

**CITY OF LINCOLN, NEBRASKA**



**ELECTRIC SYSTEM COMMERCIAL PAPER NOTES**

**OFFERING MEMORANDUM**

**DATED October 1, 2005**

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# **CITY OF LINCOLN, NEBRASKA**

## **INTRODUCTION**

This Offering Memorandum (which includes the Appendices attached hereto) is furnished by the City of Lincoln, Nebraska (the "City"), a municipal corporation existing pursuant to its home rule Charter and under the laws of the State of Nebraska (the "State"), to provide information concerning: (i) the City; (ii) the City's electric system (which is hereinafter referred to as the "Lincoln Electric System," "LES" or the "System" and which is defined in the Bond Ordinance described below to include all property and assets of the City used for or pertaining to the generation, transmission, distribution and sale of electric power and energy); and (iii) the \$150,000,000 maximum aggregate principal amount of the City's Electric System Revenue Commercial Paper Notes (the "Notes").

## **AUTHORITY**

The Notes are being issued pursuant to Nebraska law, particularly Sections 15-244 and 18-1803 to 18-1805, inclusive, Reissue Revised Statutes of Nebraska, as amended, and Section 44 of Article IX of the Charter of the City as amended from time to time, and Ordinance No. 18584, adopted August 1, 2005, the ("Note Ordinance").

This Offering Memorandum includes summaries of the terms of the Notes, certain provisions of the Note Ordinance, and certain contracts and other arrangements relating to LES. The summaries of and references to all documents, reports and other instruments referred to herein do not purport to be complete, comprehensive or definitive and each such summary and reference is qualified in its entirety by references to each such document, report or instrument, copies of which may be obtained, upon request, from Lincoln Electric System, 1040 "O" Street, Lincoln, Nebraska 68508, Attention: Chief Financial Officer. Email inquiries should be addressed to kbrown@les.com.

## **PURPOSE**

This Offering Memorandum relates to the offering, from time to time, of \$150,000,000 aggregate principal amount of the Notes under the Note Ordinance. The aggregate principal amount of Notes outstanding may be increased or decreased from time to time as provided in the Note Ordinance. The Note Ordinance provides for up to \$150,000,000 aggregate principal amount of Notes to be outstanding at any time. The Notes have been and are being issued for the purpose of providing short-term borrowing as needed by LES to pay the costs of capital projects determined by the Board to be in the best interest of LES.

## **DESCRIPTION OF THE NOTES**

The Notes will be issued in a maximum aggregate principal amount outstanding at any one time of up to \$150,000,000. The Notes will be issued in denominations of \$100,000, or any integral multiple of \$1,000 in excess of \$100,000 and will be issued in book-entry only form through the book-entry system of The Depository Trust Company, New York, New York, as described below. The Notes will be interest computed on the basis of actual days elapsed on a 365 or 366 day year, whichever is applicable, at an annual rate not in excess of 16% per annum, and shall have a purchase price of 100% of the principal amount thereof. Interest on the Notes will be payable on their respective maturity dates. The Notes will mature not more than 270 days after the date of issuance, and in no event later than the termination date of the Liquidity Agreement hereinafter described or such later date to which the Liquidity Agreement shall have been extended. The Notes will not be subject to redemption prior to maturity.

U.S. Bank National Association has been appointed as Issuing and Paying Agent for the Notes.

## **Book-Entry System**

**General.** The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Notes. The ownership of one fully registered Master Note, will be registered in the name of Cede & Co., as the nominee for DTC. Ownership interests in the Notes will be available to purchasers only through a book-entry system maintained by DTC (the “Book-Entry System”). A description of DTC, the Book-Entry System and definitions of initially capitalized terms used herein are found in “APPENDIX IV - BOOK-ENTRY SYSTEM.”

**Risk Factors.** Beneficial Owners of the Notes may experience some delay in their receipt of distributions of the principal or redemption price of and interest on the Notes because such distributions will be forwarded by the Paying Agent to DTC, credited by DTC to its Direct Participants, and then credited to the accounts of the Beneficial Owners either directly or indirectly through Indirect Participants.

Because transactions in the Notes can only be effected through DTC, DTC Participants and certain banks, the ability of a Beneficial Owner to pledge Notes to persons or entities that do not participate in the Book-Entry System, or otherwise to take actions in respect of such Notes, may be limited due to the lack of physical certificates. Beneficial Owners will not be recognized by the Paying Agent as registered owners for purposes of the Ordinance, and Beneficial Owners will be permitted to exercise the rights of registered owners only indirectly through DTC and DTC Participants.

## **SECURITY FOR THE NOTES**

### **Security and Sources of Payment for the Notes**

The Notes are special obligations of the City payable from and secured solely by the funds pledged therefor pursuant to the Note Ordinance.

To provide security for the payment of the principal of and interest on the Notes as the same shall become due and payable, the Note Ordinance grants a lien on and pledge of, subject only to the Prior Lien Bond Ordinances (hereinafter defined) and the provisions of the Bond Ordinance (hereinafter defined) permitting the application thereof for purposes and on the terms and conditions set forth therein, (a) the proceeds from the sale of Notes issued pursuant to the Note Ordinance for the purpose of refinancing, renewing or refunding the Notes, (b) the amounts held in the CP Account in the Payment Fund established by the Note Ordinance, (c) the amounts held in the Note Construction Fund established by the Note Ordinance until the amounts deposited therein are used for authorized purposes, (d) the proceeds of any other evidences of indebtedness of the City issued or incurred solely for the payment of principal of and interest on the Notes, (e) any other moneys of the City hereafter pledged by the City to the payment of principal of and interest on the Notes, and (f) the proceeds of Advances made pursuant to the Liquidity Agreement; and the principal of and interest on the Notes are equally and ratably secured by and payable from a lien on and pledge of the sources hereinabove identified in the clauses (a) through (f), subject and subordinate only to the exceptions noted therein.

Additionally, to provide security for the payment of principal of and interest on the Notes as the same shall become due and payable, the Note Ordinance grants a lien on and a pledge of, subject only to the Prior Lien Bond Ordinances and the provisions of the Bond Ordinance permitting the application thereof for purposes and on the terms and conditions set forth therein, the Net Revenues of the City’s Electric System that are subject and subordinate to the lien and pledge on, or obligation of, the Net Revenues securing the payment of principal of, premium, if any, interest on, and any reserve fund requirements for, or other obligation with respect to, the 1998 Bonds issued pursuant to Ordinance No. 16414 and certain series ordinances adopted thereunder (collectively, the “Prior Lien Bond Ordinance”) and the 2001 Bonds the “2002 Bonds and 2003 Bonds (collectively the “Outstanding Bonds”) issued pursuant to the provisions of the Ordinance No. 17879 and certain series ordinances adopted thereunder (collectively, the “Bond Ordinance”). The Bond Ordinance provides for the issuance by the City from time to time of Electric System Revenue Bonds (the “Electric System Revenue Bonds”) including the Bonds identified below. Payment of the Notes from Net Revenues is expressly subordinated to the 1998 Bonds and the Outstanding Bonds. See “Electric System Indebtedness” below.

Unless the Notes are paid from the sources described in clauses (a) through (f) above, such payment is to be made from Net Revenues deposited in the CP Account in the Payment Fund from the Net Revenues of the System.

To the extent the Notes are not to be paid from the proceeds of Advances or the other sources provided herein and to the extent required for repayment of a Note, the City, subject to the preceding limitations, shall transfer from the Net Revenues into the Note Payment Fund, amounts sufficient to pay principal of and interest on the Notes as the same become due.

## Limits on Additional Debt

The City may issue additional Securities or Parity Obligations provided (a) the Net Revenues for the Fiscal Year immediately preceding the Fiscal Year in which such additional Securities or Parity Obligations are issued are not less than 100% of the average annual Debt Service on all Securities and Parity Obligations to be Outstanding upon the issuance of such additional Securities or Parity Obligations, (b) neither the City nor LES shall be in default under the terms of the Ordinance, (c) the issuance of such additional Securities or Parity Obligations shall not cause either the City or LES to be in default under the terms of the Ordinance.

## OUTSTANDING DEBT

The following Bonds will be outstanding upon the issuance of the 2005 Bonds:

<u>Description</u>	<u>Final Maturity</u>	<u>Outstanding Amount</u>
<u>Prior Lien Bonds:</u>		
1998 Series A	September 1, 2018	\$34,810,000
<u>Commercial Paper Notes:</u>		
	Variable	\$100,173,000
<u>Bond Issued Pursuant to the General Ordinance:</u>		
2001 Bonds	September 1, 2020	\$141,150,000
2002 Bonds	September 1, 2025	\$139,805,000
2003 Bonds	September 1, 2028	\$123,460,000

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The City anticipates issuing approximately \$115,000,000 aggregate principal amount of Lincoln Electric System Revenue Bonds, Series 2005 on or before November 1, 2005 to provide long-term financing for certain costs of improvements to the Electric System.

The 1998 Bonds constitute all of the Prior Lien Bonds issued pursuant to the Prior Lien Bonds Ordinances. All of the principal of and interest on the Prior Lien Bonds will be paid from, and secured by, the sources provided for under the Prior Lien Bond Ordinances in accordance with the terms thereof. The payment of the Notes is subject to the prior lien and payment of the Prior Lien Bonds for so long as any of the Prior Lien Bonds remain outstanding. Payment of the Notes is also subject to the payment of the Outstanding Bonds, and any other bonds and obligations issued and a parity therewith pursuant to the Bond Ordinance.

No additional debt may be issued under the Prior Lien Bond Ordinances.

## LIQUIDITY AGREEMENT

### National Australia Bank Group

National Australia Bank Limited is the holding company and main operating company of the National Australia Bank Group of companies (the "Group"). The Group is an international financial services group that provides a comprehensive and integrated range of financial products and services. Globally, as at 31 March 2005, the Group had:

- Total assets of approximately AUD402 billion;
- AUD85 billion in funds under management and administration; and
- AUD372 billion in assets under custody and investment administration.

## **About Institutional Markets & Services**

Institutional Markets & Services (“IMS”) division is one of National Australia Bank Group's four business lines. A global product & services business, IMS is responsible for providing risk management, funding and investment products across all of the Group's client segments. The division is also responsible for relationship management of banks, financial institutions, supranationals (such as development banks) and government bodies on a global basis.

IMS comprises the following divisions: Financial Institutions, Markets, Structured Products, Credit Products, Loan Syndications & Portfolio Management and Services. It has operations in Australia, Europe, New Zealand, New York, and Asia.

More information can be found at:

[www.nabgroup.com](http://www.nabgroup.com)

[www.nabmarkets.com](http://www.nabmarkets.com)

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The information contained in this Offering Memorandum relates to and has been obtained from National Australia Limited Bank (the “Bank”). The delivery of the Offering Memorandum shall not create any implication that there has been no change in the affairs of the Bank since the date hereof, or that the information contained or referred to in this Offering Memorandum is correct as of any time subsequent to its date.

## **CITY OF LINCOLN**

Lincoln, the capital of Nebraska (the "City"), is located in southeastern Nebraska near the center of population of the State. The City is a municipal corporation and a city of the primary class under Nebraska law. It operates under a home rule Charter and has an elected full-time chief executive ("Mayor") and elected legislative body ("City Council"). Lincoln's government has a broad range of responsibilities, including operation and maintenance of electric, water, and sanitary sewer systems. The Charter grants the City power to purchase, construct and otherwise acquire, own, maintain and operate public utility plants, property and facilities within and without the limits of the City. The administration of City government operates under the direction of the Mayor by administrative departments.

The City's general obligation indebtedness carries a "Aaa" rating from Moody's and a "AAA" rating from Standard & Poor's. Lincoln is one of the few cities in the United States having such ratings from both Moody's and Standard & Poor's.

The City is authorized under the Constitution and laws of the State and its home rule Charter to issue revenue bonds. The Finance Director is appointed by the Mayor with the approval of the City Council. Among other duties imposed by the City Charter, the Finance Director is responsible for the issuance and sale of bonds, for depositing the proceeds therefrom and for other acts relating to bonds. Don Herz has held the position of Finance Director since June 1999. Selected demographic information with respect to the City and the LES service area is included in Appendix II to this Official Statement.

## **LINCOLN ELECTRIC SYSTEM**

### **Organization**

Since 1913, the City has owned and operated at least a partial electric system. In 1966, the City purchased the properties serving Lincoln from Consumers Public Power District and combined them with City property to form Lincoln Electric System. In 1971, following a referendum, the Administrative Board for LES was created. It is responsible for day-to-day administration of the electric system. The City, through the City Council, retained the right to approve rates and charges, the annual budget and debt financing for LES capital requirements. Historically, such approvals have been granted by the City Council based on the actions approved and recommended by LES management and the LES Administrative Board.

### **Service Area**

The LES service area includes the corporate area of the City and an area outside the City's corporate limits. The service area covers approximately 200 square miles, of which approximately 80 square miles are within the City limits. Approximately 4% of LES' customers are located outside the City's corporate limits. To the extent that the corporate limits of the City are expanded in the future, Nebraska law provides that the service area of LES may likewise be expanded. The LES service area is totally surrounded by Norris Public Power District. LES and Norris have an agreement providing a mechanism for orderly expansion of the LES service area as the City expands. LES holds an exclusive franchise to serve customers within its service area. Nebraska law contains certain provisions pertaining to the rights of municipalities within the State to acquire the electric distribution systems associated with providing service to residents of the municipality. Only one municipality, the City of Waverly, with a population less than 2,000, is located within the LES service area and is served under a ten year franchise agreement dated November 1, 1986. In 1996, Waverly, through a ten year automatic renewal of the Agreement, extended the term through November 1, 2006. LES' financial results would not be materially adversely affected by the loss of the Waverly energy sales and revenues.

LES served 121,508 customers as of December 31, 2004, of which 87% were residential, 12% were commercial and industrial and the balance, approximately 1%, was governmental and other. The total number of customers increased 1.7% in 2000, 1.9% in 2001, 2.3% in 2002, 2.1% in 2003 and 1.7% in 2004.

## **RATES**

### **General**

There are no investor-owned electric utilities serving customers in Nebraska. State residents are served exclusively by public power districts, municipally-owned utilities, such as LES, and not-for-profit rural electric cooperatives. The Nebraska Public Service Commission retains only very limited jurisdiction over the operation of electric utilities in the State, with no jurisdiction over electric rates. The City Council has exclusive jurisdiction for establishing rates for LES' retail customers. In the opinion of the General Counsel to LES, no other State or Federal regulatory body has any authority to determine or review the retail rates set by the

City Council.

The retail electric rates charged by LES are not subject to Federal regulation. Pursuant to the National Energy Policy Act of 1992, however, LES could come under the jurisdiction of the Federal Energy Regulatory Commission ("FERC") with regard to certain matters relating to providing wholesale transmission services (see "Electric Utility Deregulation and Competition"). In addition, as described above under "LINCOLN ELECTRIC SYSTEM-Nebraska Power Review Board," the NPRB is empowered by Nebraska law to render advisory opinions concerning wholesale rate disputes, which are not binding upon the parties.

### **Rate Design**

LES' rates are designed by the LES staff using cost of service principles and do not include any automatic fuel cost adjustment. Rates are adopted by the LES Administrative Board after a public hearing and then submitted to the City Council for approval. The table set forth below under the subcaption "History of Rate Changes" lists average retail rate changes since 1987; rate changes for individual customer classes have been lower and higher than the average rates.

### **History of Rate Changes**

Over the last five years, LES retail sales have represented 89.5% of LES' operating revenues. The average retail rate changes since 1987 are as follows:

<u>Effective Date</u>	<u>% Change</u>	Average
May 1, 1987		-3.0
December 1, 1987		-7.0
October 1, 1992		3.0
January 1, 1994		4.0
April 1, 2003		5.0
October 15, 2004		3.0
August 1, 2005		9.0 <sup>(1)</sup>

(1) Reflects increased fuel, freight and operations costs at LES' owned generation facilities.

For 2004, LES' average billed retail revenue was \$.0519 per kilowatt-hour ("kWh") and for 2005 is budgeted at \$.0536 per kWh.

## POWER SUPPLY

### Summary of Resources

LES satisfies its capacity and energy requirements from the following resources:

LES-owned generation facilities comprised of (i) output associated with LES' undivided ownership interest, as a tenant in common, in the Missouri Basin Power Project and its Laramie River Generating Station ("LRS") operated and maintained by Basin Electric Power Cooperative ("Basin"), (ii) generation from four LES-owned combustion turbines located at the Rokeby Generating Station and 8<sup>th</sup> & J Street, and (iii) a combined cycle and peaking generating facility located at the Salt Valley Generating Station (see "LES-Owned Generation");

Purchases from Nebraska Public Power District ("NPPD"), under separate participation contracts, of a portion of the output of the Gerald Gentleman Station, and the Sheldon Generating Station (see "Participation Contracts with Nebraska Public Power District"); and

Other power purchase arrangements include purchases from (i) the United States Department of Energy, Western Area Power Administration ("WAPA"), and (ii) purchases through the Mid-Continent Area Power Pool ("MAPP").

Total resources available during 2005 (net after sales of capacity) are projected by LES to be 934 megawatts ("MW").

### Lincoln Electric System Resources - 2005

<u>Unit Name</u>	<u>Fuel Type</u>	<u>Lead Owner</u>	<u>Commercial Operation Date</u>	<u>Net Capacity (MW)</u>	<u>LES Share</u>	
					<u>%</u>	<u>(MW)</u>
<b>Owned Units</b>						
Laramie River (Net to LES)	Coal	Basin	1982	1,710.0	10.49	179.0
J Street Combustion Turbine	Oil/Gas	LES	1972	27.0	100.0	27.0
Salt Valley 1 (Steam Unit) <sup>(1)</sup>	Oil/Gas	LES	2004	26.9	100.0	26.9
Salt Valley 2 (Combustion Turbine) <sup>(1)</sup>	Oil/Gas	LES	2003	47.9	100.0	47.9
Salt Valley 3 (Combustion Turbine) <sup>(1)</sup>	Oil/Gas	LES	2004	47.5	100.0	47.5
Salt Valley 4 (Combustion Turbine)	Oil/Gas	LES	2003	47.0	100.0	47.0
Salt Valley Black Start Diesel	Oil/Gas	LES	2004	1.6	100.0	1.6
Rokeby 1 Combustion Turbine	Oil/Gas	LES	1975	63.3	100.0	63.3
Rokeby 2 Combustion Turbine	Oil/Gas	LES	1997	86.4	100.0	86.4
Rokeby 3 Combustion Turbine	Oil/Gas	LES	2001	96.4	100.0	96.4
Rokeby Black Start Diesel	Oil/Gas	LES	1997	3.0	100.0	3.0
Wind Turbines 1&2 <sup>(2)</sup>	Wind	LES	2000	1.3	100.0	0.0
Power Purchase Program	DSM	LES	1999	4.0	100.0	4.0
<b>Participation Units</b>						
Gerald Gentleman	Coal	NPPD	1982	1,365.0	8.0	109.2
Sheldon	Coal	NPPD	1968	225.0	30.0	67.5
Springview Wind Units <sup>(2)</sup>	Wind	NPPD	1998	1.6	29.4	0.0
<b>Firm Contracts</b>						
Western Area Power Administration	Hydro	WAPA	1974			127.0
						<u>933.7</u>

(1) Salt Valley units 1, 2 and 3 are normally operated as a 2 on 1 Combined Cycle Unit.

