetings between Henry, Shelby and Trimble counties. It is more expensive to rotate the meetings because the setup at each location is different. The Board decided several years ago as a cost-saving measure to begin holding the annual member meeting at the renovated and centrally located Henry County High School every year. Relatively fewer Trimble County residents tended to attend when the meetings were held in Shelby County, and relatively fewer Shelby County members tended to attend when the meetings were held in Trimble County. Historically, the largest overall number of members have attended Henry County meetings as opposed to Trimble or Shelby County meetings. This action also makes Shelby Energy consistent with most other Kentucky electric cooperatives which do not rotate their member meetings.

Question 14: Is there any consideration for redistricting the 10 county territory?

Question 14 Response: Redistricting has not been seriously considered. While two directors must be residents of each district, all members from throughout the Cooperative vote on each director. Therefore, each director represents all of the members, not merely the members in his or her home district.

Question 15: In your reply to the August 19, 2010 member questions, it was stated that "the board of directors began considering changes to the bylaws regarding the method of director elections but decided against any changes just prior to the Annual Meeting to avoid any appearance of an effort to affect the result of the election". Again we ask will there be any consideration in the near foreseeable future given to changing the bylaws to prohibit proxy votes?

Question 15 Response: There are no plans at this time to reconsider this issue.

Question 16: Is a current staffing chart with the duties of employees available to members?

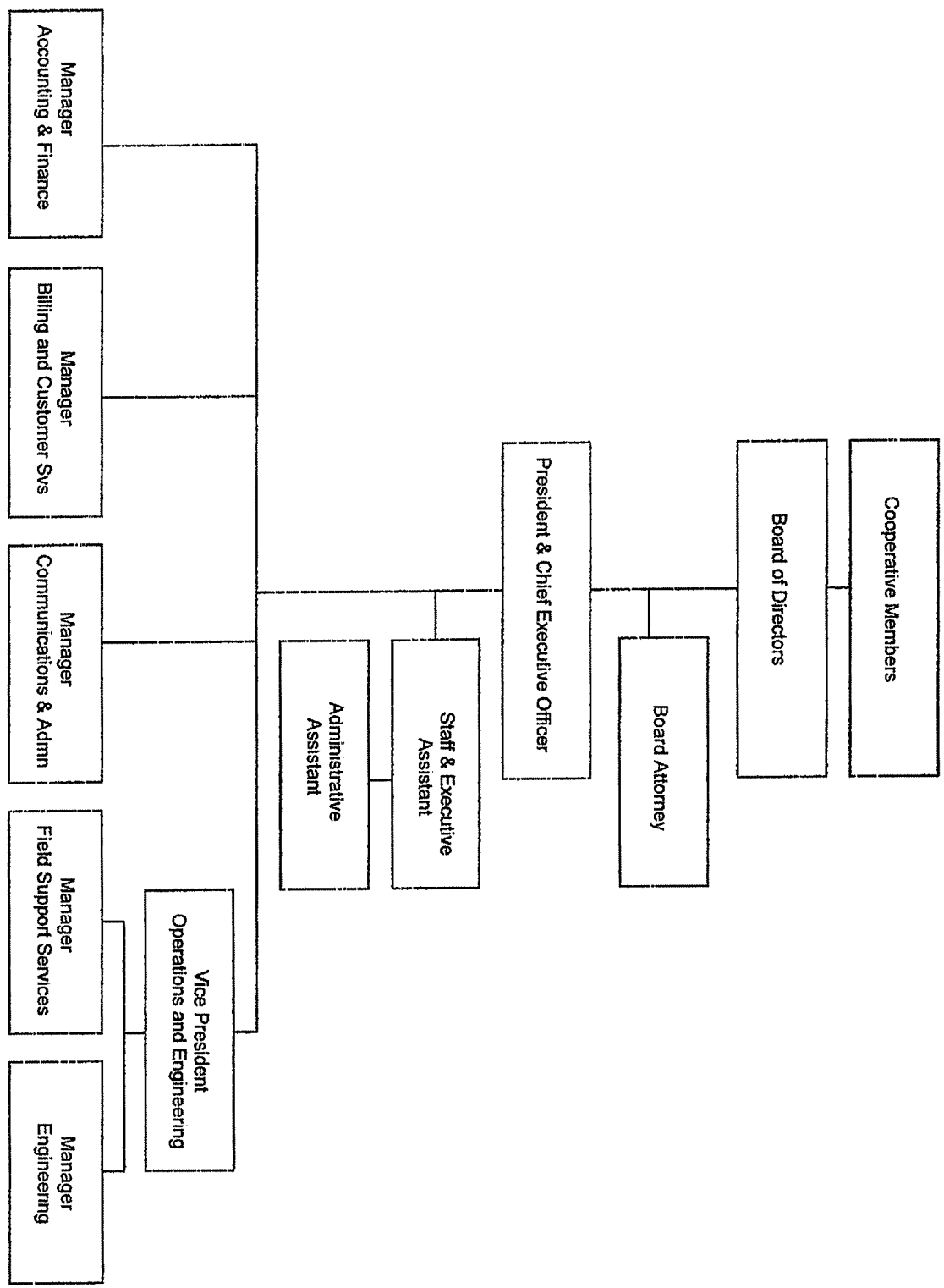
Question 16 Response: An organizational chart is attached hereto.

Question 17: Can any member obtain a list of Shelby Energy Member-customers upon request by agreeing to pay the cost of printing?

Question 17 Response: The present policy is that, due to respect for the privacy of Shelby Energy's members, a list of those members is not available except to candidates seeking election to the board of directors. Those candidates will be required to sign a statement confirming that the sole purpose of obtaining the list is for use in campaigning for the election, that the list will not be used for any other purpose, that the list will not be given to anyone else without the Cooperative's written permission, and that all copies of the list will be destroyed following the election.

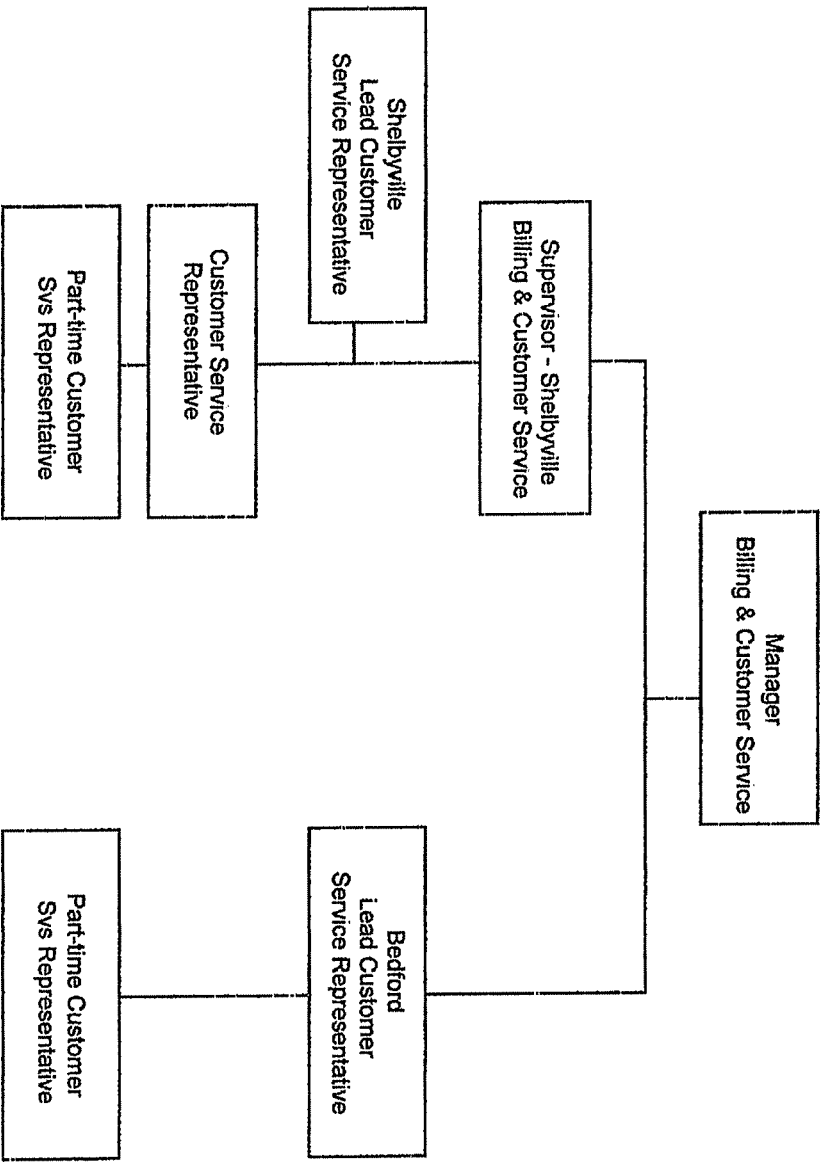
Shelby Energy Cooperative Organizational Chart

