



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

**\*\* REVISED DATES \*\***

November 5, 2010

Lincoln City Council  
Lincoln, Nebraska

Subject: Lincoln Electric System (LES) 2011 Operating and Capital Budget

Dear Chair Spatz and Members of the Lincoln City Council:

Enclosed for your review are the recommended 2011 LES Operating & Capital Budget and proposed Rate Schedules and Service Regulations for rates effective January 1, 2011. The budget and accompanying rate adjustment were approved by the LES Administrative Board at a special meeting on November 4, 2010, and recommended for your approval.

We are proposing the following schedule for your consideration of the 2011 budget and rate adjustment:

- Monday, November 15 - Introduction and First Reading
- Monday, November 15 - Pre-Council Session at 1:00 pm
- Monday, November 22 - Public Hearing at regular City Council meeting
- Monday, December 6 - City Council action on LES budget and rates

In addition, consistent with past practice we will be scheduling individual briefings with members of the Council at your convenience subsequent to November 15, 2010.

LES is recommending a 2011 Operating & Capital Budget that assumes the need for a 2.5 percent average increase in electric rates effective January 1, 2011. The rate adjustment is necessary to support increases in renewable power resources, health insurance costs, regional transmission costs, regulatory compliance expenses, and ordinary increases in operation and maintenance expenses.

As was initiated last year, we are proposing to seek concurrent approval of both the budget and the rate increase. LES staff continues to address a changing energy industry and we have accomplished a number of goals throughout 2010. These accomplishments and the 2011 initiatives will provide a stronger utility, and one which is in step with our vision, mission and core values, as well as 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 2010 with a Debt Coverage ratio in the range of 1.95, a Debt to Equity ratio of 73%, and a \$2 million increase in the Rate Stabilization fund (current balance \$8M). While the national economy has faltered, LES' customer base continues to expand. Current projections indicate that the LES retail customer count will reach 130,357 by the end of 2010, which is up almost 1% from the 2009 year end actual of 129,322.

Capital construction remains significantly below levels which occurred during recent years when LES acquired major new generating and transmission facilities. LES has added 16 MW of renewable energy to its resource portfolio in the past two years and is evaluating several additional renewable opportunities. However, the current resource plan calls for no new conventional generating resource until the 2025 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 2011.

### **2010 Accomplishments**

The 2010 budget outlined a number of goals directed toward addressing reliability, sustainable energy, customer access and efficiency, and the future of the LES workforce. The following identifies several of the major projects supporting those goals that are either completed or now underway:

- Launched the Corporate Strategic Plan
- Expansion and refinement of the Sustainable Energy Program (SEP)
- Purchase of an additional 10 MW of wind energy starting in late 2010
- Initiation of the SAP Customer and Employee Lifecycle Project
- Customer engagement in the Central Lincoln Reliability Project and in rate design considerations
- North American Transmission Forum Peer Review of LES
- Completion of 8<sup>th</sup> and J Street generation facility extended maintenance
- An employee survey, expanded training and communications offerings
- Secured long-term financing and received \$5 million Department of Energy American Recovery and Reinvestment Act grant to support the District Energy County Adult Detention Facility project
- Continued improvement in financial metrics

### **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 remains 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 our utility provides service to our customers. These are some of the challenges:

- Climate change and carbon legislation
- Renewable energy options
- Access to the customer load as a resource
- Plug-in electric 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

## **Major Initiatives and Projects for 2011**

In December 2009, through a combined effort of staff and the Administrative Board, LES adopted a new Vision and Mission Statement and a related Corporate Strategic Plan. The enclosed budget provides the resources to continue LES' effort to achieve the long-term goals of the strategic plan. The following provides an outline of LES' long-term strategic goals and the associated projects and initiatives which constitute a major portion of LES' focus for 2011.

