

MINUTES OF JOINT CITY COUNCIL AND LES STAFF PRESESSION MEETING  
LINCOLN CITY COUNCIL  
MONDAY, NOVEMBER 14, 2005  
COUNTY-CITY BUILDING  
555 SOUTH 10<sup>TH</sup> STREET  
LINCOLN, NEBRASKA 68508

RECEIVED  
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CITY COUNCIL  
OFFICE

**CITY COUNCIL MEMBERS PRESENT:** Ken Svoboda, Jon Camp, Jonathan Cook, Annette McRoy, Patte Newman, Robin Eschliman, Dan Marvin

**CITY COUNCIL MEMBERS ABSENT:** None

**LES STAFF & COUNSEL PRESENT:** Terry Bundy, Keith Brown, Todd Hall, Shelley Sahling-Zart

**OTHERS PRESENT:** Dana Roper, Coby Mack, Deena Winter

Council Chair Ken Svoboda welcomed LES to the City Council pre-session meeting at approximately 10:15 a.m. LES Administrator and CEO, Terry Bundy, introduced LES staff and proceeded to provide an overview of the 2006 LES Operating and Capital Budget that had been unanimously recommended for City Council approval by the LES Administrative Board.

**2006 LES Budget**

Bundy noted that the budget calls for a total appropriation of \$279.3 million, which is about \$25 million greater than the 2005 budget. (Exhibit I) Power costs in the operating budget are up about \$35.4 million. The primary reasons for the increase are rising natural gas costs, purchase of water rights at Laramie River Station, and a significant increase in coal freight rates to Laramie River Station. The 2006 capital budget is down \$13.7 million, primarily due to the deferral of some projects. Debt coverage in the 2006 budget is targeted at 1.77, compared to 1.66 in the 2005 budget.

He indicated that the original budget projections indicated an increase in power costs of \$22 million. Staff recalculated the projections following the two major Gulf Coast hurricanes that damaged energy infrastructure and increased natural gas prices higher than had previously been projected. This review projected 2006 power costs to be \$13 million higher than the previous projection for a total estimated budget impact of \$35 million.

Bundy noted that the budget had been reviewed in detail with the LES Board's Budget and Rates Committee and unanimously adopted by the full LES Administrative Board.

There was discussion about the recent decreases in natural gas prices and whether these decreases would cause LES to see lower than anticipated power costs in 2006. Bundy responded and showed a graph indicating that while there has been some decline in fuel prices, the futures contract price for natural gas continues to be above LES' revised projections.

### Proposed Power Cost Adjustment

There was discussion about how LES would generate revenue sufficient to meet this increasing expenses. Terry Bundy indicated that LES is recommending implementation of a power cost adjustment (PCA) rather than a base rate increase to generate the additional revenue necessary to deal with these variable costs. He indicated that the recommendation regarding the PCA would be coming to the City Council in December for consideration, but he indicated that it was necessary to review it in conjunction with the budget because it is a mechanism designed to deal with the fluctuating power costs that LES is experiencing. Because of the recent post-hurricane revisions to the budget regarding power costs, there has not been sufficient time to get the PCA proposal and the budget on the same schedule. Due to notice and approval requirements for both the budget and the PCA, it was not possible to present them both at the same time although they are related.

As previously discussed, the LES budget indicates an increase in power costs of \$35 million for 2006. Of this amount \$17 million would be covered by the nine percent rate increase that was implemented in August of this year. The remaining \$18 million would need to be met through either a general base rate increase or implementation of a PCA. Bundy indicated a PCA is a better mechanism for dealing with the fluctuations in power costs.

Bundy provided materials summarizing the PCA, which is a commonly utilized mechanism that allows a utility to adjust the amount charged for retail service in order to generate revenue necessary to cover fluctuating changes in power costs. (Exhibit II) A PCA can be adjusted upwards and downwards as necessary commensurate with cost fluctuations, rather than a base rate adjustment which remains constant.

Bundy also noted that the PCA is not a \$5 per month surcharge as has been reported in the media. The is determined monthly at a level that is based on the amount that LES fuel costs and purchased power costs deviate from a determined base cost. The PCA will be capped at \$0.0050 per kilowatt-hour in the winter billing months, and \$0.0075 per kilowatt-hour in the summer billing months. If approved, the PCA would become effective with electric bills rendered on and after February 1, 2006. He also noted that if the PCA is approved, LES will not pursue an increase in base rates in 2006 as had been planned.

