

SECURITIES AND EXCHANGE COMMISSION

(Release No. 35-27931; 70-10237)

Black Hills Corporation, et al.

Order Authorizing Financing and Certain Related Transactions, Including Investment in Exempt Wholesale Generators and Foreign Utility Holding Companies; Approving Service Company and Intrasystem Transactions; and Reserving Jurisdiction

December 28, 2004

Black Hills Corporation (“Black Hills”), a public-utility holding company exempt from registration under section 3(a)(1) of the Public Utility Holding Company Act of 1935, as amended (“Act”), by rule 2, and its sole utility subsidiary, Black Hills Power, Inc. (“Black Hills Power” or “Utility Subsidiary”), both located in Rapid City, SD, and its nonutility subsidiaries (“Nonutility Subsidiaries”)¹ (collectively, “Applicants”), have filed with the Securities and Exchange Commission (“Commission”) an application-declaration, as amended (“Application”), under sections 6(a), 7, 9(a), 10, 11, 12(b) and (c), 13(b), 32, 33 and 34 of the Act and rules 42, 43, 45, 52, 53, 54, 58 and 88 through 92 under the Act. The Commission issued a notice of the Application on November 1, 2004 (Holding Co. Act Release No. 27907).

I. Background

Black Hills, a South Dakota corporation, is an energy company with three principal subsidiaries engaged in three major lines of business: (i) Black Hills Power, a subsidiary electric-utility company engaged in the generation, transmission, distribution and sale of electricity to customers in South Dakota, Wyoming and Montana and the

¹ See Appendix A for a complete listing of its Nonutility Subsidiaries.

wholesale sale of power in the western United States;² (ii) Black Hills Energy, Inc. (“Black Hills Energy”), a direct wholly owned subsidiary engaged, through subsidiaries, in the development, ownership and operation of exempt wholesale generators, as defined in section 32 of the Act (“EWGs”), and qualifying facilities as defined in the Public Utility Regulatory Policies Act of 1978, as amended (“PURPA”) (“QFs”), the production, transportation and marketing of natural gas, oil, coal and other energy commodities, power marketing and other energy-related activities; and (iii) Black Hills FiberCom, LLC (“Black Hills FiberCom”), a subsidiary of Black Hills Energy engaged in telecommunications activities and which Applicants anticipate will become an exempt telecommunications company, as defined in section 34 of the Act (“ETC”). Black Hills Power is regulated as a public-utility company by the states of South Dakota, Wyoming and Montana, with these states regulating Black Hills Power’s retail electric rates and charges and most of its securities issuances. Black Hills Power is also subject to regulation, under the Federal Power Act, by the Federal Energy Regulatory Commission (“FERC”). Black Hills Energy, directly and indirectly, owns Black Hills’ interests in Nonutility Subsidiaries, all primarily engaged in energy-related or telecommunications activities. Black Hills states that it intends to register as a public-utility holding company under section 5 of the Act upon the issuance of the Commission’s order in this matter.

² Black Hills Power has approximately 60,000 retail customers in eleven counties throughout a 9,300 square-mile service territory in portions of western South Dakota, eastern Wyoming and southern Montana. It also sells bundled capacity and energy service to Gillette, Wyoming and wholesale capacity and energy to other wholesale customers; owns generating facilities in its South Dakota service area, in Wyoming’s Powder River Basin (just west of Black Hills Power’s service territory) and a small transmission system (consisting of 230 kV and smaller transmission facilities in southwest South Dakota and northeast Wyoming, with a 69 kV distribution extension into southeast Montana, totalling 2,195 miles of transmission facilities).

Black Hills also intends to purchase an additional electric-utility company, Cheyenne Light, Fuel & Power Company, which is currently a subsidiary of Xcel Energy, Inc., a registered holding company under the Act. The Commission issued a notice of the application-declaration in the proposed acquisition on November 19, 2004 (Holding Co. Act Release No. 27914).³

Black Hills proposes to continue developing generation projects, expanding its power marketing operations and pursuing additional, related growth opportunities. Black Hills seeks authorizations to enable it, and its Utility Subsidiary and Nonutility Subsidiaries (collectively, "Subsidiaries"), to operate and engage in financing and investment activities, intrasystem services and other related activities and transactions following its registration as a public-utility holding company under the Act. Black Hills also proposes to form Black Hills Services Company, Inc. ("Black Hills Services"), upon its registration, to provide centralized services (such as accounting, financial, human resources, information technology and legal services) to the companies in the Black Hills system ("Black Hills System"). Applicants request authority for various related affiliate transactions in connection with Black Hills' registration and the establishment of Black Hills Services.