### **Communication - Strategic Plan Goal #1**

- Central Reliability Project communication
- Initiation of Advanced Meter Infrastructure communication program
- Implementation of a three-year internal and external communication plan

### **Staff Development, Retention and Succession Planning - Strategic Plan Goals #2, #3 & #4**

- Implementation of the SAP Human Capital Management System
- Integration of seven new staff positions into the company
- Completion of a comprehensive compensation study for all non-bargaining unit employees

### **Partnerships - Strategic Plan Goal #5**

- Management of construction and operational activities for District Energy Corporation (DEC) facilities, including the County Adult Detention Facility and the West Haymarket Development
- Participation in North American Transmission Forum peer reviews at other member utilities
- Administration and continued refinement of the SEP

### **Customer Service - Strategic Plan Goal #6**

- Implementation of the SAP Customer Relations and Billing System
- Implementation of a new Outage Management System
- Additions to customer self service options
- Continue funding for the SEP

### **Strong Financial Performance - Strategic Plan Goal #7**

- Target debt coverage of 1.90-2.00 with an improving Debt to Equity Ratio
- Contribute \$2.0 million to the Rate Stabilization Fund

### **Environmental Stewardship - Strategic Plan Goal #8**

- Incorporation of an additional 10 MW of wind energy resource
- Development of an LES environmental compliance handbook
- Assessment of LES CO2 Mitigation Strategy

### **Reliability – Core Value**

- Continuation of the Central Lincoln Reliability Project
- Construction and commissioning of the new data center
- Initiation of land mobile radio system replacement
- Preparation for and participation in the NERC Reliability Compliance Audit

- Conduct a Mock Compliance Audit
- Assessment of Industrial Network Cyber Vulnerability
- Resolution of NPPD/OPPD/LES Aging Transmission Interface Issues

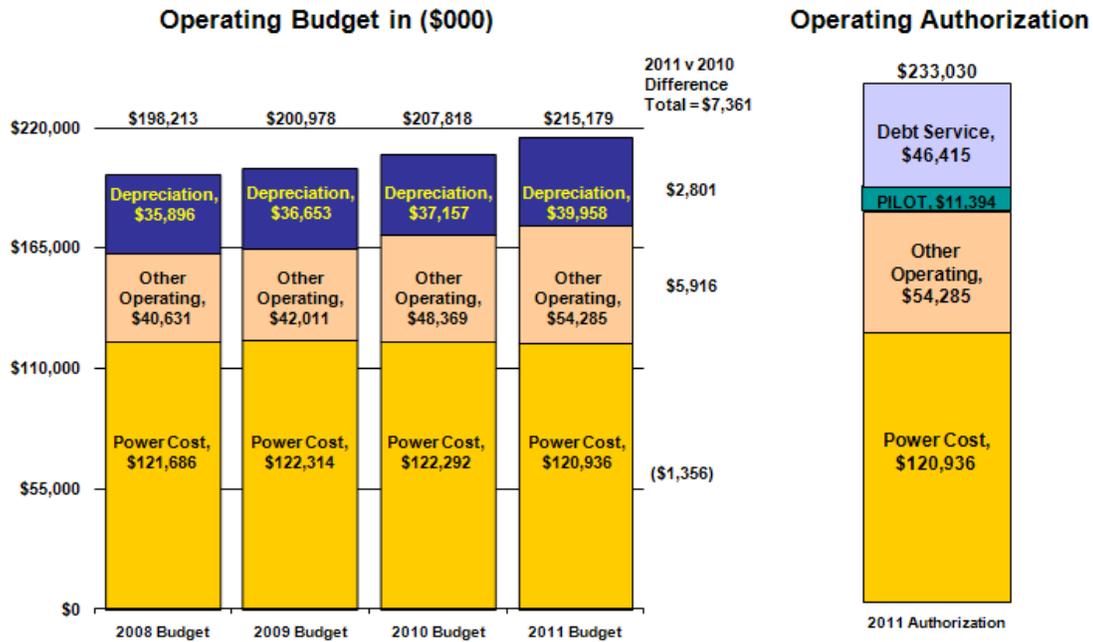
### **2011 LES Staffing**

For 2011, LES full-time employee levels are proposed to increase to 465, up seven from the 2010 level, and up six over the last five years. This rise in staffing levels is necessary to provide resources for increased regulatory requirements, inter-local support and succession planning. Specifically, the increased staffing provides: (i) two positions to support the significant increase in regulatory compliance procedure development, documentation, monitoring and reporting that is associated with the mandatory reliability requirements implemented by NERC, (ii) two positions to support the expanded DEC activity and the costs will be recovered through the DEC, (iii) two positions in Energy Delivery to develop internally trained staff for succession of the “aging workforce” that is confronting all electric utilities where greater than 25% of the skilled and technical workforce is retirement eligible, and (iv) one position to support corporate records retention requirements through SharePoint and SAP Document Management Systems.