Effective Date: 11/01/11
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Shelby Energy Cooperative Organizational Chart

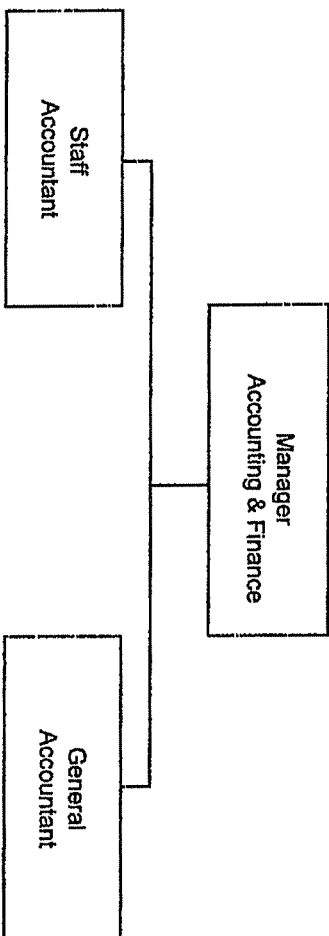
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Customer Information System
Meter Data Processing
Billing & Payment Processing
Member Records & Retention

**Shelby Energy Cooperative
Organizational Chart**

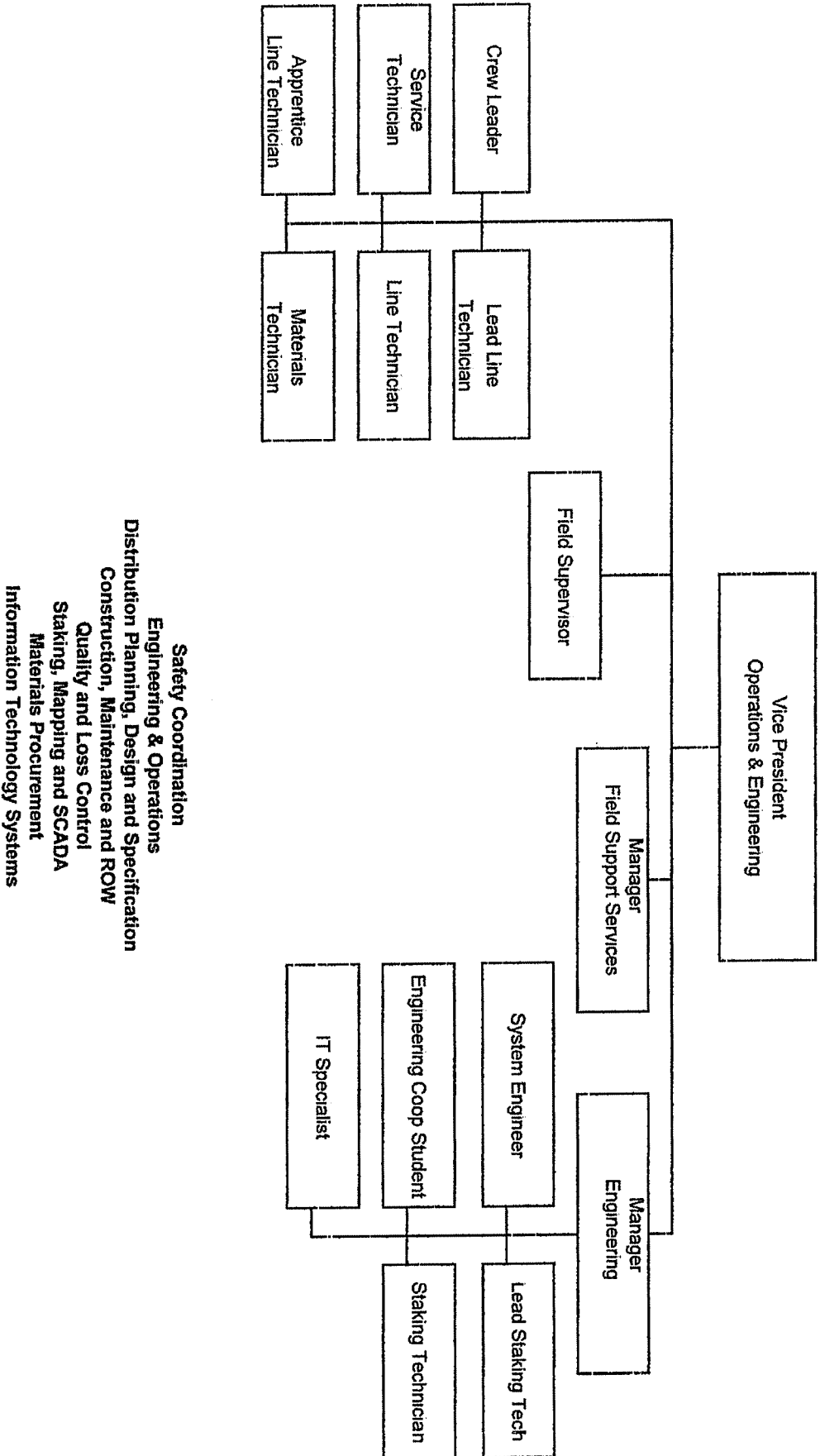
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- Financial Reporting**
- Budgeting**
- Accounts Payable**
- Materials**
- Work Orders**
- Inventory**

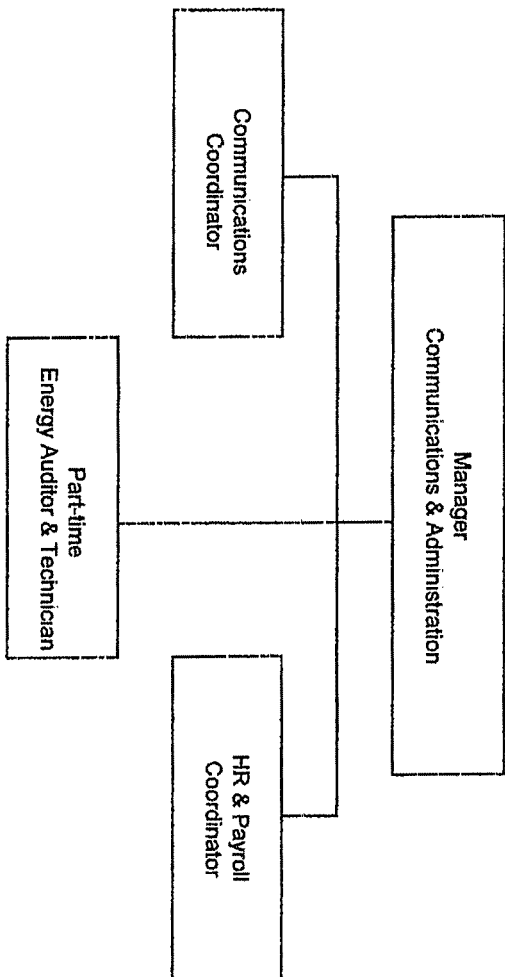
Shelby Energy Cooperative Organizational Chart

Effective Date: 11/01/14
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**Shelby Energy Cooperative
Organizational Chart**


**Effective Date: 11/01/11
Page: 5 of 5**



**Communications
Marketing
Member Programs
Human Resources
Office Administration**



Shelby Energy Cooperative, Inc.