(2) Available for energy production but capacity not accredited with MAPP.

The following sections provide a summary description of each of the above-mentioned resources and related contractual arrangements.

## Other Power Purchase Arrangements

### Western Area Power Administration (WAPA)

LES has an allocation from the United States Department of Energy, through WAPA, of firm power under contract from Upper Missouri Basin hydroelectric plants of approximately 54 MW. LES has also received an allocation of firm peaking power of WAPA, 72 MW for five months and 21 MW for the remaining months. The majority of the energy which LES receives associated with the firm peaking power is repaid to WAPA during non-peak periods. Payments for WAPA power are at the standard WAPA wholesale rates. The average cost of WAPA power in 2004 was \$.0245/kWh. The WAPA contract expires December 31, 2020. In 2006 and 2011 WAPA can adjust the contract amounts by reducing LES' share of marketable capacity by 1% in each year.

## Transmission, Distribution and Interconnections

### Lincoln Area Facilities

LES owns a network of transmission lines which interconnect its generating plants to transmission lines of adjacent utilities and to various transmission and distribution substations serving the loads of LES. The LES transmission lines are physically interconnected with the transmission systems of Omaha Public Power District ("OPPD") and NPPD.

A summary of the LES transmission lines is as follows:

<u>Circuit Voltage</u>	<u>Circuit Miles</u>
345 kV	55
161 kV	12
115 kV	<u>165</u>
Total	<u><u>232</u></u>

LES owns two 345/115 kV substations, a 161/115 kV substation and 40 substations which reduce transmission voltage to distribution voltage. LES has entered into an agreement with NPPD under which NPPD maintains LES' 345 kV transmission lines. The distribution system is operated at two primary voltage levels, 12.5 kV and 35 kV. The system includes approximately 1,810, miles of primary distribution lines that interconnect the distribution substations to the lower voltage transformers serving retail customers.

New distribution systems for developments, subdivisions, shopping centers and apartment complexes are generally served by underground 12.5 KV facilities. In the interest of upgrading electric service to some of the older parts of the City, a portion of the older overhead distribution system has been replaced with underground lines. Consequently, as of December 31, 2004, more than 65% of LES 121,508 retail customers were served by underground facilities.

LES is also one of seven participants in a project referred to as the Missouri-Iowa-Nebraska Transmission ("MINT") Project which consists of 105 miles of 345 KV transmission extending from the substation at CNS to Fairport, Missouri and then to St. Joseph, Missouri.

## Mid-Continent Area Power Pool (MAPP)

LES is a participant in MAPP, which was created pursuant to the Mid-Continent Area Power Pool Agreement, dated March 31, 1972 (the "MAPP Agreement"). The participant members of MAPP consist of municipal utilities, investor-owned utilities, generation and transmission cooperatives, rural electric cooperatives, public power districts, municipal joint action agencies, WAPA, state regulating bodies, and power marketers. MAPP's participants are engaged in the electric utility business in the upper Midwest and Manitoba, Canada.

MAPP was established to operate as a Regional Reliability Council and Power Pool to realize and further the reliability and benefits of interconnected operations. MAPP also provides for the coordination of the installation and operation of generation and transmission facilities pursuant to its contract with Midwest Independent Transmission System Operator ("MISO"), MAPP

continues to provide the coordinated sharing of generation reserves. The MAPP regional reliability council functions were transferred to the recently formed Midwest Reliability Organization (“MRO”).

### **Midwest Independent Transmission System Operator (MISO)**

The Midwest Independent Transmission System Operator, Inc. (“MISO”) is a FERC approved Regional Transmission Organization (RTO). MISO is based in Carmel, Indiana, and is responsible for monitoring the electric transmission system that delivers power from generating plants to wholesale power transmitters. MISO’s role is to ensure equal access to the transmission system, to serve as the platform for a wholesale electricity market and to maintain or improve electric system reliability in the Midwest.

The MISO was founded on February 12, 1996, and began selling transmission service under its tariff on February 1, 2002. On April 1, 2005, it commenced Day Two market service, assuming full control of transmission and generation dispatch within its footprint. Utilities with more than 100,000 miles of transmission lines covering 1.1 million square miles from Manitoba, Canada, to Kentucky and Nebraska to Pennsylvania are participating in the MISO market.

LES became a full transmission-owning member in MISO on February 28, 2001. While LES is recognized as a transmission owning member of the MISO, due to the delay by utilities adjacent to LES in transfer of transmission functional control to MISO, LES has not yet come under the active MISO tariff administration.

### **Midwest Reliability Organization (MRO)**

The Midwest Reliability Organization (“MRO”) is a not-for-profit organization dedicated to ensuring the reliability of the bulk power system in the Midwest part of North America. The primary focus of the MRO is ensuring compliance with regional and international standards and criteria utilizing open, fair processes in the public interest.

Formation of the MRO was approved by the MAPP Executive Committee in November 2002. This organization is operational and replaces the MAPP Regional Reliability Council of the North American Electric Reliability Council (“NERC”). LES’ CEO serves as Vice Chairman of the MRO Board of Directors.

### **Future Power Supply and System Improvements**

#### Future Power Supply

*General.* As part of a continual planning process, LES reviews its load and resources and participates in statewide and regional planning efforts to determine the most economical way to meet the needs of its customers. LES utilizes an integrated resource planning methodology to evaluate demand side management (“DSM”), purchases and construction alternatives. LES expects to meet its future resource needs after 2005 with a mix of alternatives which may include DSM, purchases from MAPP or MINT participants, and the participation in Council Bluffs No. 4, a regional base load resource.

*Council Bluffs No. 4 (CB4).* During 2002, LES initiated work with MidAmerican Energy Company (“MEC”) to become a joint owner in the planned CB4 coal fired generator project. LES received LES Administrative Board approval, Nebraska Power Review Board (“NPRB”) approval and Lincoln City Council approval to purchase a nominal 100 MW ownership interest in the project. LES has executed the Joint Ownership Agreement for the Council Bluffs No. 4 project and a Power Purchase Agreement (“PPA”) with MEC which provides that the 100 MW capacity be split with the first 50 MW block delivered starting in 2007 and the second 50 MW block starting in 2009. The PPA allows LES to stage the CB4 base load capacity to more closely match the system load growth.

The CB4 project consists of the fourth unit to be constructed at the MEC Council Bluffs generating station site. This new 790 MW coal fired unit will utilize high efficiency super critical boiler technology with state of the art emission control facilities. The CB4 site is served by dual rail carriers and fuel for the project will be acquired by the MEC corporate fuel purchasing structure. MEC will act as project manager for CB4 construction and as the operating agent for the fifteen joint owner utilities.

As of August 31, 2005, the total project, which includes engineering, equipment procurement, and construction activities, is approximately 60% complete. Site construction activities are over 30% complete. The on-site work force will peak at almost 1,300 craftsmen this fall. Key construction activities currently in progress include: alignment of steam turbine components, completion of

boiler building and steam turbine hall enclosures, erection of coal handling systems, installation of air quality and control system foundations and structural steel, installation of stack liner panels and boiler water wall construction.

The Project includes extensive high voltage transmission upgrades in Iowa and additional interconnections to the Nebraska high voltage facilities. The transmission work includes: 1) a new 345 kV transmission line between the plant and Des Moines, Iowa, 2) interconnection of the plant to the OPPD 161 kV transmission system and 3) upgrades at the Cooper Nuclear Station's substation.

*Council Bluffs No. 4 Environmental Issues.* Council Bluffs Unit #4 is required to hold SO<sub>2</sub> allowances under the current Acid Rain Program (ARP). As Unit #4 is a new unit, it is expected that all SO<sub>2</sub> allowances will be purchased by or transferred to this unit. Beginning in 2010, CAIR requires a 50 percent reduction below the ARP cap. While the approach will be determined by how Iowa chooses to implement CAIR in its State Implementation Plan ("SIP"), it is most likely that this reduction will be achieved by reducing the value of SO<sub>2</sub> allowances associated with Unit #4 (i.e., two allowances will be required for each ton of emissions). In 2015 the reduction will be 65 percent below the ARP cap, requiring 2.86 allowances for each ton of emissions.

Beginning in 2009, Council Bluffs Unit #4 will be required to obtain NO<sub>x</sub> allowances equal to the amount of NO<sub>x</sub> emitted. State budgets for NO<sub>x</sub> under Clean Air Interstate Rule ("CAIR") are based on system averages for 2009 and 2015, respectively. It is not yet known how Iowa will allocate NO<sub>x</sub> emission credits. Unit #4 may receive some allowances from a set-aside allowance pool or it may have to purchase all of its allowances. The SIP, which is due by September 11, 2006, is expected to address this issue.

*Other System Improvements.* LES is considering various system additions and improvements to upgrade and expand transmission and distribution systems including the following:

1. Reconstruction of a 115 KV transmission line from Sheldon Station to Rokeby.
2. Construction of a 115 KV transmission line from NW 12<sup>th</sup> and Arbor to NW 68<sup>th</sup> and Holdrege.
3. Construction of a 345 KV transmission line from Wagener Substation to NW 68<sup>th</sup> and Holdrege.
4. Construction of 345 KV substation to connect to a 345 KV OPPD line from the OPPD Nebraska City generation site.  
(1) The 345 substation will be constructed and owned by LES but financed by the Nebraska City No. 2 Project participants.
5. Addition of a second 345-115 KV, 336 MVA transformer.
6. Initiation of the replacement of underground distribution cable.

## Historical Resource Summary

The following tables show historical summer season loads (including MAPP reserve requirements), resource capabilities and the total energy production for 2000 through 2004.

<b>Load &amp; Generating Capability</b> (Megawatts)					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<b>LES Load Responsibility</b>	<b>789</b>	<b>808</b>	<b>834</b>	<b>824</b>	<b>844</b>
<b>Owned Units</b>					
<b>LRS</b>	179	179	179	179	179
<b>LES Local</b>	194	291	293	296	423
<b>Participation Units</b>					
<b>NPPD - CNS/System <sup>(1)</sup></b>	95	95	95	95	0
<b>NPPD - GGS</b>	109	109	109	109	109
<b>NPPD - Sheldon</b>	68	68	68	68	68
<b>Firm Contracts</b>					
<b>WAPA Purchases</b>	131	125	127	127	127
<b>Firm Sale</b>					
<b>Purchases</b>	59	0	0	0	0
<b>Total Resource Capability</b>	<u>835</u>	<u>867</u>	<u>871</u>	<u>874</u>	<u>906</u>
<b>Surplus or Deficit (-)</b>	<u>46</u>	<u>59</u>	<u>37</u>	<u>50</u>	<u>62</u>

<b>Energy</b> (Megawatt-hours)					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
<b>Owned Units</b>					
<b>LRS</b>	1,157,917	1,403,358	1,451,015	1,339,479	1,465,060
<b>LES Local</b>	46,045	38,325	41,205	47,237	135,690
<b>Participation Units</b>					
<b>NPPD - CNS/System <sup>(1)</sup></b>	591,476	650,564	769,070	465,890	0
<b>NPPD - GGS</b>	657,590	769,515	797,107	844,617	823,397
<b>NPPD - Sheldon</b>	458,393	469,519	474,787	429,017	466,670
<b>Firm Contracts</b>					
<b>WAPA Purchases</b>	260,688	249,297	248,010	247,508	246,331
<b>Purchases</b>	373,292	201,872	189,208	335,847	418,546
<b>Net Total Purchased and Generated</b>	<u>3,545,401</u>	<u>3,782,450</u>	<u>3,970,402</u>	<u>3,709,595</u>	<u>3,555,694</u>
<b>Wholesale Sales and Losses</b>	387,996	590,703	746,740	479,638	274,684
<b>LES System Energy</b>	<u>3,157,405</u>	<u>3,191,747</u>	<u>3,223,662</u>	<u>3,229,957</u>	<u>3,281,010</u>

(1) Cooper Nuclear Station ("CNS") is a former LES resource. LES has no continuing obligation or responsibility for CNS.

## FACTORS AFFECTING LES AND THE ELECTRIC UTILITY INDUSTRY

**General.** The electric utility industry, in general, has been, and in the future may be, affected by a number of factors which could impact the financial condition and competitiveness of an electric utility and the level of utilization of generating facilities, such as those of LES. Such factors include, but are not limited to, (i) increases in costs of operation and construction of generating units, (ii) uncertainties in predicting future load requirements, (iii) shifts in availability and relative costs of different fuels, (iv) effects of compliance with rapidly changing environmental, safety, licensing, regulatory and legislative requirements, (v) other federal and state legislative and regulatory changes, (vi) self-generation by commercial and industrial customers, (vii) changes resulting from conservation and demand side management programs on the timing and use of electric energy, (viii) increased competition from independent power producers, marketers and brokers, (ix) issues relating to the ability to issue tax exempt obligations, (x) severe restrictions on the ability to sell to nongovernmental entities electricity from generation projects financed with outstanding tax exempt obligations and (xi) effects of competition from other electric utilities (including increased competition resulting from mergers, acquisitions, and strategic alliances of competing electric (and gas) utilities from competitors transmitting less expensive energy from much greater distances over an interconnected system) and new methods of producing low cost electricity, (xii) inadequate risk management procedures and practices with respect to, among other things, the purchase and sale of energy and transmission capacity. Any of these factors could have an effect on the financial condition of any given electric utility and will likely affect individual utilities in different ways.

LES cannot predict what effects such factors will have on its business operations and financial condition of LES, but the effects could be significant. The following sections provide a brief discussion of certain of these factors. However, this discussion does not purport to be comprehensive or definitive, and these matters are subject to change after the date of this Preliminary Official Statement. Extensive information on the electric utility industry is, and is expected to be, available from legislative and regulatory bodies and other sources in the public domain, and potential purchasers of the securities of LES should obtain and review such information.

**Energy Policy Act of 2005.** On August 8, 2005, the President signed the Energy Policy Act of 2005. Provisions in the legislation include: (i) repeal of the Public Utility Holding Company Act; (ii) the grant to FERC of the authority to site transmission facilities if states are unwilling or unable to approve siting; (iii) mandatory electricity reliability standards; (iv) revisions to the Public Utility Regulatory Policies Act; (v) a broad market manipulation ban; and (vi) protections for native load customers for utilities in certain areas of the country. The legislation also contains provisions that would give FERC limited jurisdiction over interstate transmission assets of municipal utilities, cooperatives and federal utilities..

**FERC initiatives under the Energy Policy Act of 1992.** On April 24, 1996, FERC issued two Final Rules (Order No. 888 and order No. 889) to address and implement the requirements of the Energy Policy Act. These rules significantly changed the regulation of transmission services provided by public utilities (as defined by the Federal Policy Act (the “FPA”) that own, operate or control interstate transmission facilities and which are subject to the FERC’s jurisdiction over tariffs (“jurisdictional utilities”). LES is not a jurisdictional utility.

One of the Final Rules, Order No. 888, as modified on rehearing, requires, among other things, open-access, nondiscriminatory transmission tariffs be placed in effect for all jurisdictional utilities. The goal of Order No. 888, according to FERC, is to remove impediments to competition in the wholesale power market and to bring more efficient lower cost power to the nation’s electricity consumers by denying to a generator of electric energy any unfair advantage over its competitors that exists by ownership of its transmission system. Order No. 888 also requires non-jurisdictional utilities including municipal and consumer-owned utilities) that receive open-access transmission service to, in turn, provide open-access service to the transmitting utility under terms that are comparable to the service that the non-jurisdictional utility provides itself. Order No. 888 also includes provisions which, in effect, would permit a utility to recover stranded costs for generating and other facilities from wholesale customers of such utility who opt to purchase from other power providers.

The other Final Rule, Order No. 889, as modified on rehearing, implements standards of conduct for utilities that offer open access transmission services to ensure that transmission owners and affiliates do not have an unfair competitive advantage in using transmission to sell power. To this end, Order No. 889 requires those utilities to establish an electronic “Open-Access Same-time Information System” (OASIS) to share transmission-related information on a real-time basis and requires those utilities to obtain information about their transmission systems for their own wholesale power transactions in the same way that their competitors do via an OASIS. Order No. 889 also promulgates standards of conduct to ensure that utilities functionally separate their transmission and wholesale power merchant functions to prevent self-dealing.

In 1999 and 2000, respectively, FERC issued Order Nos. 2000 and 2000-A to encourage all transmission owners, including non-jurisdictional entities, to voluntarily place their transmission facilities in the hands of a regional transmission organization (RTO). The establishment of RTOs is intended to address remaining transmission-related impediments to a competitive wholesale electricity market. Order Nos. 2000 and 2000-A set minimum characteristics and functions that RTOs must meet and required FERC jurisdictional utilities to submit filings to FERC setting forth RTO proposals.

On April 28, 2003, FERC issued a "White Paper" that describes how FERC plans to significantly modify the proposal described in the 2002 NOPR in response to strong criticism by state regulators, industry interests and members of congress. The White Paper describes in skeletal form a new "Wholesale Market Platform."

Although LES is not directly subject to the new rules, the provisions of Order No. 888 have had a significant impact on the LES and other non-jurisdictional utilities, as well as marketplace as a whole. Additionally, LES is subject to the reciprocity provision of Order No. 888, as described above. The provisions of Order No. 888 were part of the impetus of LES' participation in MISO.

**Federal Tax Issues.** In September 2002, the U.S. Department of Treasury issued final private use regulations that provide guidance to issues of tax-exempt bonds for electric output facilities. The regulations took effect November 22, 2002, replacing temporary and proposed regulations released in January 2001. The final regulations provide that tax-exempt bonds may be issued to finance costs attributable to the government use portion of a mixed-use output facility without the bonds being characterized as private activity bonds. Operation of transmission facilities of public power utilities that participate in independent transmission operations approved by the Federal Energy Regulatory Commission will generally not result in private use. In addition, providing ancillary services that are required as part of an open access transmission tariff under FERC rules does not result in private business use.

