



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

October 22, 2009

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CITY COUNCIL  
OFFICE

Dear Chair Emery and Members of the City Council:

Enclosed for your review are the recommended 2010 LES Operating & Capital Budget and proposed Rate Schedules and Service Regulations for rates effective January 1, 2010. The budget and accompanying rate adjustment were approved by the LES Administrative Board on October 16, 2009 and recommended for your approval.

We are proposing the following schedule for your consideration of the 2010 budget and rate adjustment:

- Monday, October 26 – Introduction and First Reading
- Monday, November 2 – Pre-Council Session at 1:15 pm
- Monday, November 2 – Public Hearing at regular City Council meeting
- Monday, November 16 – City Council action on LES budget and rates

LES is recommending a 2010 Operating & Capital Budget that requires a 2.9 percent system average increase in electric rates effective January 1, 2010. LES staff originally proposed a 3.9 percent increase. Following LES' public input process, the LES Administrative Board's Budget and Rates Committee directed staff to reduce the 2010 budget by \$2.3 million which reduced the required rate increase to 2.9 percent.

You may recall that LES had originally targeted a rate increase of 4 percent for March 1 of this year, but we have been able to successfully defer that rate increase for this year. Unfortunately, we cannot defer a rate increase any longer. The proposed rate adjustment for January 1 is necessary to cover increases in fixed costs at LES' generation resources, increases in regional transmission costs, expansion of the LES Sustainable Energy Program, and ordinary increases in operations and maintenance expenses some of which is due to maintenance deferrals in previous years that we simply cannot defer any longer.

We are seeking concurrent approval of both the budget and the rate increases this year. This is a departure from historical practices, but we hope that it will eliminate some of the confusion experienced in recent years.

LES staff continues to address a changing energy industry and we have accomplished a number of goals throughout 2009. These accomplishments and the 2010 initiatives will provide a stronger utility (both immediately and over time), and one which is in step with the current challenges impacting the economy and the electric utility industry.

### **The state of LES**

Based upon a concerted effort to improve financial metrics, LES is expected to finish 2009 with an improving Debt Coverage ratio in the range of 1.90, an improving Debt to Equity ratio of 70%, and a \$4 million increase in the previously nearly depleted Rate Stabilization fund. While the economy has faltered somewhat, LES' customer base continues to expand. Current projections indicate that the LES customer count will reach 128,900 by the end of 2009, which is up from the 2008 average of 127,630. LES full-time employee levels will remain at 457, unchanged from the 2008 levels and down one in the last five years. We worked diligently throughout the year to initiate additional reorganization and staff reassignments in order to accomplish this goal of no new staff positions.

Capital construction remains significantly below levels which occurred during recent years when LES required the addition of major new facilities. While LES has added 6 MW of new renewable energy generation and is evaluating several additional renewable opportunities, the current resource plan calls for no new conventional resource until the 2018 time frame. This extended period prior to new resource construction allows LES management to focus on internal operational efficiencies and customer relationships. Along with the budget summary, the following provides an outline of recent accomplishments, ongoing challenges and the initiatives to be undertaken in 2010.

### **2009 Accomplishments**

The 2009 budget outlined a number of goals directed toward addressing improved access to the regional markets, and focusing on the efficiency of system operation, staffing, organizational structure, and the fundamental efficiency of energy use by LES customers. The following identifies several of the major projects either completed or now underway:

- Deferral of the planned March 1, 2009, 4.0% rate increase
- Transition to the Southwest Power Pool
- Implementation of a new Sustainable Energy Program
- Improvement in financial metrics
- Roll out of a new employee Safety Program
- Updating the LES transmission line routing process
- Completion of facilities utilization and optimization analysis
- Initiation of a generation operator apprentice program
- Updated and implemented substation transformer replacement strategy

- Integration of 562 new Norris Public Power District customers into LES
- Development of an additional District Energy central heating and cooling project
- Initiation of a formal Corporate Strategic Planning effort