Your Touchstone Energy® Partner 

November 2, 2010

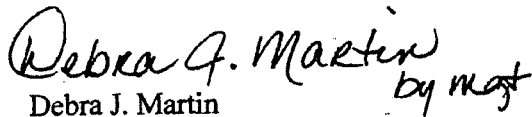
Mr. Albert Moffett
264 Mill Circle Drive
Shelbyville, KY 40065

Dear Mr. Moffett:

In regard to your letter dated October 15, 2010, the board of directors requested I provide the enclosed information as a response to your list of questions and comments.

We hope the enclosed information provides satisfactory answers to your questions and concerns.

Sincerely,


Debra J. Martin
President and CEO

Enclosures

Items 1-5:

- 1) the names and addresses of the directors,
- 2) the educational background that qualifies them to be directors of a multi-million dollar organization,
- 3) their duties as far as committees on which they serve as members of the board,
- 4) the average amount of time each devotes to his or her obligation as a director each month, and
- 5) The age, vocation and years of service on the board and the compensation of each director.

Response:

Attached is a personnel profile for each director that includes the information for Items 1-5.

Item 2:

Are the members entitled to see the yearly audit which would show the salaries of individuals that are officers of the company, and also the comparison to the last three years of such compensation so that members can see if these folks are suffering as much from recession as members are?

Response:

The yearly audit does not show individual salaries for employees and directors however; the annual IRS Form 990 provides the compensation for each board of director. Starting with 2008 the salaries of those employees who are officers, key staff and highly compensated employees are, also, provided on the IRS Form 990. Five (5) years of the Form 990 are located on the Cooperative website at www.shelbyenergy.com. Each director is provided an IRS Form 1099 annually for this compensation.

Item 3:

Are the members entitled to see how much is being spent on travel and seminars by staff?

Response:

Attached is a listing of expenses for all employees that was provided with the recent rate case. The total expense amounts for the rest of 2009 and 2010 should be similar to those listed, although the amount per individual will vary depending on individual training and employee development for each department.

Item 4:

Why, when a member writes a letter to the RECC magazine, is it not published as it should be? Who vetoes the letter's publication and then glosses over the subject in an article that minimizes the extent of the problem addressed in the letter and then spins the problem to suit the RECC position?

Response:

The Kentucky Association of Electric Cooperatives (KAEC) is the publisher of the Kentucky Living Magazine and the editor determines what letters are published in the editorial section of the magazine. Shelby Energy along with other Kentucky cooperatives use a four-page insert within each magazine to communicate various information to members, but have no decision in the content for the remainder of the magazine.

A request was made to East Kentucky Power's management to provide an update on the EKP situation after the news release and one page of Shelby Energy's insert was used for the update. You expressed a concern that it was not handled in a timely manner, but information that is printed in the magazine must be submitted one month prior to publication. The timing of the request in relation to magazine deadlines created a couple of months delay in publishing the update.

Item 5:

Has Shelby RECC ever paid for advertising or lobbied either way on Cap & Trade legislation? To your knowledge, has Eastern Kentucky Power done so?

Response:

Shelby Energy works through NRECA, the national organization for cooperatives, KAEC and East Kentucky Power and all have lobbied against Cap and Trade. These organizations provide a united group in opposition to Cap and Trade but are in support of research regarding carbon sequestration and clean coal technology.

Item 6:

Why does Shelby RECC not have a mandatory retirement age for directors? Does the staff have a mandatory retirement age?

Response:

Shelby Energy does not discriminate against employees or directors based on age. The Age Discrimination in Employment Act prohibits mandatory retirement.

Item 7:

What are the benefits that a retiring staff member or director receives? Is your retirement plan a defined benefit plan, or a plan contributed to by the employee? Please explain how it works.

Response:

Directors elected/appointed prior to July 1, 1996 and with 20 years of service have medical insurance provided after retirement. Directors elected/appointed after July 1, 1996 will not be eligible to participate in the medical insurance plan and who retire after 20 years of service will receive a monthly stipend payment of \$750. No other benefits are provided to directors upon retirement.

Employees hired prior to January 1, 1996 and who retire with 20 or more years of service will have medical insurance provided after retirement. Those employees with less than 20 years must pay a portion of the insurance ranging from 50-100% of the premium based on the number of

years of service. Employees hired after January 1, 1996 and retire may continue in the medical plan by paying 100% of the medical premium.

The Cooperative has a defined benefit plan for those employees hired on or before September 1, 2009 along with a defined contribution plan whereby the coop will contribute a limit of 2% if the employee contributes 1% to the plan. Employees may make additional contributions up to the amount allowed by IRS.

Employees hired after September 1, 2009, have a defined contribution plan in place. The Cooperative will match the above 2% plus contribution of another 6%. Anything the employee contributes up to another 4% will be matched by a contribution by the cooperative.

Item 8:

Are members allowed to sit in RECC board meetings, and if they want to comment are they allowed to request that they be put on the agenda? It would be helpful for the dates of the director's meetings and the agenda to be published for the benefit of the members. This would give members time to contact board members to voice concerns.

Response:

Yes. Members are permitted to sit in the board meetings by submitting an attendance request to the cooperative. Yes, members attending the meeting may make comments, but it isn't necessary to be listed as an agenda item.

The request to publicize board meetings and the board agenda will be presented to the directors for consideration.

George N. Busey
4390 Vigo Road
Bagdad, Ky 40003
502-747-8780

George N. Busey has been a Shelby Energy Director since 1971 and serves as Chairman of the Board of Directors. He serves the Cooperative District I that encompasses Shelby County.

Mr. Busey attended the Citadel. He also served with the United States Air Corps during World War II.

He has 45 years in the tobacco business. He is a 35 year member of the Bagdad Cemetery Board. He serves as a director on the Kentucky Association of Election Cooperatives Board and is also on the Operations Committee. Mr. Busey is a farmer and a former director of Bank One – Shelbyville. He is also a member of Bagdad Ruritan Club.

Ashley Chilton
6041 Castle Highway
Pleasureville, Ky 40057
502-878-2121

Ashley Chilton has been a Shelby Energy Director since 1976 and serves as Vice Chairman of the Board of Directors. He serves the Cooperative District II that encompasses Henry County.

He is a graduate of the University of Kentucky with a degree in agricultural economics. He is also a graduate of the LSU School of Banking from the South.

After graduation, Mr. Chilton worked as an appraiser with the right of way department for the state of Kentucky, served as Executive Vice President for the Deposit Bank of Pleasureville for 15 years, President of Chilton Insurance Co. for 23 years, and has been a real estate broker since 1964. Mr. Chilton is a member of the Henry County Historical Society, a farmer and a manager of rental property.

Roger G. Taylor
177 Lake Jericho Rd
Smithfield, Ky 40068
502-743-5288

Roger G. Taylor, Jr. has been a Shelby Energy Director since 1991 and serves as Secretary-Treasurer of the Board of Directors. He serves the Cooperative District II that encompasses Henry County.