**State of Nebraska Utility Industry Restructuring.** Currently, Nebraska is the only state in the U.S. to be served exclusively by public power districts, municipal utilities and rural electric cooperatives. In early 1996, the Nebraska Legislature approved Legislative Resolution 455 ("LR 455") providing for a study of the electric utility industry in Nebraska. The results of the LR 455 study recommended that Nebraska base any future restructuring or electric utility deregulation effort on a "condition certain" approach rather than a date certain approach. Five preconditions to a competitive retail market were identified as follows: (a) a viable wholesale market in place; (b) a regional ISO/RTO in place; (c) legislative solutions for revenue neutral state and local tax impacts; (d) opt-in choice by local utilities; and (e) wholesale electricity costs in adjoining states be equal to or less than costs in Nebraska, a condition which does not appear to be imminent.

Following completion of the LR 455 study, the Nebraska Legislature adopted LB 901, an additional legislative bill: LB 901 which requires the Nebraska Power Review Board to annually monitor and report the specific conditions to prepare the state for retail competition. The reports have been submitted annually since September 2001 and have found Nebraska's average generation costs were below the regional market price and Nebraska's annual average retail rate was below the national average. The 2004 report submitted in September determined that Nebraska's four-year average generation costs were 21 percent below the regional market and Nebraska's average retail rate was 23 percent below the national average

Presently, LES has the exclusive right to serve retail electric customers within its service area. However, as part of ongoing proposals and initiatives to achieve deregulation of the electric utility industry (see discussion above), it is possible that "retail wheeling" will be permitted in the future. If this were to occur, LES, as well as other utilities, could face retail price competition. LES is currently assessing the potential competition from other suppliers for certain of its retail loads, and has completed cost of service "unbundling" studies.

## **Environmental**

**General.** Electric utilities are subject to continuing environmental regulation. Federal, state and local standards and procedures which regulate the environmental impact of electric utilities are subject to change. These changes may arise from continuing legislative, regulatory, and judicial action regarding such standards and procedures. Consequently, there is no assurance that LES' facilities will remain subject to the regulations currently in effect, will always be in compliance with future regulations, or will always be able to obtain all required operating permits. An inability to comply with environmental standards could result in additional capital expenditures to comply, reduced operating levels or the complete shutdown of individual units not in compliance.

**Air Quality.** In 1990, Congress enacted amendments to the Clean Air Act (CAAA) with the intent of improving ambient air quality throughout the United States. One objective of these amendments is to reduce emissions of sulfur dioxide (SO<sub>2</sub>) and

nitrogen oxide (NO<sub>x</sub>) by power plants. All generating units in which LES has an ownership or "Life of Plant" contractual interest (LRS, Rokeby Units 2 and 3, Sheldon and Gentleman) operate at emission rate levels below the regulatory limits for SO<sub>2</sub> and NO<sub>x</sub> currently applicable to the units.

Beginning in 2000, LRS, Rokeby Units 2 and 3, Sheldon and Gentleman Stations became subject to the Act's SO<sub>2</sub> emission allowance system. Under the emission allowance system, each affected generating unit will be issued, annually, a number of allowances, based upon license and operating factors established in 1985-1987. Under this system, some utilities, including MBPP and NPPD, have been issued bonus allowances for certain affected units from 2000 through 2009. No utility may emit more tons of SO<sub>2</sub> in a year than is authorized by the total allowances it holds. The use of allowances is not restricted to a specific unit or plant. Allowances not needed by a utility for its own emissions may be banked for future use, or they may be sold or otherwise transferred. The CAAA provides that where a utility purchases power from an affected unit under life-of-the-unit, firm power contractual arrangements, allowances and the proceeds of transactions involving allowances will be deemed to be held or distributed in proportion to each holder's contractual reservation or entitlement, or in accordance with the provisions of a contract between the parties which expressly provides for a different distribution of allowances. LES has been receiving its pro rata share of allowances issued for generating units in which it has entitlements.

On March 10, 2005, the United States Environmental Protection Agency ("EPA") issued the Clean Air Interstate Rule (CAIR). CAIR will permanently cap emissions of sulfur dioxide (SO<sub>2</sub>) and nitrogen oxides (NO<sub>x</sub>) across 28 eastern states and the District of Columbia. In a separate but related action, on March 15, 2005, EPA issued the Clean Air Mercury Rule (CAMR), to permanently cap and reduce mercury emissions from coal-fired power plants. LES has holdings in Nebraska, Wyoming and Iowa. Of the three states in which LES has holdings, only Iowa is impacted by CAIR. See "Council Bluffs No. 4 environmental issues" on Page 11.

CAMR will affect units in all three states. Council Bluffs Unit #4 will be considered as a "new source" and will therefore be subject to the new mercury emission limits in New Source Performance Standard. All of the other units will be classified as "existing sources". Both new and existing sources will be subject to the monitoring requirements of CAMR. Existing sources are expected to receive credits to cover their emissions under the Phase 1 cap. Unit #4 is being designed with mercury control technology, it is expected that it will be able to comply with the NSPS limits and will not require additional capital investment. Phase 2 of the cap takes effect in 2018, and remaining units may need to either install mercury control technology or purchase additional allowances.

On May 31, 2005, EPA received two Petitions for Reconsideration of the Clean Air Act Section 112 final rule regarding regulation of mercury and nickel from power plants. One petition was from 14 states and another was from 5 environmental groups and 4 tribes. The petitions requested an opportunity for further public comment on parts of the final Section 112 rule. On June 24, 2005, EPA sent a letter to the petitioners to inform them that EPA has decided to initiate a reconsideration process for parts of the Section 112 rule in order to ensure ample opportunity for public comment. EPA will not stay the rule pending the reconsideration process.

In November 1995, the State of Nebraska was included in the Ozone Transport Assessment Group ("OTAG"). OTAG is a group of state air quality control agencies formed pursuant to direction by the Environmental Protection Agency ("EPA") that consists of 37 states of the continental United States. OTAG studied ozone formation, transport and methods of ozone reduction to arrive at a consensus on how to reduce high ozone levels in certain areas of the eastern United States. The authority of OTAG is supported by the EPA and comes under Title I of the Clean Air Act Amendments. In June 1997, OTAG made recommendations to the EPA regarding NO<sub>x</sub> reductions in the 37-state OTAG region. Based on these recommendations to the EPA, it is not anticipated that the EPA will require any additional NO<sub>x</sub> reductions in Nebraska.

***Hazardous Substances and Wastes.*** Since the enactment of the Resource Conservation and Recovery Act, the Toxic Substances Control Act, and the Comprehensive Environmental Response Compensation and Liability Act, the electric utility industry has found ever increasing environmental regulations and requirements for dealing with hazardous materials and wastes. LES programs dealing with hazardous materials include audits of all disposal facilities, environmental audits of all properties bought or sold by LES, the issuance of oil and hazardous materials spill plans, and employee education on the proper handling of hazardous materials.

## HISTORICAL OPERATING RESULTS

### HISTORICAL OPERATING RESULTS AND DEBT SERVICE COVERAGE

	2000	2001	2002	2003	2004
	(Dollars in Thousands)				
Operating Revenues					
Electric	\$151,242	\$155,702	\$161,112	\$164,824	\$164,520
Other	3,514	3,713	3,862	4,044	3,967
Total Operating Revenues	<u>154,756</u>	<u>159,415</u>	<u>164,974</u>	<u>168,868</u>	<u>168,487</u>
Operating Expenses <sup>(1)(2)</sup>					
Power Purchased <sup>(3)</sup>	67,275	64,302	58,688	63,692	50,852
Power Production	19,035	19,151	19,180	19,567	30,231
Operations	22,762	29,908	27,403	28,584	29,328
Maintenance	3,039	3,804	4,077	4,308	4,075
Total Operating Expenses	<u>112,111</u>	<u>117,165</u>	<u>109,348</u>	<u>116,151</u>	<u>114,486</u>
Net Operating Revenues <sup>(4)</sup>	42,645	42,250	55,626	52,717	54,001
Interest and Other Revenues	<u>3,296</u>	<u>3,467</u>	<u>3,305</u>	<u>1,542</u>	<u>1,499</u>
Available for Debt Service	<u>\$45,941</u>	<u>\$45,717</u>	<u>\$58,931</u>	<u>\$54,259</u>	<u>\$55,500</u>
Bond Debt Service					
Prior Lien Bonds-Principal	\$1,825	\$1,257	----	----	----
Prior Lien Bonds-Interest	2,188	1,419	----	----	----
Subtotal	<u>4,013</u>	<u>2,676</u>	<u>----</u>	<u>----</u>	<u>----</u>
1993 Bonds-Principal (Senior Lien)	7,852	8,195	9,217	7,379	----
1993 Bonds-Interest (Senior Lien)	10,333	9,985	7,849	1,679	----
Subtotal	<u>18,185</u>	<u>18,180</u>	<u>17,066</u>	<u>9,058</u>	<u>----</u>
1998 Bonds-Principal (Senior Lien)	1,487	1,553	1,623	1,695	1,772
1998 Bonds-Interest (Senior Lien)	1,994	1,927	1,857	1,784	1,708
Subtotal	<u>3,481</u>	<u>3,480</u>	<u>3,480</u>	<u>3,479</u>	<u>3,480</u>
2001 Bonds-Principal	----	----	----	----	----
2001 Bonds-Interest	----	2,494	7,163	7,163	7,163
Subtotal	<u>----</u>	<u>2,494</u>	<u>7,163</u>	<u>7,163</u>	<u>7,163</u>
2002 Bonds-Principal	----	----	----	2,795	8,497
2002 Bonds-Interest	----	----	1,810	7,238	7,126
Subtotal	<u>----</u>	<u>----</u>	<u>1,810</u>	<u>10,033</u>	<u>15,623</u>
2003 Bonds-Principal	----	----	----	777	2,073
2003 Bonds-Interest	----	----	----	1,390	5,907
Subtotal	<u>----</u>	<u>----</u>	<u>----</u>	<u>2,167</u>	<u>7,980</u>
Total Bond-Principal	11,164	11,005	10,840	12,646	12,342
Total Bond-Interest	<u>14,515</u>	<u>15,825</u>	<u>18,679</u>	<u>19,254</u>	<u>21,904</u>
Grand Total Debt Service	<u>\$25,679</u>	<u>\$26,830</u>	<u>\$29,519</u>	<u>\$31,900</u>	<u>\$34,246</u>
Coverage:					
Prior Lien Bonds (or Senior Lien)	11.45	17.08	2.87	4.33	15.95
Total Bonds	1.79	1.70	2.00	1.70	1.62
Net Revenues	\$4,509	\$733	\$11,609	\$6,203	(\$2,972)
Accumulated Net Revenues	\$190,270	\$191,003	\$202,612	\$208,815	\$205,843

(1) The Operating Expenses excludes depreciation for the fiscal years shown and were \$ 17,126, \$ 18,625, \$ 19,566, \$ 22,409 and \$ 27,355, respectively.

(2) The Operating Expenses excludes payments in lieu of tax for the fiscal years shown and were \$ 6,688, \$ 6,803, \$ 7,135, \$ 7,449 and \$ 7,549, respectively.

(3) The Power Purchased expenses includes fuel costs and fixed costs related to debt service.

(4) The Net Operating Revenues exclude depreciation, amortization, interest expense and payments in lieu of tax.

## LITIGATION

There are no cases pending that will have a material adverse effect on LES.

## FINANCIAL ADVISOR

Public Financial Management (“PFM”), Philadelphia, Pennsylvania and Orlando, Florida, is serving as financial advisor to LES with respect to the sale of the 2005 Notes. The financial advisor assisted in the preparation of this Offering Memorandum and in other matters relating to the planning, structuring and issuance of the 2005 Notes and provided other advice. PFM will not participate as an underwriter in any offer to purchase the 2005 Notes.

## APPROVAL OF LEGAL PROCEEDINGS

All legal matters incident to the authorization and issuance of the 2005 Notes are subject to the approval of Gilmore & Bell, P.C., Lincoln, Nebraska, Bond Counsel, whose approving opinion in connection with the issuance of the 2005 Notes in substantially the form attached hereto as Appendix V will be delivered to the City. Certain legal matters with respect to the City will be passed upon by the Lincoln City Attorney and certain matters with respect to LES will be passed upon by its General Counsel.

## TAX MATTERS

### Opinion of Bond Counsel

***Federal and Nebraska Tax Exemption.*** In the opinion of Gilmore & Bell, P.C., Bond Counsel, under existing law, the interest on the Notes is excluded from gross income for federal and Nebraska income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. It should be noted, however, that for the purpose of computing the alternative minimum tax imposed on corporations (as defined for federal income tax purposes), such interest is taken into account in determining adjusted current earnings. The opinions set forth in this paragraph are subject to the condition that the City comply with all requirements of the Internal Revenue Code of 1986, as amended (the “Code”), that must be satisfied subsequent to the issuance of the Notes in order that interest thereon be, or continue to be, excluded from gross income for federal and Nebraska income tax purposes. The City has covenanted to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of interest on the Notes in gross income for federal and Nebraska income tax purposes retroactive to the date of issuance of the Notes. The Notes have not been designated as “qualified tax-exempt obligations” for purposes of Section 265(b) of the Code.

Bond Counsel expresses no opinion regarding other federal tax consequences arising with respect to the Notes.

### ***Other Tax Consequences***

Prospective purchasers of the Notes should be aware that there may be tax consequences of purchasing the Notes other than those discussed under the caption “Opinion of Bond Counsel,” including the following:

- (1) Section 265 of the Code denies a deduction for interest on indebtedness incurred or continued to purchase or carry the Notes or, in the case of a financial institution, that portion of such institution’s interest expense allocable to interest on the Notes;
- (2) with respect to insurance companies subject to the tax imposed by Section 831 of the Code, Section 832(b)(5)(B)(i) reduces the deduction for loss reserves by 15 percent of the sum of certain items, including interest on the Notes;
- (3) interest on the Notes earned by certain foreign corporations doing business in the United States could be subject to a branch profits tax imposed by Section 884 of the Code;
- (4) passive investment income, including interest on the Notes, may be subject to federal income taxation under Section 1375 of the Code for Subchapter S corporations that have Subchapter C earnings and profits at the close of the taxable year, if greater than 25% of the gross receipts of such Subchapter S corporation is passive investment income; and
- (5) Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take into account, in determining gross income, receipts or accruals of interest on the Notes.

Bond Counsel expresses no opinion regarding these tax consequences. Purchasers of Notes should consult their own tax advisors as to the applicability of these tax consequences. Bond Counsel will render its opinion in connection with the original issuance of the Notes, expected to occur on or about September 1, 2005. Bond Counsel must reaffirm in writing the conclusions stated in this original opinion as of the date of each subsequent issuance of Notes under the program. The delivery of this confirming opinion is a condition for the issuance of tax-exempt Notes under the program.

### **ACCOUNTANTS**

The financial statements of LES included in Appendix II to the Official Statement have been audited by KPMG LLP, certified public accountants, to the extent and for the periods indicated in their report thereon. Such financial statements have been included in reliance upon the report of KPMG LLP.

The issuance of this Official Statement and the signing thereof by the City's Finance Director and LES' Administrator has been authorized by the City.

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**APPENDIX I**

**APPENDIX I-A  
LINCOLN ELECTRIC SYSTEM  
UNAUDITED FINANCIAL STATEMENTS FOR PERIODS ENDING  
JUNE 30, 2005 AND 2004**

**APPENDIX I-B  
LINCOLN ELECTRIC SYSTEM  
AUDITED FINANCIAL STATEMENTS FOR YEARS ENDING  
DECEMBER 31, 2004 AND 2003**

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**LINCOLN ELECTRIC SYSTEM  
UNAUDITED FINANCIAL STATEMENTS FOR PERIODS ENDING  
JUNE 30, 2005 AND 2004**



## LINCOLN ELECTRIC SYSTEM

### Balance Sheet

June 30, 2005 and 2004

(Dollars in thousands)

(Unaudited)

<b>Assets</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Utility plant	\$ 856,575	813,469
Less accumulated depreciation	298,464	279,105
	<hr/> 558,111	<hr/> 534,364
Construction work in progress	96,062	98,180
Net utility plant	<hr/> 654,173	<hr/> 632,544
Noncurrent assets:		
Restricted bond funds	14,815	48,845
Deferred charges:		
Unamortized debt expense	2,243	2,600
Other	8,363	9,508
Total noncurrent assets	<hr/> 25,421	<hr/> 60,953
Current assets:		
Funds:		
Operating	10,712	15,017
Designated	12,078	12,067
Restricted bond funds	16,148	18,193
Total funds	<hr/> 38,938	<hr/> 45,277
Receivables	8,363	8,729
Unbilled revenues	14,458	10,964
Accrued interest receivable	285	630
Materials, supplies, and fuel inventories	8,830	7,119
Plant operation assets	4,961	4,433
Prepaid expenses	1,654	1,402
Total current assets	<hr/> 77,489	<hr/> 78,554
Total assets	<hr/> <hr/> \$ 757,083	<hr/> <hr/> 772,051

## LINCOLN ELECTRIC SYSTEM

### Balance Sheet

June 30, 2005 and 2004  
(Dollars in thousands)  
(Unaudited)

<b>Equity and Liabilities</b>	<b><u>2005</u></b>	<b><u>2004</u></b>
Equity:		
Invested in capital assets, net of related debt	\$ 134,644	135,308
Restricted for debt service, net of related debt	19,736	21,151
Unrestricted	44,304	48,690
Total equity	<u>198,684</u>	<u>205,149</u>
Long-term liabilities:		
Long-term debt, net	511,289	521,245
Deferred credits and other liabilities	2	2
Total long-term liabilities	<u>511,291</u>	<u>521,247</u>
Current liabilities:		
Liabilities payable from restricted funds:		
Current maturities of long-term debt	10,545	12,980
Construction payable	3,539	3,955
Accrued interest	7,626	7,541
Total liabilities payable from restricted funds	<u>21,710</u>	<u>24,476</u>
Other liabilities:		
Accounts payable	14,141	10,278
Accrual for payments in lieu of taxes	4,117	3,894
Other	7,140	7,007
Total other liabilities	<u>25,398</u>	<u>21,179</u>
Total current liabilities	<u>47,108</u>	<u>45,655</u>
Total equity and liabilities	<u>\$ 757,083</u>	<u>772,051</u>

## LINCOLN ELECTRIC SYSTEM

### Statements of Revenues, Expenses, and Changes in Equity

Six-month period ended June 30, 2005 and 2004

(Dollars in thousands)

(Unaudited)

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Electric retail	\$ 76,943	72,121
Electric wholesale	5,991	4,791
Other	731	2,195
	83,665	79,107
Operating expenses:		
Purchased power	26,612	24,244
Production	19,630	14,898
Operation	3,757	4,031
Maintenance	1,965	1,553
Administrative and general	10,925	10,749
Depreciation	14,537	13,131
In lieu of taxes	3,154	3,008
	80,580	71,614
Total operating revenues	3,085	7,493
Nonoperating expenses (revenues):		
Interest expense	11,765	11,489
Allowance for funds used during construction	(1,014)	(1,520)
Amortization of debt expense	(134)	1,393
Interest income	(930)	(734)
	9,687	10,628
Total nonoperating expenses, net	(6,602)	(3,135)
Net revenues (loss) before transfers	(557)	(531)
In lieu of taxes to the City of Lincoln	(557)	(531)
	(7,159)	(3,666)
Net revenues (loss)	205,843	208,815
Equity, beginning of year	205,843	208,815
Equity, end of period	\$ 198,684	205,149



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**LINCOLN ELECTRIC SYSTEM**

Financial Statements

December 31, 2004 and 2003

(With Independent Auditors' Report Thereon)



# LINCOLN ELECTRIC SYSTEM

December 31, 2004 and 2003

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## LINCOLN ELECTRIC SYSTEM

### Management's Discussion and Analysis

December 31, 2004 and 2003

The management of Lincoln Electric System (LES) is providing the reader of its financial statements this narrative providing an overview of the financial activities completed in 2004 and 2003. LES's financial statements are comprised of three components: (1) management's discussion and analysis, (2) financial statements, and (3) notes to the financial statements. Please read the financial statements to understand the transactions, events, and conditions reflected herein.