### **Industry and Lincoln Challenges**

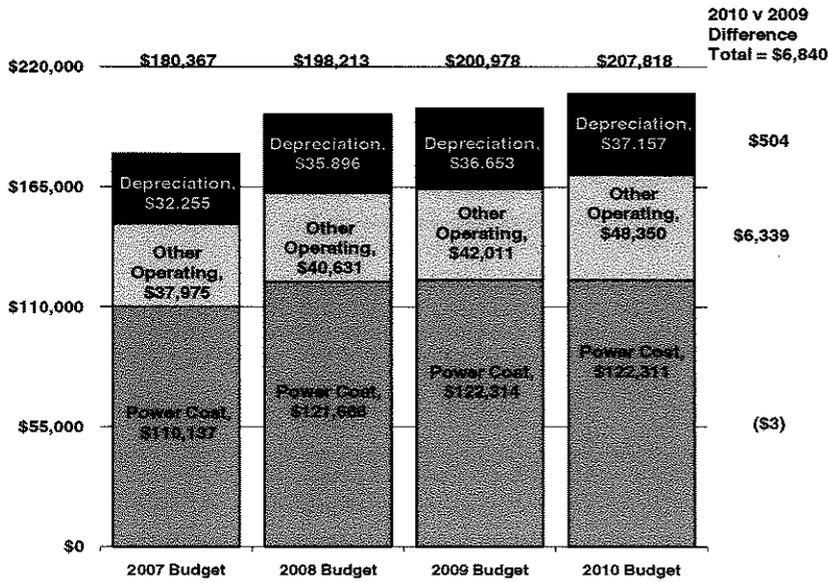
There are currently many challenges facing the utility industry. These occur in the areas of finance, resources, and customer expectations. To address these challenges, LES must remain focused on efficiency in the delivery of services, and incorporation of new measures to facilitate customer participation in an evolving energy future. These challenges require a number of changes in how the utility provides service and the increasingly close ties of our relationships with over 129,000 customers. These are some of the challenges:

- Climate change and carbon legislation
- Renewable energy options
- Access to the customer load as a resource
- Hybrid vehicle market development
- Electric reliability standards and compliance
- Aging workforce
- High voltage transmission expansion
- Fuel cost and fuel transportation volatility
- Information technology infrastructure
- Aging transmission and distribution infrastructure
- Customer involvement and education on electric rate fundamentals
- Development of flexibility in facilities and staff to address all of the above.

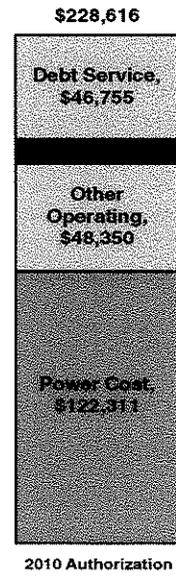
### **2010 LES Budget Request**

LES' Operating Budget for 2010 is \$207,818,000, up \$6.8 million, approximately 3.4% over the 2009 budget. The chart below shows an "Operating Budget" of \$207,818,000 and an "Operating Authorization" of \$228,616,000. The Operating Budget reflects planned operating expenses and is used to track our budget progress. For purposes of the City Council's approval we also include the Operating Authorization which is derived by subtracting depreciation (a non-cash item) from the Operating Budget and adding back debt service and Payments in Lieu of Tax (PILOT). It is important to note that any year-to-year budget comparisons made in this summary are based on the Operating budget rather than the Operating Authorization unless specifically noted to the contrary.