Mr. Taylor graduated from the University of Kentucky with a Bachelor of Science degree in agriculture education.

He is a farmer and serves on the boards of United Citizens Bank, Western District Warehousing Corporation and Little Kentucky River Watershed District.

R. Wayne Stratton
115 Bluebird Drive
Shelbyville, Ky 40065
502-633-5362

R. Wayne Stratton has been a Shelby Energy Director since 1987. He serves the Cooperative District I that encompasses Shelby County. Mr. Stratton serves as Chairman of the Board for East Kentucky Power Cooperative (EKPC), Shelby Energy's power supplier.

He graduated from the University of Cincinnati with a degree in accounting.

Mr. Stratton is a Certified Public Accountant; a partner in the accounting firm of Jones, Nale and Mattingly; and serves on the boards of Republic Bancorp, National Rural Utilities Cooperative Finance Corporation, Shelbyville Municipal Water & Sewer Commission, ACES Power Marketing and a former president of the Kentucky Society of CPA's.

Randy Stevens
849 New Hope Rd
Bedford, Ky 40006
502-255-7077

Randy Stevens has been a Shelby Energy Director since 2009, serving the Cooperative District III area which encompasses Trimble County.

Mr. Stevens graduated from Eastern Kentucky University with a Bachelor of Business Administration degree.

He serves as a board of director for: North Central Health District, Trimble County Health District, Kentucky Association of Counties, Kentuckiana Regional Planning and Development Agency and Tri-County Community Action Agency and serves as Trimble County Judge/Executive.

Debbie Martin
4181 Benson Rd
Shelbyville, Ky 40065
502-633-3683


Debra J. "Debbie" Martin was selected President and CEO of Shelby Energy Cooperative, January 1, 2007.

She holds a bachelor of business administration with a minor in business management from McKendree College. She is a graduate of the 2001 NRECA Management Internship program.

Ms. Martin has more than 17 years experience in the electric utility industry and over 12 years experience in the banking and financial industry. She is a director of the Kentucky Association of Electric Cooperatives and alternate director of East Kentucky Power Cooperative. Ms. Martin is a member of Shelbyville Business & Professional Women, Bedford Rotary Club, Shelby County Friends of the Library and Red Cross.



**Shelby Energy
Cooperative, Inc.**

Your Touchstone Energy® Partner 

November 2, 2010

Mr. Albert Moffett
264 Mill Circle Drive
Shelbyville, KY 40065

Dear Mr. Moffett:

In regard to your letter dated October 15, 2010, the board of directors requested I provide the enclosed information as a response to your list of questions and comments.

We hope the enclosed information provides satisfactory answers to your questions and concerns.

Sincerely,

Debra J. Martin
by *mat*
Debra J. Martin
President and CEO

Enclosures

Items 1-5:

- 1) the names and addresses of the directors,
- 2) the educational background that qualifies them to be directors of a multi-million dollar organization,
- 3) their duties as far as committees on which they serve as members of the board,
- 4) the average amount of time each devotes to his or her obligation as a director each month, and
- 5) The age, vocation and years of service on the board and the compensation of each director.

Response:

Attached is a personnel profile for each director that includes the information for Items 1-5.

Item 2:

Are the members entitled to see the yearly audit which would show the salaries of individuals that are officers of the company, and also the comparison to the last three years of such compensation so that members can see if these folks are suffering as much from recession as members are?

Response:

The yearly audit does not show individual salaries for employees and directors however; the annual IRS Form 990 provides the compensation for each board of director. Starting with 2008 the salaries of those employees who are officers, key staff and highly compensated employees are, also, provided on the IRS Form 990. Five (5) years of the Form 990 are located on the Cooperative website at www.shelbyenergy.com. Each director is provided an IRS Form 1099 annually for this compensation.

Item 3:

Are the members entitled to see how much is being spent on travel and seminars by staff?

Response:

Attached is a listing of expenses for all employees that was provided with the recent rate case. The total expense amounts for the rest of 2009 and 2010 should be similar to those listed, although the amount per individual will vary depending on individual training and employee development for each department.

Item 4:

Why, when a member writes a letter to the RECC magazine, is it not published as it should be? Who vetoes the letter's publication and then glosses over the subject in an article that minimizes the extent of the problem addressed in the letter and then spins the problem to suit the RECC position?

Response:

The Kentucky Association of Electric Cooperatives (KAEC) is the publisher of the Kentucky Living Magazine and the editor determines what letters are published in the editorial section of the magazine. Shelby Energy along with other Kentucky cooperatives use a four-page insert within each magazine to communicate various information to members, but have no decision in the content for the remainder of the magazine.

A request was made to East Kentucky Power's management to provide an update on the EKP situation after the news release and one page of Shelby Energy's insert was used for the update. You expressed a concern that it was not handled in a timely manner, but information that is printed in the magazine must be submitted one month prior to publication. The timing of the request in relation to magazine deadlines created a couple of months delay in publishing the update.

Item 5:

Has Shelby RECC ever paid for advertising or lobbied either way on Cap & Trade legislation? To your knowledge, has Eastern Kentucky Power done so?

Response:

Shelby Energy works through NRECA, the national organization for cooperatives, KAEC and East Kentucky Power and all have lobbied against Cap and Trade. These organizations provide a united group in opposition to Cap and Trade but are in support of research regarding carbon sequestration and clean coal technology.

Item 6:

Why does Shelby RECC not have a mandatory retirement age for directors? Does the staff have a mandatory retirement age?

Response:

Shelby Energy does not discriminate against employees or directors based on age. The Age Discrimination in Employment Act prohibits mandatory retirement.

Item 7:

What are the benefits that a retiring staff member or director receives? Is your retirement plan a defined benefit plan, or a plan contributed to by the employee? Please explain how it works.

Response:

Directors elected/appointed prior to July 1, 1996 and with 20 years of service have medical insurance provided after retirement. Directors elected/appointed after July 1, 1996 will not be eligible to participate in the medical insurance plan and who retire after 20 years of service will receive a monthly stipend payment of \$750. No other benefits are provided to directors upon retirement.

Employees hired prior to January 1, 1996 and who retire with 20 or more years of service will have medical insurance provided after retirement. Those employees with less than 20 years must pay a portion of the insurance ranging from 50-100% of the premium based on the number of

years of service. Employees hired after January 1, 1996 and retire may continue in the medical plan by paying 100% of the medical premium.

The Cooperative has a defined benefit plan for those employees hired on or before September 1, 2009 along with a defined contribution plan whereby the coop will contribute a limit of 2% if the employee contributes 1% to the plan. Employees may make additional contributions up to the amount allowed by IRS.

Employees hired after September 1, 2009, have a defined contribution plan in place. The Cooperative will match the above 2% plus contribution of another 6%. Anything the employee contributes up to another 4% will be matched by a contribution by the cooperative.

Item 8:

Are members allowed to sit in RECC board meetings, and if they want to comment are they allowed to request that they be put on the agenda? It would be helpful for the dates of the director's meetings and the agenda to be published for the benefit of the members. This would give members time to contact board members to voice concerns.

Response:

Yes. Members are permitted to sit in the board meetings by submitting an attendance request to the cooperative. Yes, members attending the meeting may make comments, but it isn't necessary to be listed as an agenda item.

The request to publicize board meetings and the board agenda will be presented to the directors for consideration.

George N. Busey
4390 Vigo Road
Bagdad, Ky 40003
502-747-8780

George N. Busey has been a Shelby Energy Director since 1971 and serves as Chairman of the Board of Directors. He serves the Cooperative District I that encompasses Shelby County.

Mr. Busey attended the Citadel. He also served with the United States Air Corps during World War II.