II. Summary of Requested Authority

Applicants request the following financing authorizations, for the period beginning with the effective date of an order issued in this matter, through December 31, 2007 ("Authorization Period"), and authorizations for certain related actions, as described

³ See also Xcel Energy Inc., *et al.*, Holding Co. Act Release No. 27914 (November 19, 2004 (SEC File No. 70-10229)).

further in subsequent sections of this order:

1. For Black Hills, directly or indirectly, to retain or refinance existing outstanding financing arrangements and debt issuances in the total amount of up to \$1.524 billion, consisting of approximately (a) \$798 million in utility and nonutility debt arrangements; (b) up to \$350 million in short-term debt and available credit lines ("Existing Short-Term Debt"); and (c) \$376.2 million in guarantees and other forms of credit support ("Existing Guarantees") (collectively, "Existing Financings");
2. For Black Hills and its Subsidiaries, to issue and sell securities, of up to an additional \$1 billion in securities outstanding at any one time ("Aggregate Additional Financing Limit") (subject to the Commission's reservation of jurisdiction over \$250 million, pending completion of the record), comprised of:
 - (a) For Black Hills, (i) common stock ("Common Stock," as defined below), (ii) preferred stock and preferred stock equivalent securities (collectively, "Preferred Securities," as defined below), (iii) unsecured short-term debt ("Short-Term Debt"), and (iv) unsecured long-term debt ("Long-Term Debt") (excluding the additional issuance of 2.7 million shares of common stock under various plans, described below); and
 - (b) For the Subsidiaries, (a) common stock ("Subsidiary Common Stock," as defined below) (b) preferred stock and preferred stock equivalent securities ("Subsidiary Preferred Securities," as defined below), (c) unsecured and secured short-term debt ("Subsidiary Short-Term Debt") and (d) unsecured and secured long-term debt ("Subsidiary Long-Term Debt") (and subject to a sublimit of \$350 million for the Utility Subsidiary);
3. For Black Hills and its Subsidiaries, to enter into transactions to manage interest rate risk, including anticipatory hedging transactions (together, "Interest Rate Hedging Transactions");
4. For Black Hills and its Subsidiaries, to issue guarantees and other credit support ("Guarantees") in an aggregate amount of up to \$400 million (excluding Existing Guarantees) ("Additional Guarantee Limit");
5. For Black Hills and its Subsidiaries, (a) to form financing entities ("Financing Subsidiaries," as defined below) and (b) to issue and sell securities through Financing Subsidiaries, subject to the Aggregate Additional Financing Limit;
6. For Black Hills and its Subsidiaries, to establish two money pools and enter into certain intrasystem financing arrangements (subject to the Commission's

reservation of jurisdiction over the addition of nonutility money pool participants and the use of certain instruments for short-term investment of money pools excess funds);

7. For Black Hills, directly or indirectly through Nonutility Subsidiaries, to engage, and make investments, in nonutility activities (such as EWGs, FUCOs, energy-related activities or subsidiaries authorized under rule 58 ("Rule 58 Subsidiaries") and other energy-related activities, assets or subsidiaries (collectively, "Permitted Nonutility Investments")):
 - (a) to (i) engage in energy marketing and brokering ("Energy Marketing," as further defined below) in Canada and Mexico and elsewhere in the world outside of the United States (subject to the Commission's reservation of jurisdiction over these activities outside of the United States, Mexico and Canada), and (ii) render energy management services ("Energy Management Services," as defined below) and consulting services ("Consulting Services," as defined below) anywhere in the world outside of the United States (collectively "Non-U.S. Energy-Related Subsidiaries");
 - (b) to invest in energy-related assets ("Energy-Related Assets," as further defined below) in an amount of up to \$300 million ("Energy-Related Assets Financing Limit");
 - (c) to invest in an aggregate amount of up to \$1.4 billion in EWGs and FUCOs (including its existing EWG investments) ("Aggregate EWG/FUCO Financing Limit"); and
 - (d) to engage, and invest an amount of up to \$100 million (on a revolving fund basis), in (i) preliminary development activities ("Development Activities," as defined below) and (ii) administrative and management activities ("Administrative Activities," as defined below) related to EWGs, FUCOs, Rule 58 Subsidiaries, Energy-Related Assets and Non-U.S. Energy-Related Subsidiaries;
8. For Black Hills and its Subsidiaries, to alter the capital stock of all wholly owned Subsidiaries (subject to the Commission's reservation of jurisdiction over partially owned Subsidiaries, pending completion of the record);
9. For Nonutility Subsidiaries, to pay dividends out of capital and unearned surplus (including revaluation reserve);
10. For Black Hills, directly or through Nonutility Subsidiaries, to acquire the securities of one or more corporations, trusts, partnerships, limited liability companies or other entities organized exclusively for the purpose of acquiring,

holding and/or financing or facilitating the acquisition or disposition of Permitted Nonutility Investments ("Intermediate Subsidiaries");