### Operating Budget in (\$000)



### Operating Authorization



2010 v 2009  
Difference  
Total = \$6,840

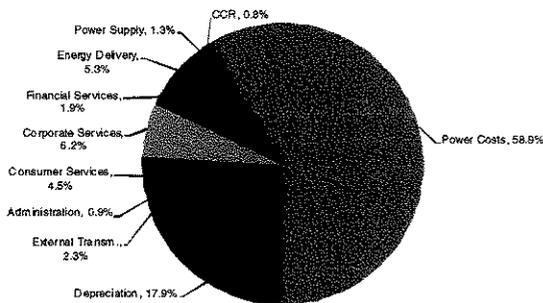
\$504

\$6,339

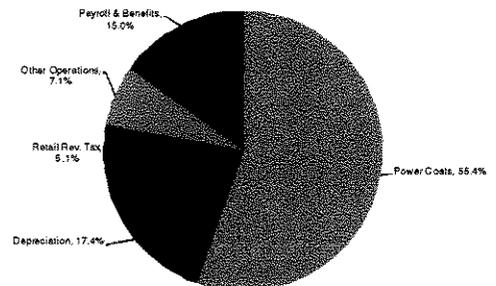
(\$3)

As you can see from the chart above, the budget increase is spread among the three components of depreciation, other operating costs and power costs. For 2010 power costs did not increase from the 2009 budget. This is the result of lower variable energy costs from Laramie River Station and lower than expected wholesale purchase prices being more than offset by higher fixed costs for our base load resources and higher generation costs. Depreciation is higher due to the addition of utility plant. LES currently has approximately \$1.2 billion in total plant value. The other operating costs are up due to fixed transmission service charges, system operation and maintenance cost increases and customer program initiatives.

### LES 2010 Operating Budget

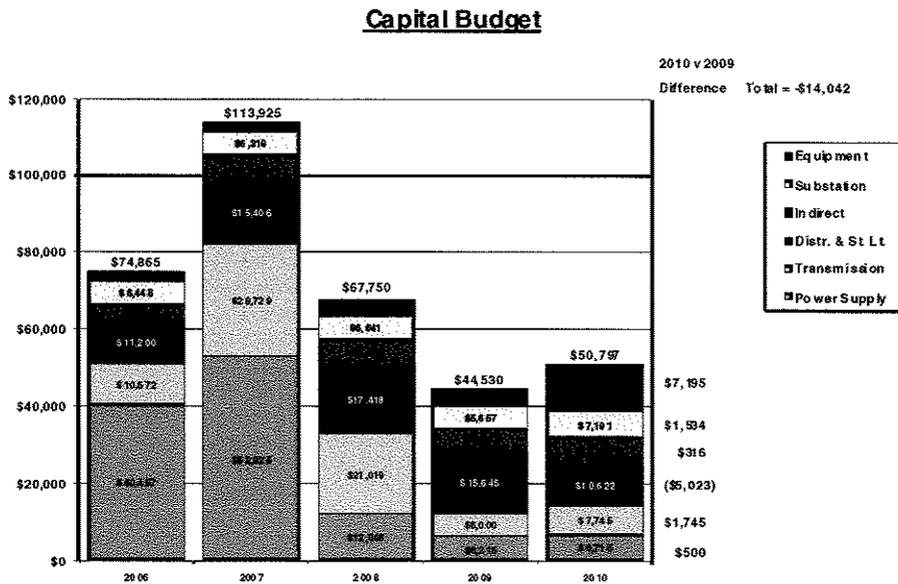


### Components of Operating Expense



Power costs comprise 58.9% of the 2010 budget and depreciation (also largely related to power plant investment) comprises 17.9%. The other operating expense makes up 23.3% of the operating budget. Because power costs constitute such a large percentage of the total, any fluctuations in fuel or transportation or purchased power from other utilities will have a significant impact on the budget.

A component of the budget process makes comparisons to other utilities to help assess whether LES continues to operate efficiently. This is done with information compiled by the American Public Power Association. Those comparisons indicate that LES' A&G expenses are typical of other public power utilities and LES' power costs and O&M expenses are significantly below the average of other public power utilities. Our rates remain lower than the average of public power utilities and even further below the average of all U.S. utilities.



**Capital Budget**

LES' Capital Budget for 2010 is \$50,797,000. The Capital Budget represents an increase of \$6,267,000, from 2009 primarily due to the inclusion of needed customer information and human resources infrastructure replacement. In many years, LES' Capital Budget will exhibit large fluctuations due to the intermittent nature of large generation and transmission projects. Generation and transmission projects are down while internal infrastructure investment is up for 2010.