He has 45 years in the tobacco business. He is a 35 year member of the Bagdad Cemetery Board. He serves as a director on the Kentucky Association of Election Cooperatives Board and is also on the Operations Committee. Mr. Busey is a farmer and a former director of Bank One – Shelbyville. He is also a member of Bagdad Ruritan Club.

Ashley Chilton
6041 Castle Highway
Pleasureville, Ky 40057
502-878-2121

Ashley Chilton has been a Shelby Energy Director since 1976 and serves as Vice Chairman of the Board of Directors. He serves the Cooperative District II that encompasses Henry County.

He is a graduate of the University of Kentucky with a degree in agricultural economics. He is also a graduate of the LSU School of Banking from the South.

After graduation, Mr. Chilton worked as an appraiser with the right of way department for the state of Kentucky, served as Executive Vice President for the Deposit Bank of Pleasureville for 15 years, President of Chilton Insurance Co. for 23 years, and has been a real estate broker since 1964. Mr. Chilton is a member of the Henry County Historical Society, a farmer and a manager of rental property.

Roger G. Taylor
177 Lake Jericho Rd
Smithfield, Ky 40068
502-743-5288

Roger G. Taylor, Jr. has been a Shelby Energy Director since 1991 and serves as Secretary-Treasurer of the Board of Directors. He serves the Cooperative District II that encompasses Henry County.

Mr. Taylor graduated from the University of Kentucky with a Bachelor of Science degree in agriculture education.

He is a farmer and serves on the boards of United Citizens Bank, Western District Warehousing Corporation and Little Kentucky River Watershed District.

R. Wayne Stratton
115 Bluebird Drive
Shelbyville, Ky 40065
502-633-5362

R. Wayne Stratton has been a Shelby Energy Director since 1987. He serves the Cooperative District I that encompasses Shelby County. Mr. Stratton serves as Chairman of the Board for East Kentucky Power Cooperative (EKPC), Shelby Energy's power supplier.

He graduated from the University of Cincinnati with a degree in accounting.

Mr. Stratton is a Certified Public Accountant; a partner in the accounting firm of Jones, Nale and Mattingly; and serves on the boards of Republic Bancorp, National Rural Utilities Cooperative Finance Corporation, Shelbyville Municipal Water & Sewer Commission, ACES Power Marketing and a former president of the Kentucky Society of CPA's.

Randy Stevens
849 New Hope Rd
Bedford, Ky 40006
502-255-7077

Randy Stevens has been a Shelby Energy Director since 2009, serving the Cooperative District III area which encompasses Trimble County.

Mr. Stevens graduated from Eastern Kentucky University with a Bachelor of Business Administration degree.

He serves as a board of director for: North Central Health District, Trimble County Health District, Kentucky Association of Counties, Kentuckiana Regional Planning and Development Agency and Tri-County Community Action Agency and serves as Trimble County Judge/Executive.

Debbie Martin
4181 Benson Rd
Shelbyville, Ky 40065
502-633-3683

Debra J. "Debbie" Martin was selected President and CEO of Shelby Energy Cooperative, January 1, 2007.

She holds a bachelor of business administration with a minor in business management from McKendree College. She is a graduate of the 2001 NRECA Management Internship program.

Ms. Martin has more than 17 years experience in the electric utility industry and over 12 years experience in the banking and financial industry. She is a director of the Kentucky Association of Electric Cooperatives and alternate director of East Kentucky Power Cooperative. Ms. Martin is a member of Shelbyville Business & Professional Women, Bedford Rotary Club, Shelby County Friends of the Library and Red Cross.

MOFFETT Realty, Inc.

P. O. Box 247 • 264 Mill Circle Drive. Shelbyville, KY 40066 • 502-633-5274

November 9, 2010

Ms. Debbie Martin
Shelby Energy Cooperative
620 Old Finchville Road
Shelbyville, KY 40065

Dear Ms. Martin:

I want to thank you for the opportunity to express my concern for an organization that I have been involved with one way or another for more than 50 years.

Mr. and Mrs. Alec Veech were two of my best customers when I was in the *florist* business for 22 years. I feel as though we must save the organization that I think Mr. Alec fought so hard to nurture for the benefit of so many rural Kentuckians. I, too, feel a kinship for rural people in that we built 50+ apartment complexes throughout the state, mostly designated for the elderly, between 1974 and 1996. Several of these were on RECC service.

I feel a compulsion to try to lend my support. The EPA pointed out that when a utility breaks the law, “the EPA will make you pay”. Torn Fitzgerald of the Kentucky Resources Council states that “the cooperative’s members should be examining why the utility wasn’t complying with federal laws in the first place”. Why were they not complying?

It was further noted that East Kentucky Power Cooperative in 2007 had been “at risk of default on major credit agreements”.

On April 23, 2010, Courier-Journal reporter Bruce Schreiner reported on a scathing audit of East Kentucky Power Cooperative which had been performed by the Liberty Consulting Group. Among other things, the audit said “needed changes will likely have to spring from the cooperative’s member-customers”. In the same article, Public Service Commission deputy executive director David Samford stated “the utility’s reaction to the initial findings ranged somewhere between dismissive and disinterested”. What an indictment for an organization whose original purpose was so noble. Mr. Samford further stated that the East Kentucky Power Cooperative’s long term debt “is on track to reach \$4 billion to \$4.6 billion.” (As a point of reference, the cost of both new bridges being considered over the Ohio River is \$4 billion.) Mr. Schreiner further reports that Wayne Stratton (Shelby Energy Cooperative’s board member) stated that “the cooperative has logged four consecutive years of positive margins, totaling more than \$110 million. (At this rate per year we can easily pay off the \$4 billion in 132 years.)

Directors of the 16 member cooperatives appear to have no interest in replacing East Kentucky Power Cooperative's directors, and especially the chairman of the East Kentucky Power Cooperative board. As the Courier-Journal article pointed out, it does seem the cooperative's board members are "dismissive and disinterested".

There were several items requested in my letter of either October 15 or 26 that were not mentioned in my response from Shelby Energy Cooperative. I would like to know the answers to these and other questions concerning Shelby Energy Cooperative and East Kentucky Power Cooperative.

- 1) The committees each board member serves on and how much time each director devotes to actual direction given to the cooperative.
- 2) The board decision of compensation for office employees and 3 year history of office compensation per year.
- 3) What is the direction of travel and entertainment expenses for office and staff—up or down?
- 4) Why are some letters to the editor of the cooperative's magazine published and others not?
- 5) Is a change in notifying members of board meetings as I suggested being considered, and can it be done at once by the new member services coordinator? I think this would please the two government regulators who suggested that the members should become more involved in the direction being taken by the cooperative management.
- 6) Are the bylaws being followed to the letter or are we "cheating" a little on directors:
 - a. Personal residence requirements as stated in bylaws, and
 - b. Failure of board to expel members who have been very lax in their duties as a representative or chairman on the East Kentucky Power board and who have led East Kentucky Power on a useless and expensive chase trying to cover up a distinct case of breaking the law.

I would like a copy of the material relating to the 1a-t election of a director including all the process mentioned in Section 4.3 of the bylaws including the names and addresses of the nomination committee, the names and addresses of the nominees, a copy of the proxy and all rules pertaining to how these proxies were handled. How is the bylaw 4.4 qualification verified

for a director to be eligible to become a director and continue as a director? In regard to 4.4(e), has there ever been a board action for such removal of a director?

Thank you for your time, and I look forward to your response.