11. For Black Hills and its Nonutility Subsidiaries, to undertake internal reorganizations of subsidiaries and businesses;
12. For Black Hills, for the Commission to find, concerning the formation of a service company, that Black Hills Services will be so organized and so conducted as to meet the requirements of section 13(b) of the Act and that the filing of a Form U-13-1 is unnecessary; to be permitted an interim transition period after registration (no later than 12 months following the date of the Commission's order in this matter), to implement fully the service company, provided that Black Hills establishes the service company and it begins operations within 60 days of Black Hills' registration, as further described below; and to be exempted, among other things, from various at-cost rules applicable to transactions among Black Hills System companies; and
13. For Black Hills, to retain all of its existing investments in (a) EWGs and QFs, (b) energy-related exploration, production, transportation and marketing of energy commodities, power marketing and other activities; (c) telecommunications activities and (d) related businesses.

III. General Financing Parameters and Use of Proceeds

Black Hills proposes that the following general terms be applicable to the external financing transactions.

A. Effective Cost of Money

Applicants propose that the effective cost of capital on the proposed Preferred Securities, Short-Term Debt and Long-Term Debt and Black Hills' Subsidiaries' preferred securities, short-term debt and long-term debt will not exceed competitive market rates available at the time of the issuance of securities, having the same or reasonably similar terms and conditions issued by companies of reasonably comparable credit quality; provided that in no event will the effective cost of capital exceed, (1) on any series of Preferred Securities, Long-Term Debt or Subsidiary Preferred Securities or Subsidiary Long-Term Debt, 500 basis points over a U.S. Treasury security having a

remaining term equal to the term of the series; and (2) on Short-Term Debt, or Subsidiary Short-Term Debt, 300 basis points over the London Interbank Offered Rate ("LIBOR") for maturities of less than one year.

B. Maturity of Debt and Final Redemption of Preferred Securities

Applicants state that the maturity of the proposed long-term indebtedness will not exceed 50 years. In addition, they state that all preferred securities are to be redeemed no later than 50 years after their issuance.

C. Issuance Expenses

Applicants state that the underwriting fees, commissions or other similar remuneration paid in connection with the non-competitive issue, sale or distribution of a security that is the subject of this Application (not including any original issue discount) will not exceed 5% of the principal or total amount of the security being issued.

D. Common Equity Ratio and Investment Grade Condition

The consolidated common equity of Black Hills was 47.5% of total consolidated capitalization (all common stock equity (comprised of common stock, additional paid-in capital, retained earnings and/or treasury stock), minority interests, preferred stock, preferred securities, equity-linked securities and long-term and short-term debt and current maturities), as of September 30, 2004. Black Hills and its Utility Subsidiary commit that they will each maintain a common equity ratio (as reflected in the most recent Form 10-K or 10-Q (filed with the Commission as required by the Securities Exchange Act of 1934, as amended ("34 Act"), and as adjusted to reflect subsequent events that affect capitalization) of at least 30% of capitalization.

Applicants represent that, apart from securities issued for the purpose of funding money pool operations, no guarantees or other securities, other than common stock, may be issued in reliance upon the authorization to be granted by the Commission in this matter, unless (i) the security to be issued, if rated, is rated investment grade; (ii) all outstanding securities of the issuer, that are rated, are rated investment grade; and (iii) all outstanding securities of Black Hills, that will be registered, that are rated, are rated investment grade ("Investment Grade Condition"). For purposes of this Investment Grade Condition, a security will be deemed to be rated "investment grade," if it is rated investment grade by at least one nationally recognized statistical rating organization, as that term is used in paragraphs (c)(2)(vi)(E), (F) and (H) of rule 15c3-1 under the 34 Act. The Investment Grade Condition ratings test will not apply to any issuance of common stock. Applicants request that the Commission reserve jurisdiction over the issuance of any of such securities that are rated below investment grade. Applicants further request that the Commission reserve jurisdiction over the issuance of any guarantee or other securities at any time that the conditions set forth in clauses (i) through (iii) above are not satisfied.

E. Use of Proceeds

Applicants state that proceeds from the sale of securities in external financing transactions will be used for general corporate purposes, including, in part, capital expenditures of the Black Hills System, working capital requirements of the Black Hills System, the acquisition, retirement or redemption under rule 42 of the securities previously issued by Black Hills or its Subsidiaries and other purposes, including direct or indirect investment in authorized assets and securities (i.e., energy-related assets and

companies, EWGs, FUCOs and ETCs).