In total, the Budget Request for 2010 is \$279,413,000 an increase of \$11 million compared to the request of \$268,322,000 last year.

## **Major Initiatives and Projects for 2010**

The enclosed budget provides the resources to initiate LES' effort to address the above challenges. The following provides a brief discussion of several areas and projects which constitute a major portion of LES' focus for 2010.

### **\*Expanded Sustainable Energy Program**

The 2009 effort to address customer energy efficiency needs was implemented in part to determine the level of customer interest in the pursuit of energy efficiency and electrical load control. By any measure the initial \$1 million Sustainable Energy Program (SEP) can be considered a success. The 2010 budget doubles this effort. Incorporated in this program will be the formation of an LES "Green Team" focusing specifically on engaging customers and assisting them in achieving their energy goals. Programs will continue to include LES staff conducted energy audits and consulting for system improvements. The 2010 SEP will also include incentives for upgrading residential insulation, high efficiency equipment replacement, innovative technology grants and encouragement of renewable energy applications.

### **\*Addition of new renewable resources**

The challenge of incorporating additional renewable resources goes well beyond the availability and construction of generation projects. Any discussion of expanding this technology quickly uncovers the weakness of the current electric grid to readily absorb the change in generation options. The challenge goes to the core of what the customer expects of a utility and how the customer must participate in this integrated effort. The currently available, large scale renewable option is primarily wind generation, a resource that can be readily constructed. However, integration of this resource requires construction of new high voltage transmission, the addition of new conventional resources to provide regulation of the intermittency of wind, and will also require that LES have on-line access and communication with individual customers to adjust loads to allow the benefits of renewable energy to flow to them. This is a complex and daunting equation. It is an equation that can only be resolved with significant changes in our relationship with customers. We must address transmission construction with the regional transmission operator and we must enhance the long standing relationships we maintain with neighboring utilities. LES will plan to add renewable energy in 2010, and will begin projects necessary to sustain and incorporate this resource into our low cost generation resource mix.

### **\*Customer access and efficiency in growth through infrastructure**

In order to retain the flexibility to expand services, address continued growth in regulation and to encourage and engage the customer in our future, LES must address the aging infrastructure that provides the backbone of our business. The current LES Customer Information System (CIS) is based upon a 1967 legacy system that is maintained and has undergone numerous patches to simply allow LES to "get the bills out." The CIS is an antiquated mainframe IT system that provides minimal information on the customer and no capability to communicate or involve the customer in efficiency, innovative rate changes, or the communication necessary to address load response options. The system is far past due for replacement. Current regulatory and smart grid technologies will not be possible with the current

system. In other words, the innovation necessary to expand the customer and LES partnership will not occur until this system is upgraded.

\*LES "Future Work Force" Program

The relationship of continued delivery of low cost and energy efficiency programs is in the end dependent upon competent, educated and committed staff. The LES dilemma is that fully one quarter of the existing work force of 457 FTE's are now eligible for retirement. The challenge, and the opportunity, is now to implement a series of human resource initiatives that drive work force development toward a goal of continued high level performance. Some of the aspects now under review and development include: phased retirement, transition employees, staff reassignments, directed tuition and educational reimbursement, reconsideration of appropriate benefits to attract the best candidates for the accomplishment of our goals, and the identification and support of future LES leaders. These programs are a shift in emphasis, from maintenance of a work force, to creating a work force for the community's energy future.