Sincerely,

Albert Moffett

cc:

Sentinel News

East Kentucky Power
Public Service Commission

MATHIS, RIGGS & PRATHER, P.S.C.
ATTORNEYS AT LAW
500 MAIN STREET, SUITE 5
SHELBYVILLE, KENTUCKY 40065

C. LEWIS MATHIS, JR.
T. SHERMAN RIGGS
DONALD. T. PRATHER
NATHAN T. RIGGS

TELEPHONE: (502) 633-5220
FAX: (502) 633-0667

E-MAIL: mrp@iglou.com

November 24, 2010

Albert Moffett
264 Mill Circle Drive
Shelbyville, Kentucky 40065

Re: Shelby Energy Cooperative, Inc.

Dear Mr. Moffett:

I have been asked to respond to your November 9, 2010 letter to Debbie Martin, your recommended actions given to the Board of Directors on November 18, and your request to Larry Bauer.

In the third paragraph of your letter, you request an explanation of why the EPA concluded East Kentucky Power Cooperative was not complying with federal laws. It is my general understanding that EKPC made alterations to a 25-megawatt generating unit, which boosted its efficiency from time to time to 26 or 27 megawatts. The EPA took the position the occasional increase above 25 megawatts shifted that unit into a much more stringent emission regulation. There was a good-faith dispute between the two sides. At some point, which I believe was during Bob Marshall's tenure, after Roy Palk retired, and after the EKPC senior management person in the environmental area retired, a business judgment decision was made to settle the case to avoid the continuing significant legal fees required to continue to contest the violation. If you wish additional information, I suggest you contact your Director, Wayne Stratton, who is very familiar with the situation, or even better, EKPC directly.

Shelby Energy does not presently have any standing Board committees other than the Audit Committee. Because of the Board's small size, the entire Board serves as that Committee. Wayne Stratton serves on the Cooperative Finance Corporation

Board, George Busey serves on the Board of the Kentucky Electric Cooperative Association, Roger Taylor serves as the Shelby Energy representative on the "Fresh Look" Committee of all EKPC distribution cooperatives. You will need to contact each director individually to determine how much time each Director devotes to Cooperative business.

All employee compensation information is confidential. Efforts are made to ensure equitable treatment of both union and non-union employees.

Travel and entertainment expenses for office and staff are similar to the average of past years, with the exception of the training expenses of the Safety Coordinator, who has undergone extensive training required by the Kentucky Public Service Commission. Any "entertainment" expenses are nominal.

Debbie Martin previously advised you that Shelby Energy has little or no control over which letters to the Editor are published by Kentucky Living magazine. We do not know the criteria used by that magazine.

During the last Board meeting, Ms. Martin pointed out that the February 2008 article entitled "Shelby Energy's Power Provider Prepares for the Future" contained in the February 2008 edition of Kentucky Living was over two years prior to, and had nothing to do with, the April 23, 2010 article entitled "Audit Scorches Power Co-op".

The four items mentioned on a separate document you have tendered regarding recommendations of actions which should be taken by Shelby Energy Cooperative are all under consideration by the Board of Directors and President and CEO. The time required to deal with the continuing information requests from members has unfortunately severely decreased the amount of time Debbie Martin and I have to deal with proposed changes to the Cooperative Bylaws. I have spent over 4 hours reviewing your correspondence and enclosures and responding to your current requests. Additionally, a number of Board policies are being changed each month in accordance with the PSC Management Audit. Your suggestions are important, and the Board of Directors, President and CEO, and I will deal with them as soon as we reasonably can do so given other time constraints. I will, however, tell you that Minutes of the Board meetings will not be published within five (5) days after the Board meeting, based upon my advice. The Minutes are not final until approved by the Board. Since I draft the Minutes and am far from perfect, there are corrections made to my draft Minutes prior to Board approval.

I believe your statement that "Two government regulators suggested the members should become more involved in the direction being taken by the Cooperative Management" should be directed at EKPC and its member distribution cooperatives rather than Shelby Energy and its individual member-customers.

The Bylaws are being "followed to the letter" regarding Directors. In particular, enclosed as we discussed is the relevant portion of Article IV dealing with Director qualifications. I have circled the relevant portions. Ashley Chilton's district is defined to include "all" of Henry County. Ashley Chilton is a member and is a resident of Henry County. Ashley Chilton is one of the two Directors from District 2, which includes all of Henry County.

You are certainly entitled to your opinion, as expressed in Paragraph 6B of your November 9, 2010 letter. Shelby Energy's Board of Directors respectfully disagree. In our lengthy conversation on the morning of November 22, 2010, I attempted to point out to you that Wayne Stratton favored the departure of Mr. Palk as the head of EKPC prior to Mr. Stratton's election as Chairman of the EKPC Board. It was not long after Mr. Stratton became Chairman that Mr. Palk retired. All of the environmental issues existed prior to Mr. Stratton's Chairmanship. The settlement with the EPA occurred during his Chairmanship. You stated you have a copy of the Bylaws, therefore you have all the material relating to election of Directors, including proxy rules. You have received a proxy each year as a member of Shelby Energy and should be familiar with the contents of that document. The names of members of past Nominating Committees and Credentials and Elections Committees are not disclosed to minimize harassment. Joe Butler and Roger Taylor were nominated by the most recent Nominating Committee. There has never been a Board action for removal of a Director. Bylaw 4.4 compliance is ensured by each Director and common knowledge.

As I stated in my conversation with you, responding to repeated information requests has become unreasonably time consuming and expensive. A cooperative member is, in many ways, similar to a shareholder of a public corporation. Shareholders elect Directors who run the corporation, not the other way around. A member's role of a cooperative is similar to that of a shareholder. Members can contact any of the Board members regarding their concerns and are free to attend Board meetings, unlike corporate shareholders. Members are free to run for office as a Director and express their preference in all Board elections by voting.

Wayne Stratton has been a Shelby Energy Director since approximately March, 1987. He has been Shelby Energy's Director (one of 16 Directors) at EKPC since June, 1990. He has been EKPC Board Chairman since June, 2004.

We are working on a process for member review of past Minutes. There is an expense associated with a Shelby Energy staff member's presence during such a review, which is needed to protect the integrity of the Minutes. The more Minutes reviewed, the greater the expense. We will contact you once a decision is made.

Finally, enclosed is a copy of the upcoming ad notifying members of the vacant director position, and application to apply for consideration. It is universal corporate practice that vacant board positions are filled by appointment by the Board for the remainder of the vacant term.

While I suspect my responses in this letter have not been completely satisfactory, I have answered your questions truthfully and to the best of my ability given the ever-increasing time demands of member information requests.

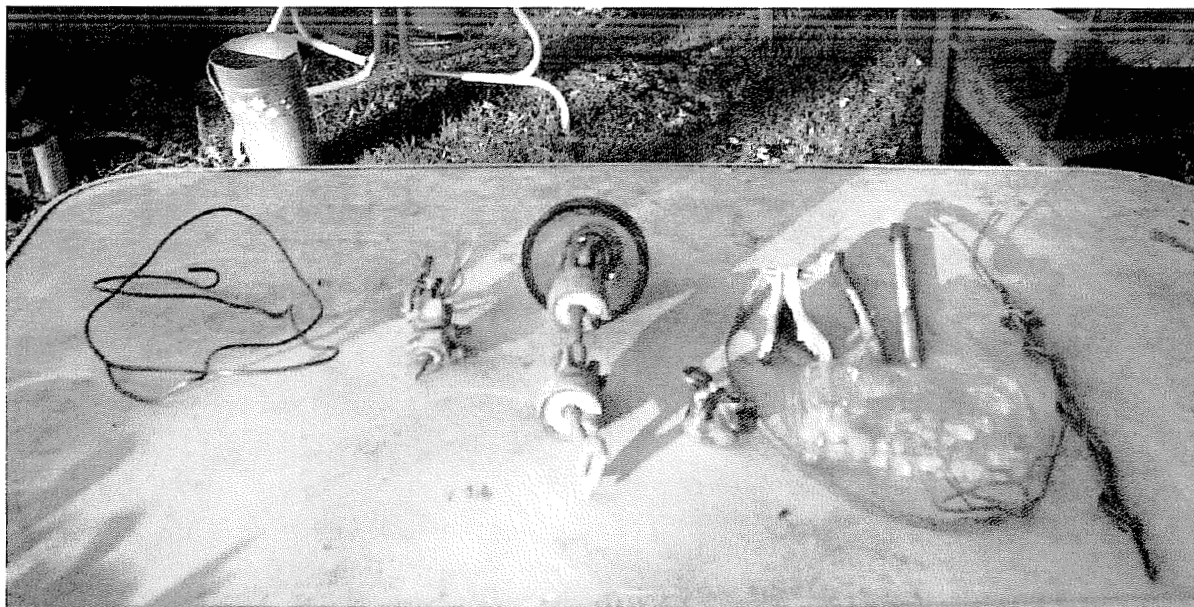
Yours Truly,

MATHIS, RIGGS & PRATHER, P.S.C.