IV. Retention and Refinancing of Existing Financing

Applicants request authorizations, during the Authorization Period, for Black Hills, directly or indirectly, to retain and refinance existing outstanding financing arrangements and debt issuances in the total amount of up to \$1.524 billion, consisting of, approximately, (a) \$798 million in Utility and Nonutility debt arrangements; (b) up to \$350 million in Existing Short-Term Debt; and (c) \$376.2 million in Existing Guarantees. With respect to its Existing Short-Term Debt, Black Hills requests that the Commission include in its approval the retention and refinancing of Black Hills' existing revolving credit facilities (up to \$350 million in borrowing ability at any one time on a short-term basis), although Black Hills may not draw down the full amount of its facilities at the time of a Commission order and, thus, not have actually incurred "short-term debt."⁴

V. Proposed Additional Financing and Other Related Authority

Applicants request authority to issue and sell additional equity and debt securities in an amount of up to \$1 billion (the Aggregate Additional Financing Limit) (subject to the Commission's reservation of jurisdiction over a \$250 million, pending completion of the record) and Additional Guarantees in an amount of up to \$400 million, among other things, in addition to the refinancing of its Existing Financings (described above), during the Authorization Period. Specifically, Black Hills requests authorization to issue, directly and indirectly, (a) common stock (other than 2.7 million shares for employee benefits plans or stock purchase and dividend reinvestment plans, discussed below), (b)

⁴ Applicants note that this request includes amounts that have been obtained through Financing Subsidiaries. Applicants also note that they are requesting authority to retain existing Financing Subsidiaries. See sections V.G. and VI, below.

preferred stock and preferred securities, (c) long-term debt and (d) short-term debt, in an aggregate amount of up to \$1 billion (the Aggregate Additional Financing Limit), and guarantees and other credit support in an aggregate amount of up to \$400 million (the Additional Guarantee Limit). Applicants also seek financing authority (a) for certain energy-related investments, in an aggregate amount of up to \$300 million (the Energy-Related Assets Financing Limit), and (b) for investments in EWGs and FUCOs, in an aggregate amount of up to \$1.4 billion (including existing EWG investments) (the Aggregate EWG/FUCO Financing Limit), during the Authorization Period and other related authority, described further below.

A. Common Stock

Black Hills requests authority to issue and sell its common stock, denominated as “common stock,” and including (unless the context indicates otherwise) outstanding options, warrants and other stock purchase rights exercisable for Black Hills’ common stock (but not Black Hills’ Preferred Stock that is convertible into its common stock, prior to conversion) (“Common Stock”), subject to the Aggregate Additional Financing Limit, during the Authorization Period.

In addition, Black Hills requests authority to issue up to 2.7 million additional shares of Common Stock through various plans, in accordance with the terms of the programs.⁵ Black Hills proposes in this regard, from time to time, to issue new shares

⁵ Black Hills maintains a dividend reinvestment plan (“DRP”) for shareholders and various employee stock-based plans (an employee stock purchase plan (the “ESPP”), a Short-Term Incentive Plan, a 1996 Stock Option Plan, a 1999 Stock Option Plan and a 2001 Omnibus Incentive Compensation Plan). The DRP enables shareholders to reinvest dividends and make optional cash investments to purchase additional shares of common stock. The ESPP sells Black Hills common stock to employees at 90% of the stock’s market price on the offering date. At September 30, 2004, 125,395 shares have been

and/or acquire in open market transactions, or by some other method, up to 400,000 additional shares of Black Hills Common Stock, during the Authorization Period. Black Hills also proposes to issue new shares and/or acquire in open market transactions, or by some other method, up to 2.3 million additional shares of Black Hills Common Stock under the employee stock-based plans (excluding shares that may be issued through the exercise of outstanding options and issuance of shares for outstanding restricted stock units and performance shares), from time to time, during the Authorization Period.⁶

B. Preferred Securities

Black Hills requests authority to issue additional shares of its authorized Preferred Stock, defined below, or other types of preferred securities of Black Hills Corporation (including trust-preferred securities, monthly income preferred securities and equity-linked securities) (together, "Preferred Securities"), directly or indirectly through one or more financing entities ("Financing Subsidiaries," as defined below), organized by Black Hills, subject to the Aggregate Additional Financing Limit. Preferred Stock is defined as

reserved and are available for issuance under the ESPP. Under the Short-Term Incentive Plan, certain key employees are awarded short-term incentive bonuses, a portion or all of which may be paid in common stock. The 1996 and 1999 Stock Option Plans permit Black Hills to grant stock options to its employees. The 2001 Omnibus Incentive Compensation Plan permits it to issue restricted stock, restricted stock units, performance shares, performance units, stock appreciation rights, stock options and other awards, as determined by the Compensation Committee of the Board of Directors.