\*Completion of facility and staff reorganization

Over the last two years LES underwent a major effort to identify the organizational structure and the management skills necessary to carry the organization forward. The results thus far have included downsizing the executive staff, consolidating entire divisions, moving functional departments between divisions for efficiency, and rotating staff to provide both opportunities for growth and placement of competent staff in expanding roles. This has been accomplished during a period of rapidly expanding regulatory pressure, fundamental changes in the energy markets and societal pressure to address new and expanding customer concerns. To date this has been accomplished with the addition of no new full-time employees. In the near future, LES staffing and the development of the organization will require some expansion in staffing levels. This will occur simply because of continued growth in customers, the necessary addition of facilities and the ever expanding regulatory atmosphere. As mentioned above it is the intent of this budget to reach the proper organizational structure and the appropriate work force plan prior to filling additional staff positions.

\*Continued support of efficient district heating and cooling systems

Over the last two decades LES provided operations and construction services to the District Energy Corporation (DEC). DEC is an Interlocal corporation founded to develop innovative energy projects that benefit the Lincoln community. DEC provides heating and cooling services for the County City complex and heating services to the Nebraska State Capitol and other State buildings. The financial and efficiency benefits of these systems have been proven over time. The 2010 goals include LES management of initial construction activities for the new Lancaster County Jail heating and cooling facility and the ground work for additional projects which will include the West Haymarket development and feasibility analysis of additional community energy opportunities.

We look forward to the New Year and the many challenges ahead. It is an exciting time to be a participant in this growing, ever changing industry. Please feel free to contact us with any questions.

Sincerely,



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Administrator and CEO

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DLC:cls

c: Mayor Chris Beutler

**LINCOLN ELECTRIC SYSTEM**  
**2010 BUDGET REQUEST SUMMARY**  
(Amounts in Thousands)

10/14/09  
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BUDGET REQUEST

OPERATING BUDGET (including PILOT)			
Less Depreciation & Amortization	219,017.6		
	(37,156.6)		\$181,861.0
<b>DEBT SERVICE</b>			
2002 Bonds	15,705.4		
2003 Bonds	8,657.2		
2005 Bonds	5,615.7		
2007A Bonds	4,549.2		
2007B Bonds	11,419.5		
Commercial Paper & AFUDC	807.9		46,754.9
<b>CAPITAL BUDGET</b>			
Previously Authorized Projects	18,919.0		
2008 Construction of Previously Authorized Projects	6,099.0		
Currently Authorized Projects	53,498.8		
2008 Construction of New Authorizations	44,697.8		
2008 Construction Cashflow/Appropriations Request	21,621.0		
Authorization Carryover to 2009			50,796.8
<b>TOTAL BUDGET REQUEST</b>			<b>\$279,412.7</b>

SOURCE OF FUNDS

<b>CASH RECEIPTS</b>			
Operating Revenue	\$261,050.4		
Interest & Other Income	630.0		
To be provided from current or borrowed funds			17,732.3
<b>TOTAL SOURCE OF FUNDS</b>			<b>\$279,412.7</b>

**LINCOLN ELECTRIC SYSTEM  
2010 CAPITAL BUDGET  
SUMMARY**

(Dollars in thousands)

DESCRIPTION	BUDGET AMOUNT
<b>DIRECT COST:</b>	
<b>Transmission &amp; Distribution:</b>	
Transmission	\$7,745.0
Substation	7,191.0
Distribution Overhead	2,522.0
Distribution Underground	7,877.0
Waverly	152.0
Street Light	<u>71.0</u>
Subtotal Transmission & Distribution	\$25,558.0
<b>Power Supply</b>	
Power Supply	<u>6,715.0</u>
<b>Subtotal Construction</b>	<b>\$32,273.0</b>
<b>General Equipment</b>	
Transportation Equipment	\$10,754.3
<b>Subtotal Equipment</b>	<u>1,041.8</u>
<b>Subtotal Equipment</b>	<b>\$11,796.1</b>
<b>Total Direct Cost</b>	<b>\$44,069.1</b>
<b>INDIRECT COST:</b>	
Administrative & General	\$222.8
Engineering/Supervision Cost	6,504.9
<b>Subtotal Indirect Cost</b>	<u>\$6,727.7</u>
<b>TOTAL</b>	<b>\$50,796.8</b>
Estimated Contributed Capital	(1,379)