By 
Donald T. Prather

cc: Board of Directors
Debbie Martin, President and CEO
Virginia Smith, Kentucky Public Service Commission

trash left on Pippin property by Shelby Energy contractor



SHELBY ENERGY COOPERATIVE, INC
Shelbyville, Kentucky
Board of Directors' Meeting – August 18, 2011

Regular Meeting	<p>The following persons were present at 9:00 a.m. at the Cooperative's headquarters on August 18, 2011:</p> <p><u>Directors:</u></p> <table border="0"> <tr> <td>Ashley Chilton</td> <td>Chairman</td> </tr> <tr> <td>Randy Stevens</td> <td>Vice-Chairman</td> </tr> <tr> <td>Roger Taylor, Jr.</td> <td>Secretary-Treasurer</td> </tr> <tr> <td>Wayne Stratton</td> <td>Director</td> </tr> <tr> <td>Diana Arnold</td> <td>Director</td> </tr> <tr> <td>Pat Hargadon</td> <td>Director</td> </tr> </table> <p><u>Also Present:</u></p> <table border="0"> <tr> <td>Debra Martin</td> <td>President & CEO</td> </tr> <tr> <td>Jason Ginn</td> <td>VP Operations & Engineering</td> </tr> <tr> <td>Gary Grubbs</td> <td>Consulting Engineer</td> </tr> <tr> <td>Kim Hay</td> <td>VP, Finance & Accounting</td> </tr> <tr> <td>Becky Jennings</td> <td>Manager, Billing & Customer Service</td> </tr> <tr> <td>Gay Tennill</td> <td>Staff & Executive Assistant</td> </tr> <tr> <td>Donald Prather</td> <td>Attorney</td> </tr> </table> <p><u>Member-Guests:</u></p> <table border="0"> <tr> <td>Bill Young</td> <td></td> </tr> <tr> <td>Carlin Pippin</td> <td></td> </tr> <tr> <td>Paul D. Wilson</td> <td></td> </tr> </table>	Ashley Chilton	Chairman	Randy Stevens	Vice-Chairman	Roger Taylor, Jr.	Secretary-Treasurer	Wayne Stratton	Director	Diana Arnold	Director	Pat Hargadon	Director	Debra Martin	President & CEO	Jason Ginn	VP Operations & Engineering	Gary Grubbs	Consulting Engineer	Kim Hay	VP, Finance & Accounting	Becky Jennings	Manager, Billing & Customer Service	Gay Tennill	Staff & Executive Assistant	Donald Prather	Attorney	Bill Young		Carlin Pippin		Paul D. Wilson	
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Call to Order	The meeting was called to order by Chairman Ashley Chilton.																																
New Director	Attorney Prather swore in Pat Hargadon as the Director for the vacant District 1 Board seat.																																
Minutes	The minutes of the Board of Directors regular meeting on July 14, 2011 were approved.																																
Member-Guests	Chairman Chilton welcomed member-guests Bill Young and Carlin Pippin.																																
Strategic Objective Summary	Martin reviewed the status of Shelby Energy's implementation of the management audit recommendations, including an August 8, 2011 letter from John Rogness, III, Director of PSC's Financial Analysis Division, which commends Shelby Energy for the prompt action it has taken in implementing the management audit recommendations.																																
Billing and Customer Service Report	Jennings gave the billing and customer service report. Only 16 of the adjustments were related to AMI meters. All of the others were due to old removed mechanical meters.																																

Board of Directors Meeting – August 18, 2011

Page 3

where the trees were cut hard in March are showing 3½ -4 feet of tree growth already this year. This accelerated tree growth over the last 3 years requires Shelby Energy to speed up right-of-way clearing work just to catch up and keep on the regular rotation schedule. Additionally, Shane Bolin has been checking out out-of-the-way off-road areas and finding sections which need additional trimming to eliminate blinks and safety concerns. Upon motion duly seconded, the requested budget amendments were approved.

PSC Work Plan Approval Ginn reported the Public Service Commission had issued an August 3, 2011 Order approving Shelby Energy's 2010-2014 construction work plan, including the AMI system installation. Staking has begun on several projects in the work plan which had been suspended pending PSC approval.

PSC Sample Meter Testing Plan Order Ginn reported PSC had also issued an August 3, 2011 Order approving Shelby Energy's application for temporary deviation from its sample meter testing plan. This allowed Shelby Energy to save approximately \$19,000 by not having to randomly test old meters which had already been tested as each meter was removed during the AMI conversion process. .

Safety Report Ginn presented the July safety report. The monthly safety inspections of Shelby Energy and contractor crews did not show any safety violations. Pursuant to the September 29, 2008 Order, monthly inspection reports to PSC will no longer be required in two months, but monthly inspections will continue. Barring an accident, Shelby Energy will tomorrow pass its goal of 100,000 hours of work without a lost-time accident. An employee recognition lunch is planned on September 9, 2011 from 11:00 a.m. to 1:00 p.m.

Pippin Complaint Member Carlin Pippin showed the Board a number of items which he stated had been left by Elliott crews next to three poles on his property on Vigo Road. His mower was damaged by some of them. Martin requested he bring in all of his mower repair invoices which will be paid by Shelby Energy. Pippin also stated Elliott has not had flaggers on duty despite its trucks being parked in a curve in front of his house. Martin thanked Pippin for bringing these items to the attention of the Board and assured him his complaints will immediately be addressed with Elliott. Later in the meeting Ginn reported Elliott would inspect the entire Vigo Road project area to ensure there was not any more construction debris on the ground.

Executive Session After the departure of all staff members and Pippin and Hudson, the Board entered into an executive session with the attorney and Martin to discuss pending legal and other matters. After emerging from the executive session, no action was taken. Member Young returned.

SHELBY ENERGY COOPERATIVE, INC
Shelbyville, Kentucky
Board of Directors' Meeting – September 15, 2011

Regular Meeting The following persons were present at 9:00 a.m. at the Cooperative's headquarters on September 15, 2011:

Directors:

Ashley Chilton	Chairman
Randy Stevens	Vice-Chairman
Roger Taylor, Jr.	Secretary-Treasurer
Wayne Stratton	Director
Diana Arnold	Director
Pat Hargadon	Director

Also Present:

Debra Martin	President & CEO
Theresa Atha	Manager, Communications & Administration
Jason Ginn	VP Operations & Engineering
Gary Grubbs	Consulting Engineer
Denise Hume	Sr. Accountant
Becky Jennings	Manager, Billing & Customer Service
Gay Tennill	Staff & Executive Assistant
Donald Prather	Attorney

Call to Order The meeting was called to order by Chairman Ashley Chilton.