⁶ Black Hills proposes that its common stock financings be effected by underwriting agreements customary in the industry and public distributions effected by private negotiation with underwriters, dealers or agents, as described below, or through competitive bidding among underwriters. In addition, Applicants propose that sales may be made through private placements or other non-public offerings to one or more persons. Black Hills states that all common stock sales would be at rates or prices and under conditions negotiated or based upon, or otherwise determined by, competitive capital markets. Black Hills may also buy back shares of its stock or options during the Authorization Period in accordance with rule 42.

stock of Black Hills Corporation denominated as "preferred stock" and having preference rights with respect to payment of dividends and other benefits, which may include, in certain circumstances, the right of conversion into Common Stock.⁷

C. Debt Securities

1. Long-Term Debt

Black Hills requests authority to issue and sell unsecured long-term debt securities, comprised of notes and debentures and other forms of unsecured indebtedness having maturities of one year or longer ("Long-Term Debt"), up to the Aggregate Additional Financing Limit (which excludes renewals of Existing Financings).⁸

⁷ Preferred Securities may be issued in one or more series with rights, preferences and priorities, as may be determined by Black Hills' Board of Directors. Dividends or distributions on Preferred Securities will be made periodically, but may be made subject to terms, which allow the issuer to defer dividend payments for specified periods. Preferred Securities may be convertible or exchangeable into shares of Black Hills common stock or indebtedness. Preferred Securities may be sold directly through underwriters or dealers in connection with an acquisition in a manner similar to that described for common stock.

⁸ Any long-term debt may: (a) be convertible into any other securities of Black Hills; (b) will have maturities ranging from one to 50 years; (c) be subject to optional and/or mandatory redemption, in whole or in part, at par or at various premiums above the principal amount; (d) be entitled to mandatory or optional sinking fund provisions; (e) provide for reset of the coupon as required by a remarketing arrangement; (f) be subject to tender or the obligation of the issuer to repurchase at the election of the holder or upon the occurrence of a specified event; (g) be called from existing investors by a third party; and (h) be entitled to the benefit of positive or negative financial or other covenant.

Maturity dates, interest rates, redemption and sinking fund provisions, tender or repurchase and conversion features, if any, with respect to the long-term securities of a particular series, as well as any associated placement, underwriting or selling agent fees, commissions and discounts, if any, will be established by negotiation or competitive bidding. Borrowings from the banks and other financial institutions may be unsecured and pari passu with debt securities issued under the Black Hills Indenture and the short-term credit facilities. Specific terms of any borrowings will be determined by Black Hills at the time of issuance and will comply in all regards with the parameters of the financing authorization described in section III, above.

2. Short-Term Debt

Black Hills seeks authority to issue unsecured short-term debt securities, comprised of commercial paper, promissory notes and other forms of indebtedness having maturities of less than one year ("Short-Term Debt"), up to the Aggregate Additional Financing Limit (which excludes renewals of Existing Financings).⁹

D. Subsidiary Financings

Applicants also request that Black Hills' Subsidiaries be authorized to issue and sell Subsidiary Common Stock and Subsidiary Preferred Securities, Subsidiary Long-Term Debt and Subsidiary Short-Term Debt, subject to the Aggregate Additional Financing Limit and the parameters described in section III, above, during the Authorization Period. Black Hills' Utility Subsidiary and its Nonutility Subsidiaries request this financing authority to the extent that Subsidiaries may require financing that is outside rule 52 exempt financing.¹⁰ The Utility Subsidiary specifically requests authority to issue unsecured and secured short-term debt securities, including commercial paper and credit lines, subject to the Aggregate Additional Financing Limit and the parameters described in section III, above, during the Authorization Period. Black Hills and Black Hills Power state, in addition, that Black Hills Power's borrowings (whether

⁹ Commercial paper may be sold in established domestic and European commercial markets. Commercial paper would be sold to dealers at the discount rate or the coupon rate per annum prevailing at the date of issuance for commercial paper of comparable quality and maturities sold to commercial paper dealers generally. It is expected that the dealers acquiring commercial paper from Black Hills will offer the paper at a discount to corporate, institutional and, with respect to European commercial paper, individual investors. Institutional investors are expected to include commercial banks, insurance companies, pension funds, investment trusts, foundations, colleges and universities, and finance companies.

¹⁰ Applicants anticipate that the majority of the financings will be exempt from prior Commission authorization under rule 52(b).

through external or internal financings, including the Utility Money Pool) will not exceed a sublimit of \$350 million.

E. Financing Risk Management Devices

Black Hills, directly or indirectly through its Subsidiaries, requests authority to enter into interest rate hedging transactions with respect to outstanding indebtedness utilizing various financial instruments (collectively, "Interest Rate Hedges"), subject to certain limitations and restrictions, in order to reduce or manage interest rate costs.

Applicants state that Interest Rate Hedges (other than exchange-traded interest rate futures or options contracts)¹¹ will only be entered into with counterparties whose senior debt ratings, or the senior debt ratings of any credit support providers who have guaranteed the obligations of such counterparties, as published by Standard and Poor's Ratings ("Standard and Poor's"), are equal to or greater than BBB, or an equivalent rating from Moody's Investor Service ("Moody's"), Fitch Investor Service ("Fitch") or Duff and Phelps ("Approved Counterparties"). Applicants also state that fees, commissions and other amounts payable to an Approved Counterparty or exchange or other party (excluding, however, the swap or option payments) in connection with an Interest Rate Hedge, will not exceed those generally obtainable in competitive markets for parties of comparable credit quality.