Several Council members asked whether there was a sunset on the PCA. Bundy responded that LES isn't proposing a sunset, but he noted that the PCA could be zeroed out or removed at such time as LES is no longer seeing large fluctuations in power costs.

Councilman Dan Marvin expressed concern about the higher impact on industrial customers. Bundy noted that industrial customers were in fact likely to see a greater impact from the PCA because it is applied to the amount of electricity consumed by a customer. Bundy also noted that even with the PCA, LES rates will continue to be among the lowest 10 percent in the nation thereby retaining a competitive rate advantage.

Councilman Cook asked if this was the first time LES has proposed a PCA. Bundy responded that it is the first time LES has proposed implementing a PCA, but the LES Administrative Board had considered the possibility of a PCA in the early 1980's and had established standards at that time for how a PCA would be implemented and administered. Among those provisions is a requirement that staff report monthly to the LES Administrative Board on power costs and the determination of the PCA level, and that similar information be reported to the City Council on a quarterly basis.

Councilman Cook also asked about LES' exposure to this kind of volatility and whether the addition of the coal-fired Council Bluffs No. 4 plant will help to shield LES from the natural gas volatility. Bundy responded that Council Bluffs No. 4 will help some. He also noted that the power cost situation would also be helped if there is some resolution next year in the case before the federal Surface Transportation Board regarding the exorbitant freight rates charged by the Burlington Northern Santa Fe for delivering coal to the Laramie River Station.

Councilwoman Newman asked about the impact on Nebraska Wesleyan University and other similarly situated customers who have already prepared their budgets and set their fees, such as tuition based on current rates. Todd Hall, Vice President Consumer Services, responded that LES staff works with the key account customers to try to keep them informed of projected cost changes. He acknowledged that the timing of this action may not be ideal for some customer's budget planning.

Councilman Marvin asked what happens to LES' financial coverage if they don't get the PCA approved. Bundy and Keith Brown, LES Chief Financial Officer, responded that it would put coverages at about 1.0 and put LES close to default on its bonds, which would also lead to significant downgrades in LES' credit rating.

Councilman Cook noted that he had indicated earlier this year that he wouldn't support another rate increase until LES had completed a review of fees, such as late payment fees and fees charged for aid to construction. He asked about the status of such a review. Bundy noted that a survey of peer utilities would be going out in the next couple of weeks and that LES plans to present a report and recommendation to the LES Administrative Board in the second quarter of 2006. He indicated that they could advance recommendations on fee changes even if there isn't a rate change in 2006.

Councilman Camp asked about the level of LES' rate stabilization fund. Bundy indicated that LES had expected to use \$5 million from the fund this year, and the 2006 budget assumes another \$5 million from the fund in 2006. He noted that at this time LES expects to only use about \$4 million this year, but will roll over the other \$1 million to be used in 2006. After 2006, the balance will be in the range of about \$2 million to \$4 million.

Councilwoman Eschliman asked if other utilities are recommending PCA's in their service areas. Bundy responded that they are aware of some utilities that have PCA's, but he indicated that he will have staff prepare a summary of other utility PCA's and he will provide it to the Council.

Councilwoman McRoy expressed some concern about considering the budget, which reflects the problem of the volatility in power costs, separately from the PCA, which is the solution to deal with the volatility in power costs. Bundy acknowledged that the timing is somewhat awkward and that they are related. He indicated that the revisions in the power costs came about fairly recently following the two Gulf Coast hurricanes. The dilemma is caused by the required public processes for getting each approved. The budget must be approved by the end of the year and it must sit for 10 days following the public hearing before the City Council before it can be approved. With the Council meeting schedule and upcoming holidays, this is the latest that the budget could be submitted. Waiting until December would not allow enough time. Conversely, the PCA can't move forward any sooner due to requirements to hold a public hearing on the PCA and provide notice to all customers in their billing statements. The public hearing is scheduled for December 1, after which the LES Administrative Board will consider action on the PCA to advance it to the City Council.

Chair Svoboda excused LES from the meeting at approximately 11:10 a.m.