Even with the increased number of employees, LES will be serving 6% more customers per employee than in 2005. Furthermore, when compared to the most recently available data for public power utilities LES will be serving 10% more customers per employee than the median in this region. While we believe that the recommended staffing additions address the near term issues associated with NERC compliance and the “Aging Workforce”, it is likely that future budgets will incorporate further additions to address both issues.

### **2011 LES Budget Request**

LES’ proposed Operating Budget for 2011 is \$215,179,000. The Operating Budget for 2011 is up \$7.4 million, approximately 3.5% over the 2010 budget. The chart below shows an Operating Budget of \$215,179,000 and an Operating Authorization of \$233,030,000. The Operating Budget reflects planned operating expenses and is used to track budget progress in our monthly financial statements. However, for purposes of the City Council’s approval we must 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.

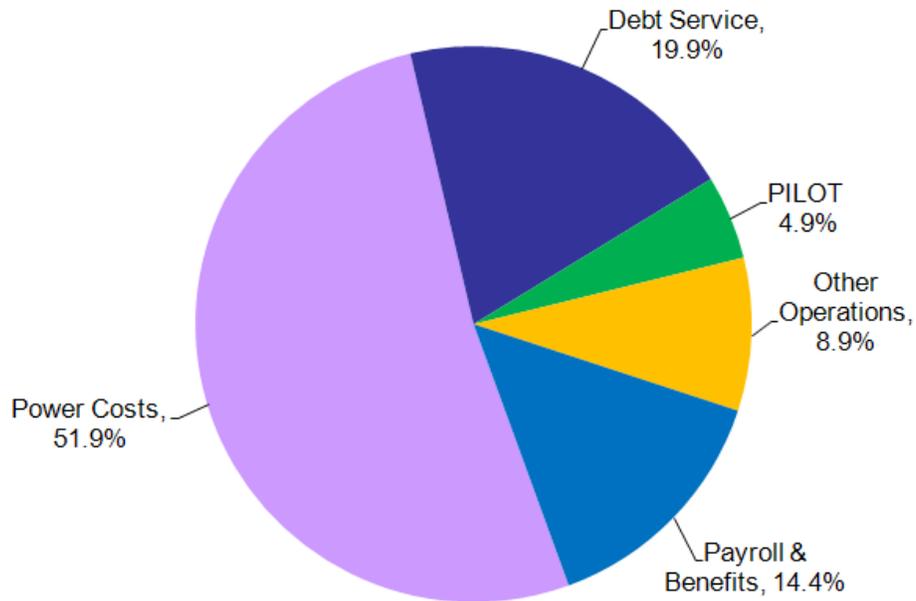


As you can see from the chart above, the increased budget expenses occur in depreciation and other operating costs. For 2011 the budgeted power costs are projected to decrease 1%. This is the result of notably lower wholesale power purchase costs caused by decreases in both the quantity of wholesale purchases and the energy cost of those wholesale purchases, and a reduction in demand costs at Walter Scott Energy Center since there is no major maintenance outage planned for 2011, as there was in 2010. Depreciation is higher due to the normal addition of utility plant and the planned amortization of existing under-depreciation on certain retired assets. LES currently has approximately \$1.2 billion in total plant value. Other operating costs are up due to system operation and maintenance cost increases and customer program initiatives. Significant differences from 2010 Budget for other operating costs are shown in the below table.

<b>Significant Other Operating Expense Differences 2011 Budget vs. 2010 Budget (Amounts in thousands)</b>	
Transmission Expense	+\$1,100
Employee Benefits (insurance)	+\$ 962
Compensation Adjustment	+\$ 617
IT Software Maintenance	+\$ 570
Staffing Additions	+\$ 538
Line Clearance Contracted Services	+\$ 474
Resource Planning Software	+\$ 200
Customer & Corporate Communication	+\$ 124
Credit Card Acceptance Fees	+\$ 100
Joint Pole Audit	+\$ 95

Power costs comprise 51.9% of the 2011 Operating Authorization and debt service (also largely related to power plant investment) comprises 19.9%. The other operating expense makes up 8.9% of the Operating Authorization. Of the total Operating Authorization, 14.4% is related to payroll and benefits. Because power costs constitute such a large percentage of the total, any fluctuations in fuel, transportation or purchased power from other utilities will have a significant impact on the budget.