Applicants also request authority to enter into interest rate hedging transactions for anticipated debt offerings ("Anticipatory Hedges"). Black Hills states that

¹¹ Interest Rate Hedges will include the use of financial instruments commonly used in today's capital markets, such as interest rate forwards, futures, swaps, caps, collars, floors and structured notes (i.e., a debt instrument in which the principal and/or interest payments are linked to the value of an underlying asset or index), or transactions

Anticipatory Hedges would be utilized to fix and/or limit the interest rate risk associated with any new issuance.¹² Anticipatory Hedges may be executed on-exchange (“On-Exchange Trades”), through brokers by the opening of futures and/or options positions traded on the Chicago Board of Trade, the opening of over-the-counter positions with one or more Approved Counterparties (“Off-Exchange Trades”) or a combination of On-Exchange Trades and Off-Exchange Trades.

Black Hills states that Applicants will not engage in speculative transactions. Applicants state that they will comply with Statement of Financial Accounting Standards No. 133 (“SFAS 133”), “Accounting for Derivatives Instruments and Hedging Activities” or other standards relating to accounting for derivative transactions as are adopted and implemented by the Financial Accounting Standards Board (“FASB”). The Interest Rate Hedges and Anticipatory Hedges will qualify for hedge accounting treatment under the FASB standards in effect and as determined at the date Interest Rate Hedges or Anticipatory Hedges are entered into.

F. Additional Guarantees (\$400 Million)

Applicants request authority to guarantee performance, and provide other forms of credit support, of Subsidiaries (“Guarantees”) in an aggregate principal amount not to exceed \$400 million outstanding at any one time, the Additional Guarantee Limit, during

involving the purchase or sale, including short sales, of government or agency (e.g., Fannie Mae) obligations or LIBOR-based swap instruments.

¹² Anticipatory Hedges may be implemented through: (a) a forward sale of exchange-traded Interest Rate Hedges (“Forward Sale”); (b) the purchase of put options on Interest Rate Hedges (“Put Options Purchase”); (c) a Put Options Purchase in combination with the sale of call options Interest Rate Hedges (“Zero Cost Collar”); (d) transactions involving the purchase or sale, including short sales, of Interest Rate Hedges; or (e) some combination of a Forward Sale, Put Options Purchase, Zero Cost Collar and/or other

the Authorization Period. Applicants also request authority to charge each Subsidiary a guarantee fee that is comparable to those fees charged by third parties. Black Hills further requests that any Guarantees outstanding at the end of the Authorization Period be permitted to continue until expiration or termination in accordance with their terms.¹³

G. Financing Subsidiaries

Applicants request authority to acquire, directly or indirectly, the equity securities of one or more corporations, trusts, partnerships, limited liability companies, or other entities, created specifically for the purpose of facilitating the financing of authorized and exempt activities (including authorized and exempt acquisitions) ("Financing Subsidiaries"), through the issuance of Subsidiary Common Stock or Subsidiary Preferred Securities, or Subsidiary Long-Term Debt, and to transfer of the proceeds to the Black Hills System company involved.¹⁴ Applicants also request authority to issue Guarantees for the Financing Subsidiaries, subject to the Additional Guarantee Limit. Applicants further request authority to enter into support, servicing or expense agreements ("Expense Agreements") for obligations of Financing Subsidiaries.¹⁵ Applicants request authority for Financing Subsidiaries to pledge revenues or other assets

derivative or cash transactions, including, but not limited to, appropriate structured notes, caps or collars.

¹³ Certain Guarantees may be for obligations not susceptible of exact quantification. For measuring compliance with the \$400 million limitation appropriate means will be utilized, including estimation of exposure based on loss experience or projected potential payment amounts. If appropriate, estimates will in be accordance with GAAP. Estimates will be reevaluated periodically.

¹⁴ Applicants are also requesting authority to retain existing Financing Subsidiaries. See section VI, below.

¹⁵ In an Expense Agreement, an Applicant would provide financial support and pay necessary operating expenses of a Financing Subsidiary to facilitate the subsidiary's agreements with third parties in financing activities approved through this Application.

or grant security interests solely to accommodate the intrasystem mirror structure of the financings; provided that the security pledged will not consist of the assets (other than an income stream in support of the financing) or stock of any Black Hills Utility Subsidiary or nonutility entity dedicated to serving a Utility Subsidiary.¹⁶

Black Hills and its Subsidiaries also request authority to issue and sell to any Financing Subsidiary, from time to time, in one or more series, unsecured debentures, unsecured promissory notes, or other unsecured debt instruments (“Notes”).¹⁷ Applicants further request authority for the Financing Subsidiaries to apply the proceeds of any external financing by a Financing Subsidiary, plus the amount of any equity contribution made to it, from time to time, by its parent corporation and other funds that may be available, or obtained in an exempt financing transaction, to purchase Notes. Applicants state that amounts issued by Financing Subsidiaries to third parties will be subject to the Aggregate Additional Financing Limit. However, Applicants request that the underlying intrasystem mirror debt (including Notes), and parent guarantee, not be so included, so as to avoid double counting.