Respectfully Submitted,

BY:   
Shelley R. Sahling-Zart  
Assistant Secretary  
LES Administrative Board

# **Exhibit I**



## 2006 Budget Review

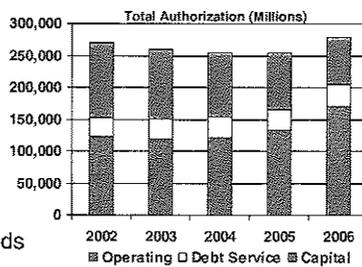
Lincoln City Council - Precouncil  
November 14, 2005



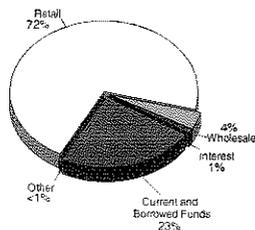
## Lincoln Electric System 2006 Budget Information for the Lincoln City Council



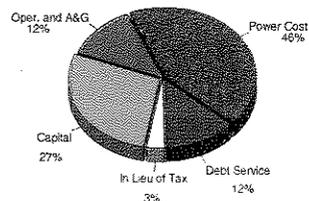
Total Authorization - \$279,310,600



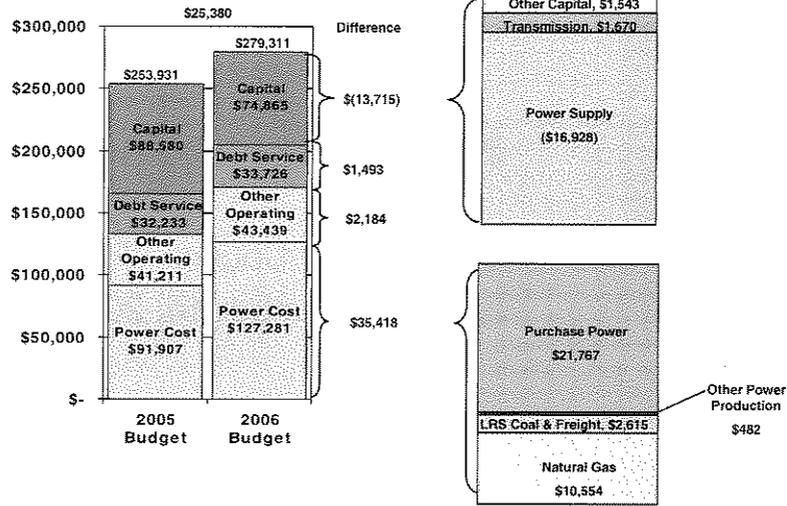
Source of Funds



Uses of Funds



## 2006 Operating & Capital Budget Use of Funds (In Thousands)

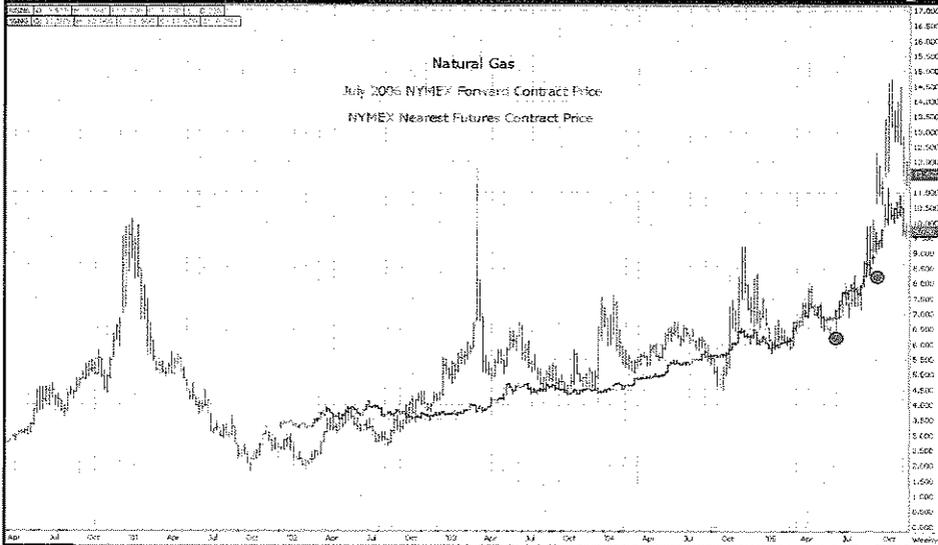


LINCOLN ELECTRIC SYSTEM



## Natural Gas Price Trends

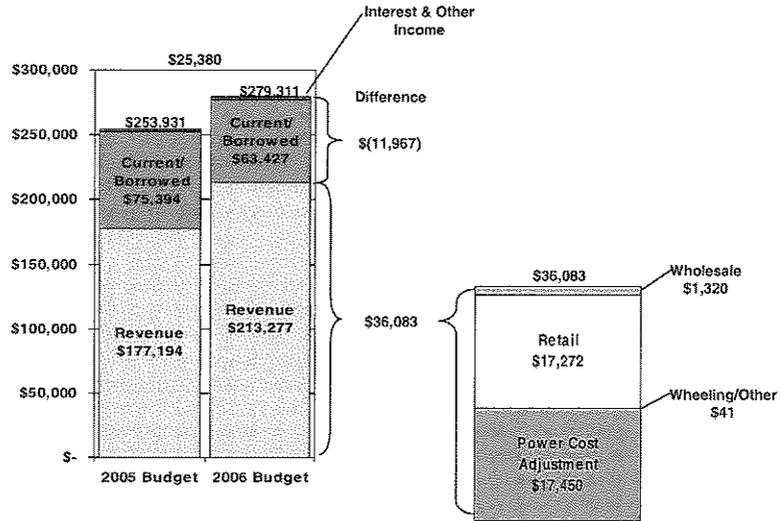
November 2005



LINCOLN ELECTRIC SYSTEM



# 2006 Operating & Capital Budget Source of Funds (In Thousands)



# **Exhibit II**



L I N C O L N   E L E C T R I C   S Y S T E M

**PROPOSED POWER COST ADJUSTMENT**

**What is a Power Cost Adjustment (PCA)?**

A Power Cost Adjustment (PCA) is a commonly utilized mechanism that allows a utility to adjust the amount charged for retail service in order to generate the revenue necessary to cover fluctuating changes in power costs. It can be adjusted upwards and downwards as necessary commensurate with cost fluctuations, rather than a base rate adjustment which remains constant.

**Why should LES implement a PCA?**

Over the past couple of years LES has experienced considerable volatility in the price of natural gas and in wholesale power purchases which also tend to follow the price of natural gas. Our research and consultation with experts indicates that this volatility can be expected to continue for some time. The cost of natural gas has spiraled upward driven by world market pressures and damage caused by two major Gulf Coast hurricanes. For example, the commodity price of natural gas has risen more than 75 percent in the last 12 months and there is no clear picture of the near-term or future expected price for this essential commodity.

The LES power cost budget was developed utilizing August 2005 forward price projections, including an anticipated increase from 2005 to 2006 of \$22 million. With the updated October 1, 2005, projections (post hurricane) the 2006 power cost budget increased by another \$13 million for a total increase of \$35 million in 2006, rather than the previously projected \$22 million. While we have hedging strategies in place, they are not sufficient to deal with these increases.