Components of Operating Authorization



A component of the budget process is to review 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 operation and maintenance expenses are significantly below the average of other public power utilities. Our rates remain much lower than the average of public power utilities and even further below the average of all U.S. utilities.

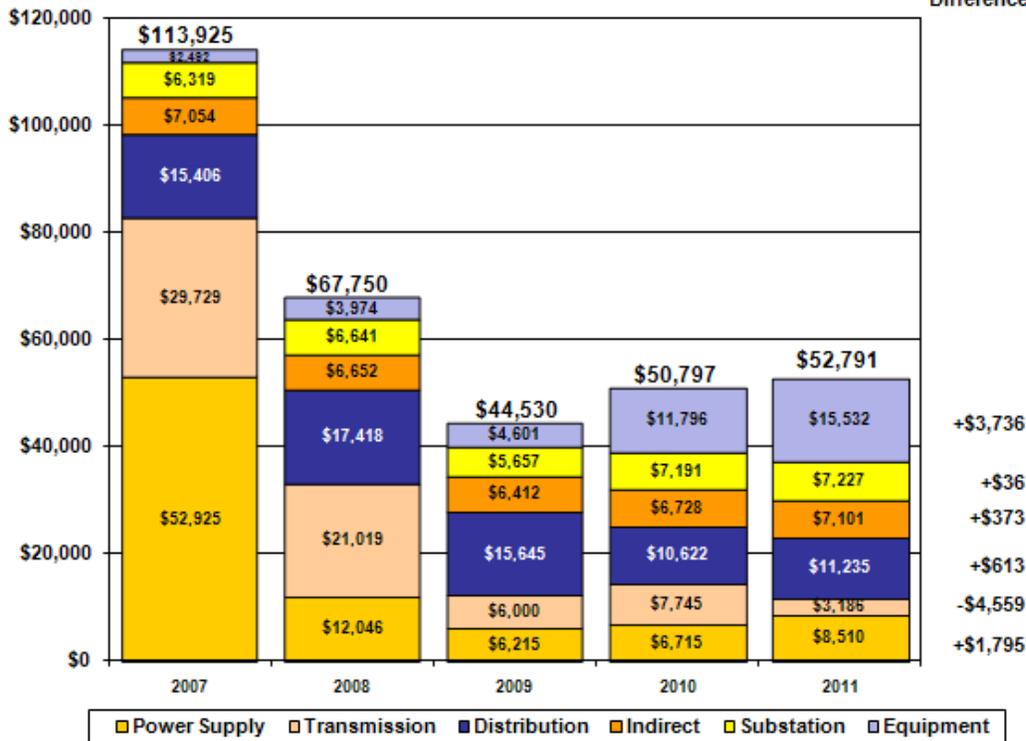
### Capital Budget

The LES proposed Capital Budget for 2011 is \$52,791,000. The Capital Budget represents an increase of \$1,994,200, from 2010 primarily due to the inclusion of needed customer information and human resources computer systems infrastructure replacement and construction for the LES Data Center offset by reduced transmission, distribution and power supply construction. 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 2011.

# Capital Budget

2011 v 2010

Difference Total = -\$1,994



## Summary

In total, the proposed Budget Authorization for 2011 is \$285,821,300, an increase of \$6.4 million compared to the 2010 authorization of \$279,412,700.

The proposed budget submitted under this cover letter was developed to maintain the high quality of service to our customers represented by the LES "Core Values" and address the elements of the strategic plan for continued improvement of the system. While the on-going changes in the electric utility industry present many challenges, they also create many opportunities that we feel are addressed through this budget process. As you review this material, please feel free to contact me, Doug Bantam, or the applicable vice-president with questions or comments.

Sincerely,

Kevin G. Wailes  
Administrator and CEO

Attachments

c: Mayor Chris Beutler

**LES Vision:** *Striving to be the world's best energy company.*  
**LES Mission:** *LES is a progressive leader, partnering with the community to maximize energy value and quality of life in an environmentally-responsible manner.*