#### OVERVIEW OF FINANCIAL STATEMENTS

The *balance sheets* present information on all of LES's assets and liabilities, with the difference between the two reported as *equity*. Over time, increases or decreases in equity may serve as a useful indicator of whether the financial position of LES is improving or deteriorating.

LES's overall financial position is summarized below. This information is derived from the financial statements and records of LES (dollar amounts in thousands).

	<u>2004</u>	<u>2003</u>	<u>% Change 2004 over (under) 2003</u>
Net utility plant	\$ 634,406	604,301	5.0 %
Noncurrent assets	46,716	83,615	(44.1)%
Current assets	89,002	90,172	(1.3)%
Total assets	<u>\$ 770,124</u>	<u>778,088</u>	(1.0)%
Invested in capital assets, net of related debt	\$ 134,871	130,141	3.6 %
Restricted	9,340	12,063	(22.6)%
Unrestricted	61,632	66,611	(7.5)%
Total equity	<u>205,843</u>	<u>208,815</u>	(1.4)%
Noncurrent liabilities	511,808	520,253	(1.6)%
Current liabilities	52,473	49,020	7.0 %
Total liabilities and equity	<u>\$ 770,124</u>	<u>778,088</u>	(1.0)%

LES's overall equity decreased by approximately \$3.0 million since 2003, primarily due to mild weather reducing revenues during 2004.

The *statements of revenues, expenses, and changes in equity* present information showing how LES's equity changed during the most recent fiscal year. All changes in equity are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods.

## LINCOLN ELECTRIC SYSTEM

### Management's Discussion and Analysis

December 31, 2004 and 2003

LES's results for the current and prior year are summarized below. This information is derived from the financial statements and records of LES.

#### Results of Operation (Dollars in Thousands)

<b>Revenues</b>	<b>2004</b>	<b>2003</b>	<b>% Change 2004 over (under) 2003</b>
Electric retail	\$ 154,422	152,113	1.5 %
Electric wholesale	10,098	12,711	(20.6)%
Other	3,967	4,044	(1.9)%
Total operating revenues	168,487	168,868	(0.2)%
<b>Expenses</b>			
Power costs	81,083	83,259	(2.6)%
Operation and maintenance	11,370	11,213	1.4 %
Administrative and general	22,033	21,679	1.6 %
Depreciation	27,355	22,409	22.1 %
In lieu of taxes	6,403	6,320	1.3 %
Total operating expenses	148,244	144,880	2.3 %
Total nonoperating expenses and transfers	23,215	17,785	30.5 %
Net revenues (loss)	\$ (2,972)	6,203	(147.9)%

The operating revenues for 2004 were 0.2% below 2003. This is primarily due to a rate increase put in place on October 15, 2004 and offset by the fact cooling and heating degree days were below 2003. Growth in the city remains constant with 2.0% more customers in 2004, now totaling over 121,000 customers. Wholesale revenue was below 2003, primarily because of less resource availability and higher prices in the wholesale markets. Wholesale revenue was reduced by 20.6%. A change in the billing for streetlights with the sale of the asset to the City of Lincoln reduced other revenue.

The operating expenses for 2004 were 2.3% above 2003 with decreased power costs and increased depreciation expense providing most of the change. A 2002 settlement agreement between Nebraska Public Power District and LES related to the Power Sales Agreement for Cooper Nuclear Station (CNS) resulted in our contractual obligation ending September 30, 2003 (see discussion in note 7 of the notes to the financial statements). Depreciation expense was above 2003 because of Salt Valley Generating Station starting commercial operation in 2004.

The increase in nonoperating expense comes from higher interest expense from increased commercial paper interest rates and lower capitalized interest expense for the construction of the Salt Valley Generating Station, which went into commercial operation, which was partially offset by Council Bluffs #4 Unit construction with increased capitalized interest.

## LINCOLN ELECTRIC SYSTEM

### Management's Discussion and Analysis

December 31, 2004 and 2003

Net revenues for 2004 were \$9.2 million below 2003 because of higher depreciation and nonoperating expense. Debt service coverage was 1.68 in 2004 and 1.95 in 2003, with a financial plan goal of 1.75 annually.

#### Results of Capital Improvements (Dollars in Millions)

	<u>2004</u>	<u>2003</u>	<u>Change</u>	<u>Percent of change</u>
Utility plant	\$ 920.5	871.8	48.7	5.6%

Construction of the Salt Valley Generating Station (SVGS) provided \$23 million to the construction work in progress in addition to local construction related to an expanding customer base. The SVGS project represents a total of 177 megawatts of intermediate-load and peaking generation utilizing natural gas, as the primary fuel, in a simple-cycle and combined-cycle operation. The construction in simple-cycle mode was substantially completed in 2003 and the combined-cycle operation was completed in 2004.

The construction costs for Council Bluffs #4 added \$22 million to the construction work in progress in 2004. An agreement with MidAmerican Energy Company was signed in mid-2002 for a 100-megawatt share of the 790-megawatt Council Bluffs #4 Unit slated to begin construction in 2003 and start commercial operation in 2007. LES's estimated cost is \$152.6 million.

On September 1, 2004, the City of Lincoln purchased the street light system, which reduced utility plant income by approximately \$20 million.

The remainder of the utility plant increase was the result of normal transmission, distribution, and substation construction.

#### Results of Financing Activities (Dollars in Millions)

	<u>2004</u>	<u>2003</u>	<u>Change</u>	<u>Percent of change</u>
Revenue bonds	\$ 439.2	452.2	(13.0)	(2.9)%
Commercial paper	90.2	90.2	—	—

No bonds were issued in 2004. With \$35 million of commercial paper capacity available, most smaller projects can be initially funded with this capacity.

#### CONTACT INFORMATION

This financial report is designed to provide a general overview of LES's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer at 1040 "O" Street, Lincoln, Nebraska 68508.

## Independent Auditors' Report

Administrative  
Lincoln Electric System:

Board

We have audited the accompanying balance sheets of Lincoln Electric System as of December 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in equity and cash flows for the years then ended. These financial statements are the responsibility of Lincoln Electric System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lincoln Electric System at December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in note 1, LES adopted on January 1, 2003 the provisions of Governmental Accounting Standards Board Statement No. 40, *Deposits and Investment Risk Disclosures, an Amendment to GASB No. 3*.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 18, 2005 on our consideration of Lincoln Electric System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 3 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. The management's discussion and analysis does not include a discussion of the 2003 results in comparison with the prior year. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The debt service coverage calculation included in the schedule on page 23 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

Lincoln, Nebraska  
February 18, 2005

## LINCOLN ELECTRIC SYSTEM

### Balance Sheets

December 31, 2004 and 2003

Assets	<u>2004</u>	<u>2003</u>
	(Dollars in thousands)	
Utility plant	\$ 838,823	768,971
Less accumulated depreciation	286,146	267,503
	552,677	501,468
Construction work in progress	81,729	102,833
Net utility plant	634,406	604,301
Noncurrent assets:		
Restricted bond funds	34,942	70,586
Deferred charges:		
Unamortized debt expense	2,463	2,670
Other	9,311	10,359
Total noncurrent assets	46,716	83,615
Current assets:		
Funds:		
Operating	33,888	38,960
Designated	12,283	12,197
Restricted bond funds	10,791	11,051
Total funds	56,962	62,208
Receivables	7,839	7,247
Unbilled revenues	9,233	8,105
Accrued interest receivable	592	669
Materials, supplies, and fuel inventories	8,175	6,982
Plant operation assets	5,093	4,095
Prepaid expenses	1,108	866
Total current assets	89,002	90,172
Total assets	\$ 770,124	778,088

**LINCOLN ELECTRIC SYSTEM**

Balance Sheets

December 31, 2004 and 2003

<b>Equity and Liabilities</b>	<b>2004</b>	<b>2003</b>
	(Dollars in thousands)	
Equity:		
Invested in capital assets, net of related debt	\$ 134,871	130,141
Restricted for debt service, net of related debt	9,340	12,063
Unrestricted	61,632	66,611
Total equity	205,843	208,815
Long-term liabilities:		
Long-term debt, net	511,805	520,133
Deferred credits and other liabilities	3	120
Total long-term liabilities	511,808	520,253
Current liabilities:		
Liabilities payable from restricted funds:		
Current maturities of long-term debt	10,545	12,980
Construction payable	8,615	6,327
Accrued interest	7,426	6,964
Total liabilities payable from restricted funds	26,586	26,271
Other liabilities:		
Accounts payable	11,714	8,991
Accrual for payments in lieu of taxes	7,827	7,674
Other	6,346	6,084
Total other liabilities	25,887	22,749
Total current liabilities	52,473	49,020
Total equity and liabilities	\$ 770,124	778,088

## LINCOLN ELECTRIC SYSTEM

### Statements of Revenues, Expenses, and Changes in Equity

Years ended December 31, 2004 and 2003

	<b>2004</b>	<b>2003</b>
	(Dollars in thousands)	
Operating revenues:		
Electric retail	\$ 154,422	152,113
Electric wholesale	10,098	12,711
Other	3,967	4,044
Total operating revenues	168,487	168,868
Operating expenses:		
Purchased power	50,852	63,692
Production	30,231	19,567
Operation	7,295	6,905
Maintenance	4,075	4,308
Administrative and general	22,033	21,679
Depreciation	27,355	22,409
In lieu of taxes	6,403	6,320
Total operating expenses	148,244	144,880
Net operating revenues	20,243	23,988
Nonoperating expenses (revenues):		
Interest expense	23,108	20,304
Allowance for funds used during construction	(2,317)	(5,068)
Amortization of debt expense	2,777	2,962
Interest income	(1,499)	(1,542)
Total nonoperating expenses, net	22,069	16,656
Net revenues (loss) before transfers	(1,826)	7,332
In lieu of taxes to the City of Lincoln	(1,146)	(1,129)
Net revenues (loss)	(2,972)	6,203
Equity, beginning of year	208,815	202,612
Equity, end of year	\$ 205,843	208,815

## LINCOLN ELECTRIC SYSTEM

### Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<b>2004</b>	<b>2003</b>
	(Dollars in thousands)	
Cash flows from operating activities:		
Receipts from customers and users	\$ 198,142	186,019
Payments to suppliers	(124,089)	(123,733)
Payments to employees	(19,070)	(17,442)
Payments in lieu of taxes	(6,250)	(6,126)
Net cash provided by operating activities	48,733	38,718
Net cash flows from noncapital financing activities:		
Interest paid on customer deposits	(11)	—
In lieu of taxes to the City of Lincoln	(1,146)	(1,129)
Net cash used in noncapital financing activities	(1,157)	(1,129)
Cash flows from capital and related financing activities:		
Expenditures for utility plant	(68,371)	(87,925)
Net cost of retiring plant	13,950	(249)
Principal payments on long-term debt	(12,980)	(46,970)
Proceeds from bond issuance	—	127,690
Interest paid	(22,635)	(18,857)
Net cash used in capital and related financing activities	(90,036)	(26,311)
Cash flows from investing activities:		
Proceeds from maturities and sales of investment securities	275,378	518,193
Purchases of investment securities	(235,875)	(531,388)
Interest and other revenues	2,560	1,765
Net cash provided by (used in) investing activities	42,063	(11,430)
Net decrease in cash	(397)	(152)
Cash, beginning of year	593	745
Cash, end of year	\$ 196	593
Reconciliation of net operating revenues to net cash provided by operating activities:		
Net operating revenues	\$ 20,243	23,988
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation and amortization	28,086	24,032
Changes in assets and liabilities:		
Receivables	(592)	1,696
Unbilled revenues	(1,128)	(1,188)
Materials, supplies, and fuel inventories	(1,193)	(1,119)
Plant operation assets	(998)	(311)
Prepaid expenses	(242)	(197)
Other assets	(751)	(1,322)
Accounts payable	5,010	(7,586)
Accrual for payments in lieu of taxes	153	194
Other current liabilities	262	530
Deferred credits and other liabilities	(117)	1
Net cash provided by operating activities	\$ 48,733	38,718

See accompanying notes to financial statements.

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

### (1) Organization and Accounting Policies

Lincoln Electric System (LES) is owned by the City of Lincoln, Nebraska (the City). LES is operated under the direction of the Lincoln Electric System Administrative Board, which is appointed by the mayor and City Council. The City Council, as required by the City Charter, reserves authority to set the rates and charges, to adopt the annual budget, and to incur debt.

The financial statements of LES are presented in conformity with accounting principles generally accepted in the United States of America and accounting practices prescribed by the Federal Energy Regulatory Commission (FERC). In reporting financial activity, LES applies all applicable Government Accounting Standards Board (GASB) pronouncements, as well as Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

LES's financial statements have been prepared using the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. LES's accounting policies also conform to Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*. Accordingly, certain transactions that result from the rate-making process are recorded that would not be recorded under accounting principles generally accepted in the United States of America for nonregulated entities.

GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment to GASB No. 3*, was adopted by LES effective January 1, 2003. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

Utility plant is stated at cost, including an allowance for funds used during construction of projects costing in excess of \$2 million. The allowance for funds used during construction consists of the plant balance times the weighted-average interest rate on debt based on FERC accounting method. The weighted-average rate for 2004 and 2003 was 4.9%. The provision for depreciation is computed at an overall straight-line rate of approximately 3%. Costs of labor, materials, supervision, and other expenses incurred in making repairs and minor replacements and in maintaining the plant in efficient operating condition are charged to expense. Plant accounts are charged with the costs of betterments and replacements of plant, except minor replacements, and the accumulated provision for depreciation is charged with retirements, together with removal costs, less salvage.

LES holds its investment securities until maturity. Investment securities are carried at cost and adjusted for amortization of premium and accretion of discount, which approximates fair market value.

Billings for electric revenues are rendered on a cycle basis monthly. Unbilled revenues, representing estimated consumer usage for the period between the last billing date and the end of the period, are accrued in the period of consumption.

Operating revenues, such as electric retail, result from exchange transactions associated with the principle activity of LES. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as interest, result from nonexchange transactions.

## LINCOLN ELECTRIC SYSTEM

### Notes to Financial Statements

December 31, 2004 and 2003

Materials, supplies, and fuel inventories are stated at cost, which does not exceed market. Cost is generally determined on a weighted-average basis.

Plant operation assets relate to the operation of Laramie River Station (LRS) and are comprised of operating assets, primarily fuel and supplies inventories and operating cash. These assets are managed by the operating agent of LRS. Operating expenses of LRS are included in the corresponding operating expense classifications in the statements of revenues, expenses, and changes in equity.

LES is engaged in various studies relating to future power needs and sources, as well as transmission and distribution facility requirements. Costs of these studies are deferred pending completion of the studies as they are expected to result in the construction and/or acquisition of additional utility plant.

Charges resulting from the issuance of revenue bonds are deferred and amortized over the repayment period of the bonds using the straight-line method, which is not materially different from the interest method. Charges resulting from the establishment of a commercial paper note program are deferred and amortized on a straight-line or bond outstanding basis over the expected life of the program.

Advances for mine development are payments made for the construction of the Dry Fork Coal Mine and are included in other deferred charges on the accompanying balance sheets. The mine is expected to provide fuel for LRS over the estimated 25-year life of the mine. The advances will be returned to LES over the estimated life of the mine.

Fixed cost payments under the power sales contract with Nebraska Public Power District (NPPD) and participation agreements are charged to purchased power.

Retirement plan costs are funded as incurred.

When both restricted and unrestricted resources are available for use, it is LES's policy to use restricted resources first, then unrestricted resources as they are needed.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

For purposes of the statement of cash flows, LES considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Certain 2003 amounts have been reclassified to conform to the current year presentation.

**LINCOLN ELECTRIC SYSTEM**

Notes to Financial Statements

December 31, 2004 and 2003

**(2) Utility Plant**

Utility plant activity for the years ended December 31, 2004 and 2003 are as follows (dollars in thousands):

	<u>December 31, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>December 31, 2004</u>
Utility plant	\$ 768,971	92,129	(22,277)	838,823
Construction work in progress (not being depreciated)	102,833	71,255	(92,359)	81,729
Less accumulated depreciation	<u>267,503</u>	<u>26,632</u>	<u>(7,989)</u>	<u>286,146</u>
	<u>\$ 604,301</u>	<u>136,752</u>	<u>(106,647)</u>	<u>634,406</u>
	<u>December 31, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>December 31, 2003</u>
Utility plant	\$ 654,127	116,932	(2,088)	768,971
Construction work in progress (not being depreciated)	127,068	93,243	(117,478)	102,833
Less accumulated depreciation	<u>248,352</u>	<u>21,785</u>	<u>(2,634)</u>	<u>267,503</u>
	<u>\$ 532,843</u>	<u>188,390</u>	<u>(116,932)</u>	<u>604,301</u>

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

### (3) Long-term and Other Debt

Long-term debt at December 31, 2004 and 2003 are presented on the balance sheets as shown below:

	2004	2003
	(Dollars in thousands)	
Revenue bonds outstanding at year end:		
Serial:		
1998 Electric revenue, 4.50% – 5.00%, due from September 1, 2004 to 2018	\$ 34,810	36,555
2001 Electric revenue, 4.00% – 5.25%, due from September 1, 2006 to 2020	141,150	141,150
2002 Electric revenue and refunding, 4.00% – 5.00%, due from September 1, 2004 to 2025	139,805	148,190
2003 Electric revenue and refunding, 3.00% – 5.00%, due from September 1, 2004 to 2026	90,195	93,045
Term:		
2003 Revenue refunding, 4.75%, due September 1, 2028	33,265	33,265
Commercial paper notes	90,173	90,173
Long-term debt	529,398	542,378
Net unamortized bond discounts	(7,048)	(9,265)
Less current maturities of long-term debt	(10,545)	(12,980)
Long-term debt, net of unamortized premiums, discounts, and current maturities	\$ 511,805	520,133

On February 15, 1998, LES issued \$45.6 million in electric revenue bonds with interest rates ranging from 4.50% to 5.00% and have annual maturities of \$1.3 million to \$3.3 million due from 1998 to 2018.