Consequently, it has proved difficult to build these types of projections into the rate base with a high degree of accuracy. LES' rate structure is designed to capture costs associated with the generation, transmission, and delivery of electric energy to our customers. The cost of service study upon which the rates are structured projects what costs are expected to be in the future based on what is known at that point in time. It does not allow for significant deviations from those projections. A PCA, however, is a rate mechanism that will allow LES to more accurately bill customers for these fluctuating costs as they occur, and charge only what is necessary to maintain financial integrity.

### How will the PCA work?

The amount of the PCA will be determined monthly and will be based on the amount by which the production fuel costs and purchased power costs deviate from the base cost approved by the LES Administrative Board. The PCA will be shown as a line item on the customer billing statement. The line item will reflect the total monthly kilowatt-hours (kWh) consumed multiplied by the PCA.

The PCA will be capped at \$0.0050 per kWh in the winter billing months, and \$0.0075 per kWh in the summer billing months, thereby limiting our customers' exposure to volatility. As costs stabilize or return to more predictable levels, the PCA will be reduced. The payments will be reconciled at the end of each month to determine any overpayment or underpayment by any customer class, with the appropriate adjustment presented on the following month's billing statements.

Although this would be the first time that LES has instituted a PCA, in 1980 the LES Administrative Board approved a standard outlining the process for utilizing a PCA. Pursuant to that action, which was also approved by the Lincoln City Council, LES staff must comply with certain reporting requirements. Staff will report monthly to the LES Administrative Board on the resources, how costs compare to the rate base costs, and report and explain any variances. LES staff will also report similar information to the Lincoln City Council on a quarterly basis. The PCA will also be the subject of periodic reviews by the internal and independent auditors.

The PCA is targeted to become effective with electric bills rendered on and after February 1, 2006.

If the PCA is adopted by both the LES Administrative Board and the Lincoln City Council, LES would not pursue the expected August 1, 2006, rate increase.

#### **LES will hold a public hearing on the PCA:**

**Thursday, December 1, 2005  
7:00 p.m.  
All-Purpose Room  
Walter A. Canney Service Center  
2620 Fairfield St.  
Lincoln, NE**