H. Money Pools

Black Hills and its Utility Subsidiary request authorization to establish a utility money pool (“Utility Money Pool”) and Black Hills and its Nonutility Subsidiaries

¹⁶ See section V.N., below. Applicants also request approval under section 13(b) of the Act and rules 87 and 90 to provide these services at market prices but only so long as an Expense Agreement is in place. Applicants explain that, to have ratings agencies recognize Financing Subsidiaries as separate from their parents or affiliates, Expense Agreements must be at market prices (i.e., the contracts would be assumable by a successor without interruption or an increase of fees).

¹⁷ The terms (e.g., interest rate, maturity, amortization, prepayment terms, default provisions, etc.) of the Notes would be designed to parallel the terms of the securities issued by the Financing Subsidiary to which the Notes relate.

request authority to establish a nonutility money pool ("Nonutility Money Pool"), separate from the Utility Money Pool. Black Hills represents that it will not borrow from either of the money pools. Black Hills also asks the Commission to reserve jurisdiction over the addition of other participants to the Nonutility Money Pool in the future.¹⁸

Black Hills states that it will form and operate the Utility and Nonutility Money Pools by July 1, 2005. The Utility Subsidiary, to the extent not exempted under rule 52, requests authority to make unsecured short-term borrowings from, contribute surplus funds to, and to lend and extend credit to (and acquire promissory notes from) other participants in the Utility Money Pool, through the Utility Money Pool.¹⁹ The Utility Subsidiary also will be subject to a financing sublimit, described in section V.D. above.

¹⁸ Black Hills states that initial participants in the Nonutility Money Pool will be BHFC Publishing, Inc.; Black Hills Cabresto Pipeline, LLC; Black Hills Colorado, LLC; Black Hills Energy, Pipeline, LLC; Black Hills Energy Resources, Inc.; Black Hills Energy Terminal, LLC; Black Hills Energy, Inc.; Black Hills Exploration and Production, Inc.; Black Hills Fiber Systems, Inc.; Black Hills FiberCom, LLC; Fountain Valley II, LLC; Black Hills Fountain Valley, LLC; Black Hills Gas Holdings Corp.; Black Hills Gas Resources, Inc.; Black Hills Generation, Inc.; Black Hills Idaho Operations, LLC; Black Hills Ivanpah GP, LLC; Black Hills Ivanpah, LLC; Black Hills Kilgore Energy Pipeline, LLC; Black Hills Kilgore Pipeline Company, LP; Black Hills Kilgore Pipeline, Inc.; Black Hills Millennium Pipeline, Inc.; Black Hills Millennium Terminal, Inc.; Black Hills Montana Publishing, LLC; Black Hills Nevada Operations, LLC; Black Hills Nevada, LLC; Black Hills Ontario, LLC; Black Hills Operating Company, LLC; Black Hills Pepperell Power Associates, Inc.; Black Hills Southwest, LLC; Black Hills Wyoming, LLC; Desert Arc I, LLC; Desert Arc II, LLC; EIF Investors, Inc.; Enserco Energy Inc.; Fountain Valley Power, LLC; Harbor Cogeneration Company, LLC; Las Vegas Cogeneration II, LLC; Las Vegas Cogeneration Limited Partnership; Millennium Pipeline Company, LP; Millennium Terminal Company, LP; Sunco, Ltd.; West Cascade Energy, LLC; and Wyodak Resources Development Corporation.

¹⁹ Under the proposed Utility Money Pool terms, short-term funds would be available from: (1) surplus funds in the treasuries of Utility Money Pool participants other than Black Hills, (2) surplus funds in the treasury of Black Hills, and (3) proceeds from bank borrowings by Utility Money Pool participants or the sale of commercial paper by Black Hills or the Utility Subsidiary for loan to the Utility Money Pool. Funds would be made available as Black Hills Services may determine would result in a lower cost of

Applicants propose that the Nonutility Money Pool would be operated on the same terms and conditions as the Utility Money Pool, except that Black Hills' funds made available to Money Pools will be made available to the Utility Money Pool first and only afterward to the Nonutility Money Pool. No loans would be made to, and no borrowings from, the Nonutility Money Pool by a Utility Subsidiary.