On August 15, 2001, LES issued \$141.2 million in electric revenue bonds with interest rates ranging from 4.00% to 5.25% and have annual maturities of \$1 million to \$29.5 million due from 2006 to 2020.

On October 1, 2002, LES issued \$148.2 million in electric revenue and refunding bonds with interest rates ranging from 4% to 5% and have annual maturities of \$3.7 million to \$13.5 million due from 2004 to 2025.

On October 1, 2003, LES issued \$126.3 million in serial and term electric revenue and refunding bonds with interest rates ranging from 3% to 5% and have annual maturities of \$2.9 million to \$33.3 million due from 2004 to 2028. These bonds were issued to refund \$45.3 million in outstanding 1993 Series bonds with an average interest rate of 5.2% and to pay the costs of capital improvements to LES's system. LES refunded the remaining portion of the 1993 bonds to restructure its debt and to provide for flexible covenants and business operations. The refunding resulted in an economic gain of approximately \$2.7 million, and an accounting loss of approximately \$6.5 million, which is deferred and is being amortized through 2015, the period over which LES expects to recover the costs. The net proceeds of \$37.3 million plus an additional \$2.7 million of the 1993 series reserve fund were used to repay the 1993 bonds. At December 31, 2004 and 2003, there was no defeased debt outstanding.

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

Revenue bond debt service requirements to maturity are as follows (dollars in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending December 31:			
2005	\$ 10,545	21,534	32,079
2006	11,050	21,103	32,153
2007	14,430	20,570	35,000
2008	15,085	19,916	35,001
2009	15,780	19,201	34,981
2010 – 2014	94,470	83,613	178,083
2015 – 2019	132,420	55,967	188,387
2020 – 2024	81,970	25,976	107,946
2025 – 2028	63,475	7,833	71,308
	<u>\$ 439,225</u>	<u>275,713</u>	<u>714,938</u>

Established by City Ordinance, LES may borrow up to \$125 million under a commercial paper note program. At December 31, 2004 and 2003, LES had \$90.2 million of tax-exempt commercial paper notes outstanding. The notes mature at various dates, but not more than 270 days after the date of issuance. The weighted-average interest rate for the year ended December 31, 2004 was approximately 1.8%. The outstanding commercial paper notes are secured by a revolving credit agreement that provides for borrowings up to \$125 million. LES pays a commitment fee for the credit agreement. Under the terms of the agreement, LES refinances the commercial paper upon maturity.

Long-term debt activity for the years ended December 31, 2004 and 2003 are as follows (dollars in thousands):

	<u>December 31, 2003</u>	<u>Increases</u>	<u>Decreases</u>	<u>December 31, 2004</u>	<u>Due within one year</u>
Revenue bonds	\$ 452,205	—	(12,980)	439,225	10,545
Commercial paper notes	<u>90,173</u>	<u>—</u>	<u>—</u>	<u>90,173</u>	<u>—</u>
	<u>\$ 542,378</u>	<u>—</u>	<u>(12,980)</u>	<u>529,398</u>	<u>10,545</u>
	<u>December 31, 2002</u>	<u>Increases</u>	<u>Decreases</u>	<u>December 31, 2003</u>	<u>Due within one year</u>
Revenue bonds	\$ 372,865	126,310	(46,970)	452,205	12,980
Commercial paper notes	<u>90,173</u>	<u>—</u>	<u>—</u>	<u>90,173</u>	<u>—</u>
	<u>\$ 463,038</u>	<u>126,310</u>	<u>(46,970)</u>	<u>542,378</u>	<u>12,980</u>

#### (4) Payments in Lieu of Taxes

The City Charter provides that LES will make payments in lieu of taxes, aggregating 5% of its electric retail revenues derived from within the city limits of incorporated cities and towns served. Approximately 15% of the

**LINCOLN ELECTRIC SYSTEM**

Notes to Financial Statements

December 31, 2004 and 2003

payments are transferred to the City of Lincoln. LES is exempt from Federal and state income taxes and local property taxes as it is owned by a municipality.

**(5) Plant Construction**

The 2005 construction and acquisition program is estimated at approximately \$88.7 million. An agreement signed in May 2002 provides for LES joint ownership in the Council Bluffs No. 4 coal-fired unit located south of Council Bluffs, Iowa, in the amount of 100 megawatts. The plant is scheduled for commercial operation in May 2007 with MidAmerican Energy Company (MEC) acting as operating agent. In addition to joint ownership, LES executed a Power Purchase Agreement with MEC that will sell 50 megawatts of the 100 megawatt capacity back to MEC for the first 19 months, which optimizes the economics of LES's participation and better fits LES's anticipated load growth. The LES share of the total estimated cost of construction is \$152.6 million dollars, including approximately \$21.6 million and \$6.9 million, which were capitalized in 2004 and 2003, respectively. LES anticipates financing this construction through operations, available funds, and short- and long-term financing.

Plant under construction at December 31, 2004 and 2003 was approximately \$81.7 million and \$102.8 million, respectively.

**(6) Funds**

Deposits and investments at December 31, 2004 and 2003 are shown below:

	<b>2004</b>	<b>2003</b>
	(Dollars in thousands)	
Classified as restricted:		
Bond reserve and construction funds	\$ 34,942	70,586
Classified as current assets:		
Operating, revenue fund:		
Operation and maintenance	6,859	6,756
General reserve	27,029	32,204
Restricted bond principal and interest funds	10,791	11,051
	44,679	50,011
Designated:		
Rate stabilization fund	12,000	12,000
Other funds	283	197
	12,283	12,197
	\$ 91,904	132,794

A rate stabilization fund was established by the LES administrative board and approved by the Lincoln City Council in December 1998. The fund was established to pay for operation and maintenance expenses and extraordinary renewals and replacements or repairs. Funds can be budgeted and deposited monthly or at year-end from surplus revenues. The maximum balance in the fund is 15% of the operating budget, less depreciation, and currently would equal approximately \$20 million.

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

At December 31, 2004 and 2003, all bank balances were covered by federal depository insurance.

As of December 31, 2004, LES had the following investments (in thousands):

<u>Investments</u>	<u>Maturities</u>	<u>Fair Value</u>
Money Market Fund—U.S. Government Obligations	N/A	\$ 66,500
Federal Home Loan Mortgage Corp.	1/15/2005	2,904
Federal Home Loan Mortgage Corp.	6/15/2005	2,060
Federal Farm Credit Bank	7/25/2006	2,182
Federal Home Loan Bank	4/15/2005	3,212
Federal Home Loan Bank	9/15/2006	4,547
Federal National Mortgage Assoc.	2/15/2005	10,247
Total		\$ <u>91,652</u>

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

As of December 31, 2003, LES had the following investments (in thousands):

<u>Investments</u>	<u>Maturities</u>	<u>Fair Value</u>
Money Market Fund—U.S. Government Obligations	N/A	\$ 52,071
Federal Home Loan Mortgage Corp.	01/08/04	6,481
Federal Home Loan Mortgage Corp.	02/04/04	6,372
Federal Home Mortgage Corp.	08/12/04	9,094
Federal Home Loan Mortgage Corp.	06/15/05	2,149
Federal Home Loan Bank	06/01/04	6,326
Federal Home Loan Bank	06/15/04	2,263
Federal Home Loan Bank	12/15/04	3,480
Federal Home Loan Bank	04/15/05	3,482
Federal Home Loan Bank	09/15/06	4,636
Federal Farm Credit Bank	07/25/06	2,368
Federal National Mortgage Association	03/10/04	15,200
Freddie Mac	11/15/04	4,983
Freddie Mac	01/15/05	3,273
Fannie Mae	02/15/05	11,853
Total		\$ <u>134,031</u>

**Interest Rate Risk:** LES has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

**Credit Risk:** LES investment policy limits investments in commercial paper, corporate bonds, and mutual bond funds to the top two ratings issued by nationally recognized statistical rating organizations as described in the table below. Money market funds are the only current investment type that requires a specific rating. At December 31, 2004 and 2003 all money market accounts were rated AAAM except for \$8,000,000 was not rated but is fully comprised of government securities.

**Concentration of Credit Risk:** LES investment policy places the following limits on the amount that may be invested in any one type of investment and/or issuer.

**LINCOLN ELECTRIC SYSTEM**

Notes to Financial Statements

December 31, 2004 and 2003

<u>Investment Type</u>	<u>Portfolio composition</u>	<u>Limits of individual issuers</u>	<u>Maturity limitations</u>
U.S. Government securities	100%	None	10 years
U.S. Government agencies	75%	50%	10 years
Federal instrumentalities	80%	40%	10 years
Interest-bearing time deposit or savings accounts	25%	15%	1 year
Repurchase agreements	50%	25%	90 days
Commercial paper:	30%	10%	180 days
Moody's Prime-1			
S&P's A-1			
High-grade corporate notes:	15%	5%	3 years
Moody's Aa			
S&P's AA			
Bankers' acceptances:	30%	10%	180 days
Moody's P-1			
S&P's A-1			
State and/or local government debt:	20%	None	3 years
Moody's Aa or MIG-2			
S&P's AA or SP-2			
Money market mutual funds:	50%	25%	N/A
S&P's AAm or AAm-G			

Composition of investments at December 31, 2004 and 2003 were as follows:

	<u>Portfolio composition</u>		<u>Limits of individual issuers</u>	
	<u>2004</u>	<u>2003</u>	<u>2004</u>	<u>2003</u>
U.S. Government agencies	40%	71%	3-17%	2-28%
Money market mutual funds	60%	29%	6-31%	0-16%

**(7) Participation Contract with NPPD for Cooper Nuclear Station**

On May 21, 1968, LES and Consumers Public Power District, now known as Nebraska Public Power District (NPPD), entered into a Power Sales Contract (PSC) relating to the sale of capacity and energy from Cooper Nuclear Station (CNS). CNS is an approximately 800-megawatt nuclear generating plant located near Brownville, Nebraska, and is owned and operated by NPPD. The LES share under the original contract was 12.5% of the output of the facility. From 1973 through July 2002, LES received energy from the Cooper facility while contributing fixed and variable expenses equivalent to ownership costs and fuel costs.

## LINCOLN ELECTRIC SYSTEM

### Notes to Financial Statements

December 31, 2004 and 2003

On July 31, 2002, the LES administrative board approved the settlement with NPPD and executed the "Settlement Agreement, Mutual Release and Indemnity" outlining all terms and conditions of the settlement. The settlement included:

- A new Power Sales Agreement (PSA) with NPPD effective August 1, 2002 through September 30, 2003 for 95 MW of accredited capacity and energy from NPPD.
- An amendment to the agreement for Gerald Gentleman Station (GGS) relating to LES's entitlement to fully schedule an additional 7 MW from GGS.
- Authorization for the LES administrator, CEO, and legal counsel to prepare and file all documents necessary to effectuate the dismissal of all outstanding litigation with NPPD related to CNS.

A significant and key factor in the overall settlement is the provision whereby NPPD agrees not only to release LES from any future decommissioning obligation, but also to indemnify and hold LES harmless from any claim of any nature from any person or entity (including government agencies) that arises from or relates to the PSC or the operation of CNS.

#### **(8) Other Participation Contracts with NPPD**

LES has participating interests in the output of two existing NPPD power plants, a 30% (68 MW) and 8% (109 MW) entitlement to the output of the Sheldon Station Power Plant (nominally rated 225-MW coal plant) and Gerald Gentlemen Station Power Plant (nominally rated 1,268-MW coal plant), respectively.

LES is responsible for its respective participating interests in the two facilities' capital additions and improvements. LES's share of debt service payments necessary to retire the respective participating interests of principal and interest on bonds issued by NPPD for the facilities was approximately \$7.0 million and \$7.1 million in 2004 and 2003, respectively. LES recognizes its share of capital acquisition costs and debt service payments as power costs in the period the costs are billed. Fixed cost payments under the agreements are on a participation basis whether or not such plants are operating or operable. LES recognized expense for its share of the total fixed costs of approximately \$16.7 million and \$16.7 million in 2004 and 2003, respectively.

The participation contracts continue until the facilities are removed from commercial operation or the final maturity occurs on the related debt incurred by NPPD to finance the facilities, whichever occurs last. The estimated fixed cost payments to NPPD under these contracts, including capital additions and improvements, debt service payments and fixed costs, and credits, aggregate approximately \$16.3 million, \$16.1 million, \$16.2 million, \$16.9 million, and \$17.3 million, respectively, in each of the five years subsequent to December 31, 2004.

#### **(9) Laramie River Station (LRS)**

LES is a 12.76% co-owner of the Missouri Basin Power Project that includes LRS, a three-unit, 1,650-MW coal-fired generating station in eastern Wyoming and a related transmission system. Costs, net of accumulated depreciation, associated with LRS of approximately \$48 million and \$56 million are reflected in utility plant at December 31, 2004 and 2003, respectively.

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

LES has a participation power sales agreement with the County of Los Alamos, New Mexico (the County) whereby the County purchases from LES 10 MW of LES's capacity interest in LRS. The agreement provides for the County to pay LES approximately \$117,300 per month through July 1, 2005 for demand charges. The amount is subject to change each July 1 based on debt costs of LES relative to the current market rates, until termination of the agreement. The agreement remains in effect until either the final maturity occurs on any LRS-related debt, LRS is removed from commercial operation, or the County gives LES six-months' notice to terminate the agreement. LES billed the County approximately \$2.4 million in 2004 and 2003 for demand and energy charges.

### (10) Jointly Governed Organizations

#### *District Energy Corporation*

LES, in conjunction with two other governmental entities, created the District Energy Corporation (DEC) in 1989 to own, operate, maintain, and finance the heating and cooling facilities utilized by certain city, county, and state buildings. The board of directors of DEC is comprised of five members: two appointed by the county board of commissioners, two by the mayor of Lincoln who must be confirmed by the City Council, and one by LES. No participant has any obligation, entitlement, or residual interest.

The DEC board of directors, under a 20-year management agreement, has appointed LES to supervise and manage the system and business affairs of DEC. LES is reimbursed for these management services based on the allocated actual costs of these services. LES also provides electric energy to DEC at an established interruptible commercial rate. The total amount of payments to LES for management, operations, and maintenance services was approximately \$183,000 and \$144,000 in 2004 and 2003, respectively. The total amount of payments to LES for energy was approximately \$67,000 and \$68,000 in 2004 and 2003, respectively.

#### *Nebraska Utility Corporation*

On May 17, 2001, LES, in conjunction with another governmental entity, created the Nebraska Utility Corporation (NUCorp) to purchase, lease, construct, and finance facilities and acquire services in order to furnish energy requirements, utility and infrastructure facilities, and all related energy, utility, and infrastructure services to counties, cities, villages, school districts, sanitary and improvement districts, or other municipal corporations or political subdivisions of the State of Nebraska or political subdivisions of another state. The board of directors of NUCorp is comprised of five members: three members appointed by the University of Nebraska and two members appointed by LES. No participant has any obligation, entitlement, or residual interest.

Operations commenced in January 2002. The NUCorp board of directors, under a 20-year management agreement, appointed LES to supervise and manage the system and business affairs of NUCorp. LES is reimbursed for these management services based on the allocated actual costs of these services. LES also provides electric energy to NUCorp on an established rate schedule. The total payment to LES for management, operations, and maintenance services was approximately \$81,000 and \$83,000 in 2004 and 2003, respectively. The total amount of payments to LES for energy was approximately \$5.6 million and \$4.9 million in 2004 and 2003, respectively.

## LINCOLN ELECTRIC SYSTEM

Notes to Financial Statements

December 31, 2004 and 2003

### (11) Employee Benefit Plans

LES has a defined contribution retirement plan covering all employees upon employment; however, employees are not eligible to receive employer contributions until they have been employed six months. The plan is a straight-money purchase plan. LES's contribution is equal to 200% of the employees' contributions, which range from 2% to 5% of gross wages. Vesting of LES contributions occurs over a five-year period. Employee forfeitures are used to reduce employer contributions. Vested benefits are fully funded. Approximate contribution information is shown below:

	<u>2004</u>	<u>2003</u>
Employer contribution	\$ 2,718,000	2,469,000
Employee contributions	<u>1,634,000</u>	<u>1,395,000</u>
	<u>\$ 4,352,000</u>	<u>3,864,000</u>

In addition, LES offers all full-time employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan permits the employees to defer a portion of their salary until termination, retirement, or death. Plan assets and liabilities are not included in the balance sheets as LES has no fiduciary responsibility.

### (12) Disclosures About Fair Value of Financial Instruments

Operating, designated, and restricted funds, receivables, accrued interest receivable, other assets, accounts payable, accrued interest, accrual for payments in lieu of taxes, commercial paper notes, and other liabilities approximate fair value because of the short maturity of these instruments, except for certain operating, designated, and restricted funds whose fair value is presented in note 6.

The fair value of long-term debt instruments is based on the amount of future cash flows associated with each instrument discounted using LES's current borrowing rate of similar debt instruments of comparable maturity.

The estimated fair value of LES's revenue bonds is \$468 million and \$483 million at December 31, 2004 and 2003, respectively.

The carrying amount of the commercial paper notes approximates fair value because of the short maturity and/or variable rate of interest associated with these financial instruments.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**(13) Risk Management**

LES is subject to various risks of loss related to general liability and property insurance. LES has purchased commercially available indemnity insurance to cover these risks. The deductible amounts for this insurance would be immaterial to LES. The amount of insurance settlements has not exceeded insurance coverage in the past three years.

**(14) Contingencies**

LES is named as a party in legal proceedings that occur in the normal course of operations. It is not possible at the present time to estimate the ultimate outcome or liability. However, management of LES believes that any ultimate liability is not expected to have a material adverse effect on LES's financial position.