CFC refinancing of 5% RUS loans Brian Stavish, representing the National Rural Cooperative Finance Corporation, ("CFC") presented a proposal whereby Shelby Energy could refinance its existing \$3,181,581 in 5% loans with Rural Utility Services ("RUS"). Each new CFC loan would have the same maturity date as the RUS loan it replaces. There would be no pre-payment fees to RUS, no loan fees paid to CFC, and the refinancing will not adversely affect Shelby Energy's ability to borrow from RUS in the future. Shelby Energy customers would save approximately \$203,099 from the refinancing, consisting of \$114,056 in saved interest payments and \$89,046 in patronage capital refunded from CFC to Shelby Energy. A number of Kentucky electric cooperatives refinanced their 5% RUS loans in 2010; however, interest rates have fallen even further since then, increasing the savings from such refinancing. Shelby Energy's current 5% interest rate would decrease to a blended overall CFC fixed interest rate of less than 4.1%. This interest rate is guaranteed if Shelby Energy completes the refinancing within 60 days from today. In response to a question from Director Stevens, Stavish and Martin explained Shelby Energy should not refinance the existing RUS loans with a higher

Board of Directors Meeting – September 15, 2011

Page 4

budget. A summary of the Directors, Attorney and CEO expenses for the second quarter of 2011 was presented.

FEMA Reimbursement Hume reported Shelby Energy is owed \$113,441 from FEMA from ice storm damages, and may receive some part of the \$200,000 in additional unexpected repairs due to the storm. An additional \$11,824 is owed from windstorm damages.

Operations and Engineering Reports Ginn presented the operation & engineering report for August. The number of pole change-outs was higher than normal due to the last of the ice storm repairs. The higher-than-normal number of security light repairs continues due to replacement of failed bulbs. The old high-pressure sodium bulbs have proven extremely susceptible to lightening damage. He is expecting the new induction bulbs to be much more reliable. New service requests are down to 18 year-to-date due to the bad economy compared to 24 in August 2010.

Pippin Complaint Ginn reported on his investigation of Carlin Pippin's complaint voiced at the August 18, 2011 Board meeting. After the Complaint, Elliott Construction inspected every pole, but found almost no construction debris on the ground in the entire Vigo Road project area. Martin reported she had spoken with George Busey to ask what he had observed while the work was being performed. Mr. Busey stated he had encountered flagmen every time he had traveled the road in question during times when work was occurring. Ginn's discussions with Dr. Pippin's neighbors produced no significant complaints with traffic control or construction activities. The neighbors visited by Ginn covered an area beginning a mile before and ending a mile after Dr. Pippin's property.

Main office Maintenance Work Ginn reported the painting of the outside of the headquarters facilities had been completed at almost 50% less than the expected cost. The parking lot blacktop also cost significantly less than expected. The transformers and new air conditioning system have been installed and are working, and a portion of the cost was covered by insurance.

Safety Report Ginn reported the September 9, 2011 employee lunch recognizing their safe performance was really appreciated by the employees. The total hours worked by Shelby Energy employees without a lost time accident has now increased to 103,122.18, stretching from May 8, 2010 through August 2011. Shelby Energy's contractors are also working safely. In particular, Elliott has several years of Shelby Energy work without a single lost time accident resulting in 88,035 hours worked without a lost time accident since September 2008. He is very impressed with the much-improved Shelby Energy employee attitude towards safety. It has been months since any of the inspections have disclosed any significant safety issues. Although the monthly safety inspections will continue, he has filed the last inspection report required by the Public Service Commission.

November 16, 2011 to Shelby Energy BOD/CEO

1. How are sub contractors selected for new line and pole construction (specifically the Vigo Road job) projects? Are the staking and engineer personnel of these projects done by S E employees or by a sub contractor?
2. Is there a bidding process?
3. Are crews paid by the hour or by the specific job?
4. Who furnishes the poles and materials?
5. How are crews paid on rain days?
6. When crew trucks block a lane on a two lane road (such as Vigo Road) are flaggers required for traffic safety?
7. Is a specific S E employee responsible for insuring that contractor crews are on the job, performing a quality, effective and timely job adhering to all safety standards required of S E crews?
 - a. Is the same individual responsible for the final inspection and acceptance of these sub contracted jobs?
 - b. What happens when a sub contractor performs unacceptable work? Are S E crews used to correct sub contractor errors and is the cost taken out of the sub contractor final payment? Has the Vigo Road project been completed by the sub contractor and accepted by S E?
 - c. Why were 3 poles moved to a greater distance from the edge of the roadway?
 - d. Was this a staking and engineering error?
 - e. Also, when one of the poles was relocated the sub contractor dug into the water main that required repairs by the North Shelby Water Company disrupting the neighborhood water supply.
 - f. Was this a sub contractor error? Who was charged for these errors? How do we as member-customers know that we did or did not pay for these sub contractor errors?

8 I had my first contact with an Elliot Electrical crew member early in the construction phase when I was asked if they could enter my property to service the entry pole to my house. The conversation was cordial and I showed him the gates while agreeing to his request. The second conversation occurred when I asked a crew member why three poles near my house were set so close to the road? I was told that was where the stakes were placed for the poles to be located by an earlier staking and engineering crew. Pole stakes had been in since the fall of 2010. This conversation occurred from my car while getting by all their trucks which were (I was on my way to Shelbyville) parked in the road and just after the water main had been broken. I didn't know that the main was broken at the this time. The conversation again was cordial. The third and final conversation occurred when I was informed that they were going to disconnect the electrical service to my house and replace the wires. I asked him how long that this would take and he informed me approximately 1-2 hours. He also informed me that I was the last one that they had left to complete this job. Again the conversation was cordial. During the week of August 8th my neighbor was mowing my field near the electrical pole behind my house when he struck a large insulator breaking the bottom glass. I found the insulator a few days later when I was mowing near the fence and pole with my tractor. I also noticed that 1 tire on my tractor and 2 on my lawn mower were loosing air. After searching the area around the 3 poles near my property I found a total of 10 items on the ground including the broken glass. These items were displayed to the Board of Directors and Management at their monthly meeting on August 18, 2011. On August 20th I searched around 10 poles to the east of my property and 12 poles to the west without finding any such objects left on the ground by the electrical contractor. My neighbors informed me that they were contacted by a S E employee on Friday August 19, 2011 asking questions concerning the electrical contractor's work. I was not contacted by any S E employee concerning the location of the found objects in question. Three tires were repaired August 22, 2011. It seems strange that I was chosen to be the last one to be connected to the new service and that my yard and pasture was trashed with debris? I will assure everyone that I did not remove these items from and Elliot Electrical Construction truck.

The delay in submitting the receipt for tire repairs has been due to a family situation out of state which has taken me there for extended lengths of time assisting my daughter, grandchildren and ill son-in-law. I had also expected a written reply from management or the BOD after Jason's investigation of the complaint. I consider this a serious matter of personal retaliation by a sub contractor hired by and under the supervision of Shelby Energy.

My small lawn tractor had two tires with punctures and my large farm tractor had one punctured tire. I removed the smaller tires and hauled them and the larger tractor to the repair shop which saved a repair shop farm repair call. A copy of the tire receipt for \$33.00 is attached.

I was disappointed that Jason did not contact me as he did contact my neighbors for information. I would gladly have shown him where every item was found on my property. I feel that the information would have been helpful in dealing with the sub contractor involved.

I would appreciate a copy of Jason's report to the CEO?BOARD as to his findings and how the matter was handled with the sub contractor.

Carlen Pippin DVM (retired)
502-633-1913
502-321-0221

I was sent a check for \$33.00
(tire repairs)