## LINCOLN ELECTRIC SYSTEM

### Debt Service Coverage

Years ended December 31, 2004 and 2003

	<b>2004</b>	<b>2003</b>
	(Dollars in thousands)	
Operating revenues:		
Electric retail	\$ 154,422	152,113
Electric wholesale	10,098	12,711
Other	3,967	4,044
Total operating revenues	168,487	168,868
Operating expense:		
Purchased power	50,852	63,692
Production	30,231	19,567
Operation	7,295	6,905
Other maintenance	4,075	4,308
Administrative and general	22,033	21,679
Total operating expenses, excluding depreciation and in lieu of taxes	114,486	116,151
Net operating revenues, excluding depreciation and taxes	54,001	52,717
Interest income	1,499	1,542
Available for debt service	\$ 55,500	54,259
Debt service*	\$ 33,131	27,881
Debt coverage	1.68	1.95

\* Includes bond interest, bond principal, commercial paper interest, and allowance for funds used during construction.

See accompanying independent auditors' report.

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**APPENDIX II**

**SUMMARY OF CERTAIN PROVISIONS OF THE BOND ORDINANCE**

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## SUMMARY OF CERTAIN PROVISIONS OF THE BOND ORDINANCE

The following is a summary of certain provisions of the Bond Ordinance. Summaries of certain definitions contained the Bond Ordinance are set forth below. Other terms defined in the Bond Ordinance for which summary definitions are not set forth are indicated by capitalization. The summary does not purport to be a complete description of the terms of the Bond Ordinance and, accordingly, is qualified by reference thereto and is subject to the full text thereof. Copies of the Bond Ordinance may be obtained from Lincoln Electric System or its Financial Advisor.

### Definitions

The following are summaries of certain definitions in the Bond Ordinance.

“Accreted Value” means, with respect to any Capital Appreciation Bond or Capital Appreciation Parity Obligation, the principal amount thereof plus the interest accrued thereon from the date of original issuance thereof to the Periodic Compounding Date next preceding the date of computation or the date of computation if a Periodic Compounding Date, such interest to accrue at the interest rate per annum of the Capital Appreciation Bonds or Capital Appreciation Parity Obligation set forth in such Series Ordinance or Parity Instrument, respectively, compounded periodically on each Periodic Compounding Date, plus, if such date of computation shall not be a Periodic Compounding Date, a portion of the difference between the Accreted Value as of the immediately preceding Periodic Compounding Date (or the date of original issuance if the date of computation is prior to the first Periodic Compounding Date succeeding the date of original issuance) and the Accreted Value as of the immediately succeeding Periodic Compounding Date, calculated based upon an assumption that, unless otherwise provided in such Series Ordinance or Parity Instrument, Accreted Value accrues in equal daily amounts on the basis of a year consisting of twelve 30-day months.

“Aggregate Debt Service” for any period means, as of any date of calculation, the sum of the amounts of Debt Service for such period with respect to all Bonds and Parity Obligations.

“Appreciated Value” means, with respect to any Deferred Income Bond, (i) as of any date of computation prior to the Current Interest Commencement Date with respect to such Deferred Income Bond, an amount equal to the principal amount of such Bond plus the interest accrued on such Bond from the date of original issuance of such Bond to the Periodic Compounding Date next preceding the date of computation or the date of computation if a Periodic Compounding Date, such interest to accrue at the interest rate per annum of the Deferred Income Bonds set forth in the Series Ordinance authorizing such Bonds, compounded periodically on each Periodic Compounding Date, plus, if such date of computation shall not be a Periodic Compounding Date, a portion of the difference between the Appreciated Value as of the immediately preceding Periodic Compounding date (or the date of original issuance if the date of computation is prior to the first Periodic Compounding Date succeeding the date of original issuance) and the Appreciated Value as of the immediately succeeding Periodic Compounding Date, calculated based upon an assumption that, unless otherwise provided in the Series Ordinance authorizing such Deferred Income Bonds, Appreciated Value accrues in equal daily amounts on the basis of a year consisting of twelve 30-day months and (ii) as of any date of computation on and after the Current Interest Commencement Date, the Appreciated Value on the Current Interest Commencement Date.

“Authorized Investments” means any investments in which the City may legally invest sums subject to its control pursuant to the Constitution and statutes of the State of Nebraska and the Charter of the City (all amended from time to time).

“Bond” or “Bonds” means any bonds, notes or other obligations or evidences of indebtedness, as the case may be, authenticated and delivered under and Outstanding pursuant to the Bond Ordinance but shall not mean Parity Obligations or Subordinated Indebtedness.

“Bond Obligation” means, as of any date of calculation, (1) with respect to any Outstanding Current Interest Bond, the principal amount of such Bond, (2) with respect to any Outstanding Capital Appreciation Bond, the Accreted Value thereof as of the date on which interest on such Capital Appreciation Bond is compounded next preceding such date of calculation (unless such date of calculation is a date on which such interest is compounded, in which case, as of such date), and (3) with respect to any Outstanding Deferred Income Bond, the Appreciated Value thereof as of the date on which interest on such Deferred Income Bond is computed next preceding such date of calculation (unless such date of calculation is a date on which such interest is compounded, in which case as of such date).

“Capital Appreciation Bonds” means any Bonds the interest on which is (i) compounded periodically on dates that are specified in the Series Ordinance authorizing such Capital Appreciation Bonds and (ii) payable only at the maturity, earlier redemption or other payment thereof pursuant to the Bond Ordinance or the Series Ordinance authorizing such Capital Appreciation Bonds.

“Capital Appreciation Parity Obligations” means any Parity Obligations the interest with respect to which is (i) compounded periodically on dates that are specified in such Parity Obligation or in the Parity Instrument authorizing such Parity Obligation and (ii) payable only at the maturity, earlier redemption or prepayment or other payment thereof pursuant to the Parity Instrument authorizing such Capital Appreciation Parity Obligation.

“Costs,” with respect to the Electric System or any part thereof, means the costs, expenses and liabilities paid or incurred or to be paid or incurred by the City in connection with the planning, engineering, designing, acquiring, constructing, installing, financing, operating, maintaining, repairing, extending, improving, reconstructing, retiring, decommissioning and disposing thereof and the obtaining of governmental approvals, certificates, permits and licenses with respect thereto, including, but not limited to, any good faith or other similar payment or deposits required in connection with the acquisition or construction of such part of the Electric System, the cost of acquisition by or for the City of real and personal property or any interests therein, costs of physical construction of such part of the Electric System and costs of the City incidental to such construction or acquisition, the cost of acquisition of fuel or fuel inventory or facilities for the production or transportation of fuel and for additional fuel inventories, all costs relating to injury and damage claims relating to such part of the System, preliminary investigation and development costs, engineering fees and expenses, contractors' fees and expenses, the costs of labor, materials, equipment and utility services and supplies, legal and financial advisory fees and expenses, interest and financing costs, including, without limitation, bank commitment and letter of credit fees and bond insurance and indemnity premiums, fees and expenses of the Fiduciaries, administration and general overhead expense and costs of keeping accounts and making reports required by the Bond Ordinance prior to or in connection with the completion of acquisition or construction of such part of the Electric System, amounts, if any, required by the Bond Ordinance to be paid into the Bond Fund to provide, among other things, for interest accruing on Bonds and to provide for such reserves, if any, as may be specified in a Series or Supplemental Ordinance or to be paid into the Revenue Fund for any of the respective purposes thereof, payments when due (whether at the maturity of principal or the due date of interest or upon redemption) on any indebtedness of the City with respect to the Electric System and reserves therefor, and all federal, state and local taxes and payments in lieu of taxes in connection with any part of the Electric System and shall include reimbursements to the City for any of the above items theretofore paid by or on behalf of the City.

“Credit Facility” means a letter of credit, line of credit, liquidity facility or other credit facility issued by a financial institution or other form of credit enhancement, including, but not limited to, municipal bond insurance and guarantees, delivered to the Paying Agent for all or a portion of a Series of Bonds, which provides for payment, in accordance with the terms of such Credit Facility, of principal, Accreted Value, Appreciated Value, premium and/or interest of all or a portion of a Series of Bonds and/or the purchase price of such Series of Bonds or portion thereof. A Credit Facility may be comprised of one or more credit facilities issued by one or more financial institutions.

“Current Interest Commencement Date” means with respect to any particular Deferred Income Bonds, the date specified in the Series Ordinance authorizing such Deferred Income Bonds (which date must be prior to the maturity date for such Deferred Income Bonds) after which interest accruing on such Deferred Income Bonds shall be payable periodically on dates specified in such Series Ordinance, with the first such payment date being the first such periodic date immediately succeeding such Current Interest Commencement Date.

“Debt Service” for any period means, as of any date of calculation and with respect to any Series of Bonds or Parity Obligations, an amount equal to the sum of (i) interest accruing during such period on Bonds of such Series or such Parity Obligations, except to the extent that such interest is to be paid from deposits in the Bond Fund made from the proceeds of Bonds, Subordinated Indebtedness or other evidences of indebtedness of the City (including amounts, if any, transferred thereto from the Construction Fund) or from the proceeds of such Parity Obligations and (ii) that portion of each Principal Installment for such Series or Parity Obligation which would accrue during such period if such Principal Installment were deemed to accrue daily in equal amounts from the next preceding Principal Installment due date for such Series or Parity Obligation (or, if (a) there shall be no such preceding Principal Installment due date or (b) such preceding Principal Installment due date is more than one year prior to the due date of such Principal Installment, then, from a date one year preceding the due date of such Principal Installment or from the date of issuance of the Bonds of such Series or Parity Obligation, whichever date is later). Such interest and Principal Installments for such

Series or Parity Obligations shall be calculated on the assumption that (x) no Bonds (except for Option Bonds actually tendered for payment prior to the stated maturity thereof) of such Series Outstanding at the date of calculation will cease to be Outstanding except by reason of the payment of each Principal Installment on the due date thereof, (y) the principal amount of Option Bonds tendered for payment before the stated maturity thereof shall be deemed to accrue on the date required to be paid pursuant to such tender, and (z) no Principal Installment with respect to any Parity Obligation will be paid except by reason of the payment of such Principal Installment on the due date thereof.

“Deferred Income Bonds” means any Bond issued under the Bond Ordinance as to which interest accruing prior to the Current Interest Commencement Date is (i) compounded periodically on dates specified in the Series Ordinance authorizing such Deferred Income Bonds and (ii) payable only at the maturity, earlier redemption or other payment thereof pursuant to the Bond Ordinance or the Series Ordinance authorizing such Deferred Income Bonds.

“Derivative Obligations” means, to the extent permitted by law, any financial arrangement entered into by the City for the purposes of moderating interest rate fluctuations or otherwise and may include any interest rate swap agreement, currency swap agreement, forward payment conversion agreement, future, or contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, or a contract to exchange cash flows or a series of payments, or any other exchange or rate protection transaction agreement, including, without limitation, interest rates floors, caps or collars, options, rates or call to a hedge payment, currency, rate, spread, or similar exposure or any similar contract (however designated).

“Derivative Payment” means any payment required to be made by the City with respect to a Derivative Obligation.

“Electric System” means all properties and assets, and interests in properties and assets, real and personal and tangible and intangible, of the City now or hereafter existing used for or pertaining to (a) the generation, transmission, distribution and sale of electric power and energy or (b) such other activities and transactions as the Board and the City shall from time to time determine, and shall be broadly construed to encompass and include all Projects, and all electric production, transmission, distribution, conservation, load management, general plant and other related facilities, equipment or property and any mine, well, pipeline, plant, structure or other facility for the development, production, manufacture, storage, fabrication or processing of fossil, nuclear or other fuel of any kind or any facility or rights with respect to the supply of water, in each case for use, in whole or in major part, in any of the City's electric generating plants, now existing and hereafter acquired by lease, contract, purchase or otherwise or constructed by the City, including any interest or participation of the City in any such facilities or any rights to the output or capacity thereof, together with all additions, betterments, extensions and improvements to said Electric System or any part thereof hereafter made and together with all lands, easements and rights of way of the City and all other works, property or structures of the City and contract rights and other tangible and intangible assets of the City used or useful in connection with or related to said Electric System, including without limitation a contract right or other contractual arrangement for the long-term or short-term interconnection, interchange, exchange, pooling, wheeling, transmission, purchase or sale of electric power and energy and other similar arrangements with entities having generation and transmission capabilities and located within or without the City or the State of Nebraska. Without limiting the generality of the foregoing, the term “Electric System” shall include (1) the properties and assets for the generation, transmission and distribution and sale of electric power and energy owned by the City on the date of passage of the Bond Ordinance and (2) all additions, extensions, expansions, improvements, betterments and equipments hereafter made thereto. “Electric System” shall not include any properties or interests in properties of the City which the Board and the City, in accordance with the provisions of the Bond Ordinance, determines shall not constitute a part of the Electric System.

“Federal Securities” means direct obligations of, or obligations the timely payment of which are unconditionally guaranteed by, the United States of America or the Treasury Department of the United States of America or securities or receipts evidencing direct ownership interests in the foregoing obligations or specific portions (such as principal or interest) of the foregoing obligations which are maintained under the book entry system operated by Federal Reserve Banks.

“Independent Consultant” means an independent firm, person or corporation recognized as having expertise and with a favorable reputation for special skill and knowledge in the operations and financing of municipal electric light and power facilities and systems similar in size to the Electric System.

“Lincoln Electric System” means all assets, properties and employees under the jurisdiction and control of the Board as set forth in Chapter 4.24 of the Municipal Code.

“Municipal Obligations” means municipal obligations, rated in the highest Rating Category by any Rating Agency, meeting the following conditions:

- (a) the municipal obligations are not to be redeemable prior to maturity, or the trustee with respect to such obligations has been given irrevocable instructions concerning their calling and redemption;
- (b) the municipal obligations are secured by Federal Securities, which Federal Securities, except for provisions relating to surplus moneys not required for the payment of the municipal obligations and the substitution of such Federal Securities for other Federal Securities satisfying all criteria for Federal Securities, may be applied only to interest, principal and premium payments of such municipal obligations;
- (c) the principal of and interest on the Federal Securities (plus any cash in the escrow fund) are sufficient, without reinvestment, to meet the liabilities of the municipal obligations; and
- (d) the Federal Securities serving as security for the municipal obligations are held by an escrow agent or trustee.

“Net Revenues” shall mean Revenues less Operation and Maintenance Expenses paid from Revenues.

“Operation and Maintenance Expenses” shall mean all of the costs and expenses for operation, maintenance, and ordinary repairs, renewals and replacements of the Electric System, including all costs of purchasing, producing and delivering electric power and energy from the Electric System and reserves for items of Operation and Maintenance Expenses the payment of which is not immediately required, and shall include, without limiting the generality of the foregoing, costs of purchased power, fuel costs, costs of transmission service, generating capacity reserve service, regulation, or other interchange and coordination services, rents, administrative and general expenses, engineering expenses, legal, accounting and financial advisory expenses, payments to pension, retirement, health and hospitalization funds, taxes, payments in-lieu-of taxes and other governmental charges, insurance and surety bond premiums including obligations to a stock mutual or reciprocal insurance company, and any other current expenses or obligations required to be paid by the City under the provisions of the Bond Ordinance or by law or regulation, all to the extent properly allocable to the Electric System, and any fees and expenses incurred in the administration the Bonds, Parity Obligations and Derivative Payments to the extent the same are treated as operation and maintenance expenses pursuant to generally accepted accounting principles for electric utilities. Operation and Maintenance Expenses shall not include any allowance for depreciation.

“Option Bonds” shall mean Bonds which by their terms may or are required to be tendered by and at the option of the Owner thereof for payment by the City prior to the stated maturity thereof, or the maturities of which may be extended by and at the option of the Owner thereof.

“Outstanding” means (1) when used as of any particular time with reference to Bonds, all Bonds theretofore, or thereupon being, authenticated and delivered by the Registrar under the Bond Ordinance except (a) Bonds theretofore canceled by the Paying Agent or surrendered to the Paying Agent for cancellation (or in the case of Book Entry Bonds, to the extent provided in the Bond Ordinance, portions thereof deemed to have been canceled); (b) Bonds (or in the case of Book Entry Bonds, to the extent provided in the Bond Ordinance, portions thereof with respect to which all liability of the City shall have been discharged in accordance with the Bond Ordinance; (c) Bonds for the transfer or exchange of or in lieu of or in substitution for which other Bonds shall have been authenticated and delivered by the Registrar pursuant to the Bond Ordinance; and (d) Bonds no longer deemed to be outstanding hereunder as provided in the Series Ordinance pursuant to which such Bonds were issued; (2) when used as of any particular time with reference to Prior Lien Bonds, all Prior Lien Bonds deemed outstanding within the meaning of the respective Prior Lien Bond Ordinances; and (3) when used as of any particular time with reference to Parity Obligations, all Parity Obligations deemed outstanding or not satisfied within the meaning of the Parity Instrument authorizing such Parity Obligations.

“Parity Instrument” means an instrument pursuant to which the City shall have provided for the issuance of Parity Obligations.

“Parity Obligations” means any indebtedness or other obligation of the City, including, but not limited to Derivative Payments, and all other payments or other obligation of the City, with respect to the Electric System and in each case having a lien and charge upon, or being payable from, the Net Revenues on a parity with the Bonds.

“Paying Agent” means the person or institution, which may include the City Treasurer or the Finance Director or his

designee, or such other agent or official of the City as may be designated in a Series Ordinance to make payments of the principal of, Redemption Price and interest on the Series of Bonds authorized by such Series Ordinance to the registered owners thereof.

“Payment Date” means, with respect to a Series of Bonds or Parity Obligations, the date upon which any principal, Accreted Value, Appreciated Value or Redemption Price, and interest thereon is payable to the registered owners of such Series of Bonds or Parity Obligations.

“Principal Installment” means, as of any date of calculation and with respect to any Series, so long as any Bonds thereof are Outstanding or with respect to any Outstanding Parity Obligation, (i) the principal amount of Bonds (including the principal amount of any Option Bonds tendered for payment prior to the stated maturity thereof) of such Series or Parity Obligation due (or so tendered for payment) on a certain future date for which no Sinking Fund Installments have been established, or (ii) the unsatisfied balance (determined as provided in the Bond Ordinance) of any Sinking Fund Installments due on a certain future date for Bonds of such Series or Parity Obligation, plus the amount of the sinking fund redemption premiums, if any, which would be applicable upon redemption of such Bond, or Parity Obligation on such future date in a principal amount equal to said unsatisfied balance of such Sinking Fund Installments, or (iii) if such future dates coincide as to different Bonds of such Series and different Parity Obligations, the sum of such principal amount of Bonds and Parity Obligations and of such unsatisfied balance of Sinking Fund Installments due on such future date plus such applicable redemption premiums, if any.

“Prior Lien Bonds” means the bonds issued and outstanding pursuant to the Prior Lien Bond Ordinances.

“Prior Lien Bond Ordinances” shall mean Bond Ordinance Nos. 11902, 11904, 12202, 14556, 16188, 16416, 16417 and 17288 of the City.

“Project” means any electric generation, transmission, distribution and general plant facilities, together with any other property necessary, desirable or advisable for such activities as the Board is authorized to undertake, and all other property, real and personal, of every kind and nature material or pertinent thereto or necessary therefor, located within or without the City or the State of Nebraska, which may be used or useful in the generation, transmission, distribution, sale, purchase, exchange or interchange of electric power and energy, and in the supplying of electric power and energy to all those contracting with the City therefor and such other activities as the Board is authorized to undertake, as provided in the Act, including any interest therein or right to capacity thereof, and may include, without limitations, a divided or undivided interest in any electric generation, transmission, distribution or general plant facility in which the City shall participate as an owner in common with others, a contract right or other contractual arrangement for the short-term or long-term provision of electric power and energy, transmission and other services to the City on a prepaid basis and the acquisition of water and fuel of any kind for such purposes, including the acquisition of water rights, fuel deposits and facilities for the development, production, processing, manufacture, fabrication, transportation and storage of water and fuel.

“Prudent Utility Practice” means any of the practices, methods and acts which, in the exercise of reasonable judgment, in the light of the facts (including, but not limited to, any practices, methods and acts engaged in or approved by a significant portion of the electrical utility industry prior thereto) known at the time the decision was made, could have been expected to accomplish the desired result at reasonable cost consistent with reliability, safety and expediency. In applying the standard of Prudent Utility Practice to any matter under the Bond Ordinance, equitable consideration shall be given to the circumstances, requirements and obligations of the City, and there shall be taken into account the fact that the City is a political subdivision of the State of Nebraska with prescribed statutory powers, duties and responsibilities. Prudent Utility Practice is not intended to be limited to the optimum practice, method or act to the exclusion of all others, but rather is a spectrum of possible practices, methods or acts which could have been expected to accomplish the desired result at reasonable cost consistent with reliability, safety and expediency. Prudent Utility Practice includes due regard for manufactures' warranties and the requirements of governmental agencies which have jurisdiction.

“Registrar” means the person or institution, which may include the City Treasurer or the Finance Director or his designee, or such other agent or official of the City as may be designated in a Series Ordinance to maintain on behalf of the City books of record in which the registered owners of the Bonds authorized by such Series Ordinance and their registered addresses shall be duly recorded.

“Revenues” means (i) all revenues, income, rents and receipts derived by the City from or attributable to the ownership and operation of the Electric System, including all revenues attributable to the Electric System or to the payment of the costs thereof

received by the City under any contract for the sale of power, energy, transmission or other service from the Electric System or any part thereof or any contractual arrangement with respect to the use of the Electric System or any portion thereof or the services, output or capacity thereof, (ii) the proceeds of any insurance covering business interruption loss relating to the Electric System and (iii) interest received on any moneys or securities held pursuant to the Bond Ordinance; provided, however, that Revenues shall not include (i) any revenues, receipts, rents, money or funds in aid of construction and income to the City when acting in the capacity of project manager with respect to a Project, (ii) customer deposits, or (iii) amounts received upon the sale, exchange or disposition of assets pursuant to the provisions of Section 7.05(b).

“Sinking Fund Installment” shall mean an amount so designated which is established pursuant to a Series Ordinance authorizing a Series of Bonds and which is required by the Bond Ordinance to be deposited in the Bond Fund for the payment of Term Bonds of such series and maturity.

“Subordinated Indebtedness” shall mean an evidence of indebtedness or obligation to pay money complying with the provisions of the Bond Ordinance requiring that the payment of the principal of and interest on the same be payable be, and shall be expressed to be, subordinated in all respects to the security interest in and pledge created by the Bond Ordinance as security for the Bonds.

“Variable Rate Indebtedness” means any indebtedness or obligation the interest rate on, or amount of, which is not fixed at the time of incurrence of such indebtedness or obligation, and has not at some subsequent date been fixed, at a single numerical rate for the entire remaining term of the indebtedness or obligation.

## **Pledge**

The Bonds of each Series are special limited obligations of the City and are secured by a pledge of and shall be a charge upon and shall be payable, as to the principal, Accreted Value and Appreciated Value thereof, interest thereon, and any premiums upon redemption thereof, solely from and secured by a lien upon (i) the Net Revenues, subordinate to the lien thereon of the Prior Lien Bonds pursuant to the Prior Lien Bond Ordinances, and (ii) the other funds, assets and security described under the Bond Ordinance and under the Series Ordinance creating that Series. In the Bond Ordinance, the City pledges and places a charge upon all Net Revenues, subordinate only to the lien thereon of the Prior Lien Bonds pursuant to the Prior Lien Bond Ordinances, to secure the payment of the principal, Accreted Value and Appreciated Value of, premium, if any, and interest on the Bonds and Parity Obligations in accordance with their respective terms without priority or distinction of one over the other, subject only to the provisions of the Bond Ordinance, permitting the application thereof for the purposes and on the terms and conditions set forth herein, and the Net Revenues constitute a trust for the security and payment of the interest and any premium on and principal, Accreted Value and Appreciated Value of the Bonds and Parity Obligations subordinate only to the lien thereon of the Prior Lien Bonds pursuant to the Prior Lien Bond Ordinances. The Bond Ordinance pledges to secure the payment of the principal, Accreted Value and Appreciated Value of and premium, if any, and interest on the Bonds in accordance with their terms all amounts (including proceeds of the Bonds) held by the City in the Bond Fund, subject only to the provisions of the Bond Ordinance permitting the application thereof for the purposes and on the terms and conditions set forth herein. The pledge of Net Revenues herein made shall remain in effect until there are no Bonds or Parity Obligations Outstanding.

## **Application of Revenues**

Revenues are pledged by the Bond Ordinance to payment of principal of and interest and redemption premium on the Bonds of all series and Parity Obligations, subject to the provisions of the Bond Ordinance permitting application for other purposes. For the application of Revenues, the Bond Ordinance establishes a Revenue Fund, a Bond Fund and a Construction Fund held by the City.

The Bond Ordinance establishes with the City the Electric Revenue Fund into which all Revenues of the Electric System shall be deposited; provided, however, that for so long as (1) any Prior Lien Bonds are Outstanding and (2) any Notes are Outstanding, the City shall (i) continue and maintain all funds and accounts established by the Prior Lien Bond Ordinances or the Note Ordinance, as appropriate, and (ii) except as provided in a Series Ordinance authorizing the issuance of a Series of Bonds and providing for the deposit of a portion of the proceeds of such Series of Bonds into one or more of the funds established by the Bond Ordinance, deposit Revenues into the Electric Revenue Fund and make deposits to the funds and accounts as provided by the Bond

Ordinance only after the deposits and payments required to be made by the Prior Lien Bond Ordinances and the Note Ordinance, as appropriate, have been made.

Not less than three (3) Business Days prior to any Payment Date for a Series of Bonds the City shall pay from the Electric Revenue Fund into the Bond Fund the Debt Service due on such Series of Bonds on such Payment Date; provided that, for the purposes of computing the amount to be deposited in the Bond Fund, there shall be excluded from such deposit the amount, if any, set aside in the Bond Fund from the proceeds of Bonds, Parity Obligations, Subordinated Indebtedness or other evidences of indebtedness of the City (including amounts, if any, transferred thereto from the Construction Fund) for the payment of interest on such Series of Bonds; provided, however, that so long as there shall be held in the Bond Fund an amount sufficient to pay in full all Outstanding Bonds in accordance with their terms (including the maximum amount of principal, mandatory sinking fund payments, Accreted Value, Appreciated Value or applicable Redemption Price and all interest which could become payable thereon), no transfers shall be required to be made to the Bond Fund.

### **Construction Fund**

The Bond Ordinance establishes a Construction Fund to be held by the City. There shall be paid into the Construction Fund the amounts required to be so paid by the provisions of the Bond Ordinance and any Series Ordinance, and there may be paid into the Construction Fund, at the option of the City, any moneys received for or in connection with the Electric System by the City from any other source, unless required to be applied otherwise as provided by the Bond Ordinance. Amounts in the Construction Fund shall be applied to the Costs of the Electric System in the manner provided in the Bond Ordinance.

The Board shall make payments from the Construction Fund in the amounts, at the times, in the manner and on the other terms and conditions established by a resolution of the Board.

To the extent that other moneys are not available therefor, amounts in the Construction Fund shall be applied to the payment of principal of and interest on Bonds when due. Amounts credited to the Construction Fund which the City at any time determines to be in excess of the amounts required for the purposes thereof shall be transferred to the Electric Revenue Fund; provided, however, that the amount of any such credit to the Electric Revenue Fund shall not constitute or be deemed to constitute Revenues for any purpose of the Bond Ordinance.

### **Bond Fund**

The Board shall pay out of the Bond Fund to the respective Paying Agents not less than three (3) Business Days before (i) each Payment Date for any of the Bonds the amount required for the interest and principal; and (ii) before any redemption date for the Bonds, the amount required for the payment of interest on and the Redemption Price of the Bonds then to be redeemed.

### **Debt Service Reserve Fund**

The City may, but shall not be required to, establish a debt service reserve fund or account for a Series of Bonds issued pursuant to the Bond Ordinance, each of which shall be for the benefit and security such Series of Bonds, in the manner and to the extent provided in the Series Ordinance establishing each such fund or account. The entity that shall hold any such account or fund, the amounts to be deposited therein, and any other matters and things relative to such account or fund which are not contrary to or inconsistent with the Bond Ordinance as theretofore in effect, shall be set forth in such resolution or Supplemental Ordinance establishing such account or fund or any Supplemental Ordinance thereafter adopted in connection therewith.

### **Investment of Funds and Accounts**

Unless limited by the provisions of a Series Ordinance, all amounts held in any fund or account established under the Bond Ordinance may be invested and reinvested as shall be provided in the applicable policies established from time to time by the Board which investment shall mature not later than such times as shall be necessary to provide moneys when needed for payments to be made from such funds and accounts. Any Paying Agent shall make all such investments of moneys held by it in accordance with written instructions received from any Authorized Representative. If any Paying Agent does not receive any such written instructions, such Paying Agent shall invest such fund in such Federal Securities as the Paying Agent shall determine.

Interest (net of that which represents a return of accrued interest paid in connection with the purchase of any investment)

earned on any moneys or investments in any fund or account shall be paid into the respective fund or account in which such investment is held; provided, however, that at the direction of the Board, such interest earned on moneys or investments in any such fund or account or any portion thereof shall be paid into the Construction Fund. Interest earned on any moneys or investments in the Construction Fund shall be held in the Construction Fund for application as provided in Section 5.03 or paid into the Electric Revenue Fund.

Obligations purchased as an investment of moneys in any fund or account created under the provisions of the Bond Ordinance shall be deemed at all times to be a part of such fund or account and any profit realized from the liquidation of such investment shall be credited to such fund or account and any loss resulting from the liquidation of such investment shall be charged to such fund or account.

In computing the amount in any fund or account created under the provisions of the Bond Ordinance for any purpose provided in the Bond Ordinance, obligations purchased as an investment of moneys therein shall be valued as provided in the applicable policies established by the Board from time to time.

### **Covenant as to Rates, Fees and Charges**

Subject to any rate regulation by any state or federal regulatory authority, the City and the Board will fix, establish, maintain and collect such rates, charges and fees for electric power and energy and services furnished by the Electric System and to the extent legally permissible, revise such rates, charges and fees to produce Revenues each Fiscal Year sufficient:

- (i) to pay all Operation and Maintenance Expenses;
- (ii) to produce Net Revenues, after deducting amounts expended during the Fiscal Year from the Net Revenues for the payment of debt service requirements of the Prior Lien Bonds, equal to an amount sufficient to pay the annual debt service due and payable in such Fiscal Year of the then Outstanding Bonds and Parity Obligations; and
- (iii) to pay after deducting the amounts determined in (i) and (ii) above, all other financial obligations of the Electric System reasonably anticipated to be paid from Revenues.

If the Net Revenues in any Fiscal Year are less than the aggregate amount specified above the City and the Board shall within sixty (60) days from the date of receipt of the annual audit for such Fiscal Year either (a) cause such rates and charges to be revised and adjusted to comply with the requirements set forth in this paragraph or (b) obtain a written report from an Independent Consultant after a review and study of the operations of the Electric System has been made concluding that, in their opinion, the rates and charges then in effect for the current Fiscal Year are sufficient or adjustments and revisions need to be made to such rates and charges to comply with the provisions set forth under the heading "Covenant as to Rates, Fees and Charges" and such adjustments and revisions to electric rates and charges are promptly implemented and enacted in accordance with such Independent Consultant's report.

### **Certain Other Covenants**

Creation of Liens; Sale and Lease of Property. (a) The City shall not issue any bonds, notes, debentures, or other evidences of indebtedness of similar nature, other than the Bonds or Parity Obligations, payable out of or secured by a security interest in or pledge or assignment of the Net Revenues or other moneys, securities or funds held or set aside by the City, the Board or by any Paying Agent under the Bond Ordinance and shall not create or cause to be created any lien or charge on the Net Revenues or such moneys, securities or funds; provided, however, that nothing contained in the Bond Ordinance shall prevent the City from issuing, if and to the extent permitted by law (i) evidences of indebtedness (A) payable out of moneys in the Construction Fund as part of the costs of the Electric System, or (B) payable out of, or secured by a security interest in or pledge or assignment of, Net Revenues to be received on and after such date as the pledge of the Net Revenues provided in the Bond Ordinance shall be discharged and satisfied as provided in Article X, or (ii) Subordinated Indebtedness.

(b) To the extent and in the manner provided by law, the Board may sell, exchange or otherwise dispose of property, facilities and assets of the Electric System at any time and from time to time having a fair market value not to exceed \$5,000,000 annually, as such amount shall be indexed based on the Consumer Price Index for All Urban Consumer (CPI-U) for the U.S. City Average for All items, 1982-84 = 100 (the "CPI") in effect on the date of adoption of the Basic Ordinance. Furthermore, the Board,

to the extent and in the manner provided by law, may lease, contract, or grant licenses for the operation of, or make arrangements for the use of, or grant easements or other rights to the properties and facilities of the Electric System. The proceeds of any such sale, exchange or disposal of property or facilities shall be used (i) to provide for the payment and redemption of Bonds or Parity Obligations or (ii) to acquire capital assets for any Electric System purpose.

Maintenance of Insurance. (a) The Board shall at all times use its best efforts to keep or cause to be kept the properties of the Electric System which are of an insurable nature and of the character usually insured by those operating properties similar to the Electric System insured against loss or damage by fire and from other causes customarily insured against and in such relative amounts as are usually obtained. The Board shall at all times use its best efforts to maintain or cause to be maintained insurance or reserves against loss or damage from such hazards and risks to the person and property of others as are usually insured or reserved against by those operating properties similar to the properties of the Electric System. The Board shall only be required to obtain such insurance if the same is available at reasonable rates and upon reasonable terms and conditions.

In lieu of obtaining policies for insurance as provided above, the Board may self-insure against risks, accidents, claims or casualties described above, or such risks, accidents, claims or casualties may be covered under one or more blanket insurance policies maintained by the City or the Board.

Reconstruction: Application of Insurance Proceeds. If any useful portion of the Electric System shall be damaged or destroyed, the Board shall make due proof of loss and shall do all things necessary or desirable to cause the insuring companies to make payment in full directly to the Board. The proceeds of insurance covering such property, together with any other funds available for such purpose as the Board in its sole discretion shall determine, shall be used to repair the property damaged or replace the property destroyed; provided, however, if the insurance proceeds and other funds that might be lawfully appropriated therefore are insufficient to repair or replace the damaged property, then such insurance proceeds received for the damaged or destroyed property shall be deposited to the credit of a special insurance account or fund until other funds become available which, together with funds on deposit to the credit of such special insurance account, will be sufficient to make the repairs or replacements to the property damaged or destroyed that resulted in such insurance proceeds or make other improvements to the Electric System.

Records and Accounts. The Board shall keep or cause to be kept proper books of record and account (separate from all other records and accounts) in which complete and correct entries shall be made of its transactions relating to the Electric System and each fund and account established under the Bond Ordinance, and which, together with all other books and papers of the Board or the City, including insurance policies, relating to the Electric System, shall upon reasonable advance notice and during regular business hours, be subject to the inspection of the Owners of an aggregate of not less than 5% in principal amount of the Bonds and Parity Obligations then Outstanding or their representatives duly authorized in writing.

### **Amendment of Bond Ordinance**

The Bond Ordinance and the rights and obligations of the City and of the Owners of the bonds may be amended by a Supplemental Ordinance with the written consent (1) of the Owners of a majority in principal amount of the Bonds affected by such modification or amendment and (2) in case the modification or amendment changes the terms of any Sinking Fund Installment, of the Owners of a majority in principal amount of the Bonds of the particular series and maturity entitled to the benefit of such Sinking Fund Installment. No such modification or amendment may (1) permit a change in the terms of redemption or maturity of the principal of any Bond or any installment of interest or a reduction in the principal, Redemption Price or rate of interest thereon without consent of each affected Owner, or (2) reduce the percentages or otherwise affect the classes of Bonds the consent of the Owners of which is required to effect any such modification or amendment. For purposes of the foregoing, Owners of Bonds may include the initial Owners thereof regardless of whether such Bonds are being held for resale.

The Bond Ordinance may be amended without the consent of Bondholders, (1) to cure any ambiguity, omission, defect or inconsistent provision in the Bond Ordinance; (2) to insert provisions clarifying the Bond Ordinance; or (3) to make any other modification or amendment of the Resolution which the Board, in its sole discretion, determines will not have a material adverse effect on the interests of the Bond Ordinance.

Without the consent of the Bondholders, the City may adopt a Supplemental Ordinance which (1) closes the Bond Ordinance against, or provides additional conditions to, the issuance of Bonds or other evidences of indebtedness; (2) adds covenants and agreements of the City or the Board; (3) adds limitations and restrictions to be observed by the City or the Board; (4)

authorizes Bonds of an additional series; (5) confirms any security interest, pledge or assignment of the Revenues or of any other moneys, securities or funds; (6) makes any modification which is to be effective only after all Bonds of each series Outstanding as of the date of the adoption of such Supplemental Ordinance cease to be Outstanding; or (7) authorizes Subordinated Indebtedness.

### **Defeasance**

Except as may be provided in any Series Ordinance creating a Series of Bonds, Bonds of any Series may be paid by the City in any of the following ways:

- (a) by paying or causing to be paid the Bond Obligation of and interest on all Bonds Outstanding of the Series, as and when the same become due and payable;
- (b) by depositing with the Paying Agent, an escrow agent or other fiduciary, in trust, at or before maturity, money or securities in the necessary amount (as provided in the Bond Ordinance) to pay or redeem all Bonds Outstanding of the Series; or
- (c) by delivering to the Paying Agent, for cancellation by it, all Bonds then Outstanding of the Series.

Upon the deposit with the Paying Agent, an escrow agent or other fiduciary, in trust, at or before maturity, of money or securities in the necessary amount (as provided in the Bond Ordinance) to pay or redeem any Outstanding Bond (whether upon or prior to its maturity or the redemption date of such Bond), provided that, if such Bond is to be redeemed prior to maturity, irrevocable notice of such redemption shall have been given as provided in the Bond Ordinance or provision satisfactory to the Registrar and Paying Agent shall have been made for the giving of such notice, then all liability of the City in respect of such Bond shall cease, terminate and be completely discharged; provided that the Owner thereof shall thereafter be entitled to the payment of the principal of and premium, if any, and interest on such Bond, and the City shall remain liable for such payment, but only out of such money or securities deposited as aforesaid for their payment, subject, however, to the provisions of the Bond Ordinance and the continuing duties of the Registrar and Paying Agent.

Whenever in the Bond Ordinance it is provided or permitted that there be deposited with or held in trust by the Paying Agent, an escrow agent or other fiduciary, money or securities in the necessary amount to pay or redeem any Bonds, the money or securities so to be deposited or held may include money or securities held by the Paying Agent in the funds and accounts established pursuant to the Bond Ordinance and shall be one or more of the following:

- (i) lawful money of the United States of America in an amount equal to the Bond Obligation of such Bonds and all unpaid interest thereon to maturity, except that, in the case of Bonds which are to be redeemed prior to maturity and in respect of which notice of such redemption shall have been given as provided in Article IV or provision satisfactory to the Paying Agent shall have been made for the giving of such notice, the amount to be deposited or held shall be the Bond Obligation or Redemption Price of such Bonds and all unpaid interest thereon to the redemption date; or
- (ii) non-callable Federal Securities or Municipal Obligations, the principal of and interest on which when due will, in the opinion of an independent certified public accountant delivered to the Paying Agent for which payment is being made (upon which opinion the Paying Agent may conclusively rely), provide money sufficient to pay the Bond Obligation or Redemption Price of and all unpaid interest to maturity, or to the redemption date, as the case may be, on the Bonds to be paid or redeemed, as such Bond Obligation or Redemption Price and interest become due; provided that, in the case of Bonds which are to be redeemed prior to the maturity thereof, notice of such redemption shall have been given as provided in the Bond Ordinance or provision satisfactory to the shall have been made for the giving of such notice.

### **Events of Default; Remedies**

Events of Default. Each of the following events shall be an "Event of Default":

- (a) Default by the City or the Board in the due and punctual payment of the principal, Accreted Value or Appreciated Value of, or premium, if any, on any Bond (whether at maturity, by acceleration, call for redemption or otherwise);

(b) Default by the City or the Board in the due and punctual payment of the interest on any Bond and such default shall continue for a period of thirty (30) days after the due date for the payment of such interest;

(c) Failure of the City or the Board to observe and perform any of its other covenants, conditions or agreements under the Bond Ordinance or in the Bonds for a period of 90 days after written notice from the Owners of 25% in aggregate amount of Bond Obligation of the Bonds then outstanding, specifying such failure and requesting that it be remedied, or in the case of any such default that cannot with due diligence be cured within such 90 day period, failure of the City to proceed promptly to cure the same and thereafter prosecute the curing of such default with due diligence;

(d) (1) Failure of the Board generally to pay its debts as the same become due, (2) commencement by the Board of a voluntary case under the Federal bankruptcy laws, as now or hereafter constituted, or any other applicable Federal or state bankruptcy, insolvency or other similar law, (3) consent by the Board to the appointment of a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official for the Board, the Electric System or any substantial part of the Board's property, or to the taking possession by any such official of the Electric System or any substantial part of the Board's property, (4) making by the Board of any assignment for the benefit of creditors, or (5) taking of corporate action by the Board in furtherance of any of the foregoing;

(e) The entry of any (1) decree or order for relief by a court having jurisdiction over the Board or its property in an involuntary case under the Federal bankruptcy laws, as now or hereafter constituted, or any other applicable Federal or state bankruptcy, insolvency or other similar law, (2) appointment of a receiver, liquidator, assignee, trustee, custodian, sequestrator or similar official for the Board, the Electric System or any substantial part of the Board's property, or (3) order for the termination or liquidation of the City, the Board, the Electric System or affairs of any of them;

(f) Failure of the City or the Board within 90 days after the commencement of any proceedings against either of them under the Federal bankruptcy laws prior any other applicable Federal or state bankruptcy, insolvency or similar law, to have such proceedings dismissed or stayed; or

(g) Any Event of Default under the Prior Lien Bond Ordinances shall occur and shall not be cured as provided by the Prior Lien Bond Ordinances.

Remedies Upon Occurrence of an Event of Default. Upon the happening and continuance of any event of default, then and in every such case the Owners of not less than twenty-five percent (25%) of the Bond Obligation may appoint any state bank, national bank, trust company or national banking association qualified to transact business in the State of Nebraska to serve as trustee for the benefit of the Owners of all Bonds then outstanding (the "Receiver"). Notice of such appointment, together with evidence of the requisite signatures of the Owners of twenty-five percent (25%) of the Bond Obligation and the trust instrument under which the Receiver shall have agreed to serve shall be filed with the City and the Board with a copy to the Receiver and notice of such appointment shall be mailed to the Owners of the Bonds. After the appointment of a Receiver hereunder, no further Receivers may be appointed; however, the Owners of a majority of the Bond Obligation may remove the Receiver initially appointed and appoint a successor and subsequent successors at any time. If the default for which the Receiver was appointed is cured or waived pursuant to the Bond Ordinance, the appointment of the Receiver shall terminate with respect to such default.

After a Receiver has been appointed pursuant to the foregoing, the Receiver may proceed, and upon the written request of Owners of twenty-five percent (25%) of the Bond Obligation shall proceed, to protect and enforce the rights of the Owners under the laws of the State of Nebraska, including the Act, and under the Bond Ordinance, by such suits, actions or special proceedings in equity or at law, or by regulatory or administrative proceedings in the office of any board, body or officer having jurisdiction, either for the specific performance of any covenant or agreement contained herein or in aid of execution of any power herein granted or for the enforcement of any proper legal or equitable remedy, all as the Receiver, being advised by counsel, shall deem most effectual to protect and enforce such rights.

In the enforcement of any remedy against the City or the Board, under the Bond Ordinance the Receiver shall be entitled to sue for, enforce payment of and receive any and all amounts then or during any default becoming, and at any time remaining, due from the City or the Board, for principal, interest or other sums due under any provisions of the Bond Ordinance or of such Bonds and unpaid, with interest on overdue payments of principal and, if permitted by law, at the rate or rates of interest specified in such Bonds, together with any and all reasonable costs and expenses of collection and of all proceedings hereunder and under such Bonds

without prejudice to any other right or remedy of the Receiver or of the Owners, and to recover and enforce any judgment or decree against the City or the Board, but solely as provided herein and in such Bonds, for any portion of such amounts remaining unpaid and interest, costs and expenses as above provided, and to collect (but solely from moneys in the Electric Revenue Fund, as the case may be, and any other moneys available for such purpose) in any manner provided by law, the moneys adjudged or decreed to be payable.

Directions to Receiver as to Remedial Proceedings. Anything in the Bond Ordinance to the contrary notwithstanding, the Owners of a majority of the Bond Obligation shall have the right, by an instrument or concurrent instruments in writing executed and delivered to the Receiver, to direct the method and place of conducting all remedial proceedings to be taken by the Receiver hereunder, provided that such direction shall not be otherwise than in accordance with law or the provisions of the Bond Ordinance, and that the Receiver shall have the right to decline to follow any such direction which in the opinion of the Receiver would be unjustly prejudicial to Owners not parties to such direction.

Pro Rata Application of Funds. (a) Anything in the Bond Ordinance to the contrary notwithstanding, if at any time the moneys in the Electric Revenue Fund, shall not be sufficient to pay the principal Accreted Value, Appreciated Value or Redemption Price of or the interest on the Bonds as the same become due and payable, such moneys, together with any moneys then available or thereafter becoming available for such purpose, whether through the exercise of the remedies provided for in the Bond Ordinance or otherwise, shall be applied as follows:

(i) Unless the principal of all the Bonds and Parity Obligations shall have become due and payable, all such moneys shall be applied (A) to the payment of all installments of interest then due on the bonds and the interest component of Parity Obligations then due, in the order of the maturity of the installments of such interest, to the persons entitled thereto, ratable, without any discrimination or preference, and (B) to the payment of all installments of principal of Bonds and Parity Obligations then due.

(ii) If the principal of all the Bonds and Parity Obligations shall have become due and payable, all such moneys shall be applied to the payment of the principal Accreted Value, Appreciated Value or Redemption Price or interest then due and unpaid upon the Parity Obligations, without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bonds or Parity Obligations over any other Bonds or Parity Obligations, ratable, according to the amounts due, respectively, for principal or interest to the persons entitled thereto without any discrimination or preference except as to any difference in the respective rates of interest specified in the Bond and Parity Obligations.

(b) Whenever moneys are to be applied by the Receiver pursuant to the provisions stated above, such moneys shall be applied by the Receiver at such times, and from time to time, as the Receiver in its sole discretion shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional moneys becoming available for such application in the future; the setting aside of such moneys, in trust for the proper purpose, shall constitute proper application by the Receiver; and the Receiver shall incur no liability whatsoever to the City, to the Board, to any Owner or to any other person for any delay in applying any such moneys, so long as the Receiver acts with reasonable diligence, having due regard to the circumstances, and ultimately applies the same in accordance with such provisions of the Bond Ordinance as may be applicable at the time of application by the Receiver. Whenever the receiver shall exercise such discretion in applying such moneys, it shall fix the date (which shall be an interest payment date unless the Receiver shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue, the Accreted Value of Capital Appreciation Bonds shall cease to accrete and the Appreciated Value of any Deferred Income Bond. The Receiver shall give such notice as it may deem appropriate of the fixing of any such date, and shall not be required to make payment to the Owner of any Bond unless such Bond shall be presented to the Receiver for appropriate endorsement or for cancellation if fully paid.

Restrictions on Actions by Individual Owners. No Owner shall have any right to institute any suit, action or proceeding in equity or at law for the execution of any trust under the Bond Ordinance or for any other remedy hereunder unless such Owner previously shall have given to the Receiver written notice of the event of default on account of which such suit, action or proceeding is to be taken, and unless the Owners of not less than twenty-five percent (25%) of the Bond Obligation shall have made written request of the Receiver after the right to exercise such powers or right of action, as the case may be, shall have accrued and shall have afforded the Receiver a reasonable opportunity either to proceed to exercise the powers granted in the Bond Ordinance or to institute such action, suit or proceeding in its or their name, and unless, also, there shall have been offered to the Receiver reasonable

security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby, including the reasonable fees of its attorneys (including fees on appeal), and the Receiver shall have refused or neglected to comply with such request within a reasonable time; and such notification, request and offer of indemnity are hereby declared in every such case, at the option of the Receiver, to be conditions precedent to the execution of the powers and trusts of the Bond Ordinance or for any other remedy hereunder. It is understood and intended that no one or more Owners of the Bonds secured by the Bond Ordinance shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Bond Ordinance, or to enforce any right hereunder, except in the manner provided in the Bond Ordinance, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner provided in the Bond Ordinance and for the benefit of all Owners, and that any individual rights of action or any other right given to one or more of such Owners by law are restricted by the Bond Ordinance to the rights and remedies provided in the Bond Ordinance.

Nothing contained in the Bond Ordinance, however, shall affect or impair the right of any Owner individually, to enforce the payment of the principal of and interest on his Bond or Bonds at and after the maturity thereof, at the time, place, from the source and in the manner provided in the Bond Ordinance.

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**APPENDIX III**

**OPINION OF BOND COUNSEL**

[FORM OF OPINION OF BOND COUNSEL]

August 29, 2005

City of Lincoln, Nebraska  
Acting for and on behalf of  
Lincoln Electric System  
1040 "O" Street  
Lincoln, NE 68508

Re: City of Lincoln, Nebraska Lincoln Electric System Revenue Commercial Paper Notes

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Ladies & Gentlemen:

We have acted as bond counsel in connection with the issuance and sale from time to time by the City of Lincoln, Nebraska (the "City") of its Lincoln Electric System Commercial Paper Notes in an aggregate principal amount outstanding at any time not to exceed \$150,000,000 (the "Notes"). The Notes are issued under the authority of and in full compliance with the Constitution and statutes of the State of Nebraska and the City Charter of the City and pursuant to Ordinance No. 18584 adopted on August 1, 2005 by the Council (the "Ordinance"). Capitalized terms used herein and not otherwise defined herein shall have the meanings assigned to such terms in the Ordinance.

The Notes, when issued and delivered in accordance with the Ordinance, will constitute "Subordinated Indebtedness" for purposes of Ordinance No. 17879, pursuant to which Bonds and Parity Obligations of the City payable from the Net Revenues of Lincoln Electric System (LES") have been and may be issued. Under the terms of the Ordinance, the lien on the Net Revenues for the payment of the Notes is subordinated and inferior to the lien on such Net Revenues for the payment of the Bonds and Parity Obligations.

We have not been engaged or undertaken to review the accuracy, completeness or sufficiency of the Offering Memorandum or other offering material relating to the Notes (except to the extent, if any, stated in the Offering Memorandum) and we express no opinion relating thereto (excepting only the matters set forth as our opinion in the Offering Memorandum).

We have examined the law and such certified proceedings and other documents as we deem necessary to render this opinion. As to questions of fact material to our opinion, we have relied upon the representations of the City contained in the Ordinance and in the certified proceedings and other certifications of public officials furnished to us without undertaking to verify the same by independent investigation.

Based upon the foregoing, we are of the opinion, under existing law, as follows:

1. The City is a municipal corporation, duly organized and existing with full power and authority to offer, issue and sell the Notes and perform its obligations under the Notes and the Ordinance.

2. The proceedings leading to the authorization for sale and issuance of the Notes have been taken in accordance with the laws and Constitution of the State of Nebraska, the Act and the Charter of the City, and the Notes, once issued in duly authorized form, executed by officials of the City and authenticated by the issuing and paying agent, when delivered to and paid for by such purchasers thereof, will constitute valid and legally binding obligations of the City, payable from the sources provided for in the Ordinance.

3. The Ordinance has been duly adopted by the City Council of the City and approved by the Mayor and constitutes a valid and legally binding obligation of the City enforceable in accordance with its terms.

4. The interest on the Notes is excluded from gross income for federal and Nebraska income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations; it should be noted, however, that, for the purpose of computing the alternative minimum tax imposed on corporations (as defined for federal income tax purposes), such interest is taken into account in determining adjusted current earnings. The opinions set forth in the preceding sentence are subject to the condition that the City and LES comply with all requirements of the Internal Revenue Code of 1986, as amended (the "Code") that must be satisfied subsequent to the issuance of the Notes in order that interest thereon be, or continue to be, excluded from gross income for federal income tax purposes. The City and LES have covenanted to comply with each such requirement. Failure to comply with certain of such requirements may cause the inclusion of interest on the Notes in gross income for federal income tax purposes to be retroactive to the date of issuance of the Notes. In furtherance of such covenant, on the date hereof, the City and LES have delivered a Federal Tax Certificate, containing certain representations, warranties, agreements and covenants upon which we have relied in rendering the opinions in this paragraph. We have assumed that all such representations, warranties, agreements and covenants are true and correct and that the City and LES will comply with all of such agreements and covenants. We express no opinion with respect to the exclusion of interest on the Notes from gross income under the Code in the event that any of such representations or warranties are untrue or either the City or LES fails to comply with such agreements and covenants. We also express no opinion regarding other federal tax consequences arising with respect to the Notes.

It is to be understood that the rights of the holders of the Notes and the enforceability of the Notes and the Ordinances may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted to the extent constitutionally applicable and that their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.

You may continue to rely upon this opinion to the extent that (a) there is no change in existing law, (b) the representations, warranties, agreements and covenants of the City and LES contained in the Ordinance, any certificate executed and delivered by the City or LES concerning compliance with the provisions of the Code with respect to any Notes, any Liquidity Facility executed and delivered by the City or LES in connection with the issuance, sale and delivery of the Notes, and certain other certificates dated the date hereof and executed and delivered by City or LES remain true and accurate and are complied with in all material respects, and (c) we deliver an opinion reaffirming in writing the conclusions stated in this opinion as of the date of each subsequent issuance of Notes.

Very truly yours,

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**APPENDIX IV**

**BOOK-ENTRY SYSTEM**



## BOOK-ENTRY SYSTEM

The Notes are available in book-entry form and beneficial ownership interests therein may be purchased in the principal amount of \$100,000 or any integral multiple of \$1,000 in excess of \$100,000. Purchasers of the Notes will not receive certificates representing their interests in the Notes.

The following information concerning The Depository Trust Company (“DTC”), New York, New York and DTC’s book-entry system has been obtained from sources LES believes to be reliable. However, LES takes no responsibility as to the accuracy or completeness thereof and the Beneficial Owners should not rely on the following information with respect to such matters, but should instead confirm the same with DTC or the Direct Participants, as the case may be. There can be no assurance that DTC will abide by its procedures or that such procedures will not be changed from time to time.

DTC will act as securities depository for the Notes. The Notes will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Master Note certificate will be issued and will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at [www.dtcc.com](http://www.dtcc.com) and [www.dtc.org](http://www.dtc.org).

Purchases of the Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Notes on DTC’s records. The ownership interest of each actual purchaser of each Note (each a “Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, the Master Note deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee; Cede & Co. or such other name as may be requested by an authorized representative of DTC. The deposit of the Notes with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Notes; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Notes may

wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Notes, such as, defaults, and proposed amendments to the Note documents. For example, Beneficial Owners of the Notes may wish to ascertain that the nominee holding the Notes for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Notes unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to LES as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payment of principal of and interest on the Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts, upon DTC's receipt of funds and corresponding detail information from LES or the Paying Agent, on the payment date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, its nominee, the Paying Agent, the City or LES, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal or redemption price of and interest on the Notes to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of LES or the Paying Agent. Disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Notes at any time by giving reasonable notice to LES or the Paying Agent. Under such circumstances, in the event that a successor securities depository is not obtained, Note certificates are required to be printed and delivered.

LES may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Note certificates will be printed, registered in the name of DTC's partnership nominee, Cede & Co. (or such other name as may be requested by an authorized representative of DTC), and delivered to DTC (or a successor securities depository), to be held by it as securities depository for Direct Participants. If, however, the system of book-entry-only transfers has been discontinued and a Direct Participant has elected to withdraw its Notes from DTC (or such successor securities depository), Note certificates may be delivered to Beneficial Owners.