Black Hills requests authorization to contribute surplus funds and to lend and extend credit to: (1) the Utility Subsidiary through the Utility Money Pool and (2) the Nonutility Subsidiaries through the Nonutility Money Pool. Black Hills and the Utility Subsidiary may contribute funds from the issuance of short-term debt to the Utility Money Pool. Black Hills and the Nonutility Subsidiaries may contribute funds from the issuance of short-term debt to the Nonutility Money Pool.²⁰ Black Hills also requests authority, for both the Utility Money Pool and the Nonutility Money Pool, to make certain short-term investments with funds not required by the respective money pool to make loans (with the exception of funds required to satisfy the money pool's liquidity requirements).²¹ In addition, Black Hills requests the Commission to reserve jurisdiction

borrowing, consistent with the individual borrowing needs and financial standing of pool participants.

²⁰ Applicants state that Black Hills Services will operate the Money Pools on an at-cost basis and separate records will be maintained for each pool. Surplus funds of the Utility Money Pool and the Nonutility Money Pool may be combined in common short-term investments, but separate records will be maintained and interest will be allocated separately, on a daily basis, to each money pool in the proportion that the amount of each money pool's surplus funds bears to the total amount of surplus funds available for investment from both money pools.

²¹ Applicants state that these short-term investments would include: (1) interest-bearing accounts with banks; (2) obligations issued or guaranteed by the U.S. government and/or its agencies and instrumentalities, including obligations under repurchase agreements; (3) obligations issued or guaranteed by any state or political subdivision, provided that the obligations are rated not less than "A" by a nationally recognized rating agency; (4) commercial paper rated not less than "A-1" or "P-1" or their equivalent by a nationally

over these investments in (a) short-term debt securities rated AAA by Standard and Poor's, Aaa by Moody's, or AAA by Fitch and (b) short-term debt securities issued or guaranteed by an entity rated AAA by Standard and Poor's, AAa or by Moody's, or AAA by Fitch, pending completion of the record.

I. Intrasystem Financing

Black Hills and the Subsidiaries request that they be permitted, when making intrasystem loans or extending intrasystem credit (in the event a loan or an extension of credit is not exempt under rules 45(b) or 52), to charge interest at the same effective rate of interest as the daily weighted average of commercial paper, revolving credit and/or other short-term borrowings of the respective lending Subsidiary, including an allocated share of commitment fees and related expenses.²²

Applicants also request authority for Black Hills, directly or indirectly through a Nonutility Subsidiary, to make loans to partially owned Subsidiaries at interest rates and maturities designed to provide a return to the lending company of not less than its effective cost of capital.²³

recognized rating agency; (5) money market funds; (6) bank certificates of deposit; (7) Eurodollar funds; and (8) other investments permitted under section 9(c) of the Act and rule 40.

²² Applicants state that, if no borrowings are outstanding, then the interest rate will be predicated on the Federal Funds' effective rate of interest as quoted daily by the Federal Reserve Bank of New York.

²³ Similar authority has been granted to other registered holding companies. See Emera, Inc., Holding Co. Act Release No. 27445 (October 1, 2001); Progress Energy, Inc., Holding Co. Act Release No. 27297 (December 12, 2000); Entergy Corporation, Holding Co. Act Release No. 27039 (June 22, 1999). Black Hills states that, generally, loans to, and purchases of capital stock from, Subsidiaries will be exempt under rule 52 and capital contributions and open account advances without interest will be exempt under rule 45(b). Loans by Black Hills or a Nonutility Subsidiary to a Nonutility Subsidiary will have interest rates and maturity dates that are designed to parallel the lending company's effective cost of capital, in accordance with rule 52(b).

J. Energy-Related Activities and Other Additional Nonutility Investments

Applicants seek authorization for certain activities related to nonutility investments in EWGs, FUCOs and other energy-related investments permitted under rule 58, as well as investments in Energy-Related Assets and Non-U.S. Energy Related Subsidiaries, for the duration of the Authorization Period, i.e., Permitted Nonutility Investments, as discussed below.

1. Certain Energy-Related Activities

Black Hills requests authority, directly or indirectly through Nonutility Subsidiaries, to (a) engage in Energy Marketing²⁴ in Canada and Mexico and elsewhere in the world outside of the United States, subject to the Commission's reservation of jurisdiction over these activities outside of the United States, Mexico and Canada, and (b) render Energy Management Services²⁵ and Consulting Services²⁶ anywhere in the world

²⁴ Black Hills defines Energy Marketing to consist of the brokering and marketing of electricity, natural gas and other energy commodities, as well as incidental related services, such as fuel management, storage and procurement.

²⁵ Black Hills defines Energy Management Services to include the marketing, sale, installation, operation and maintenance of various products and services related to energy management and demand-side management, including energy and efficiency audits; meter data management, facility design and process control and enhancements; construction, installation, testing, sales and maintenance of (and training client personnel to operate) energy conservation equipment; design implementation, monitoring and evaluation of energy conservation programs; development and review of architectural, structural and engineering drawings for energy efficiencies, design and specification of energy consuming equipment and general advice on programs; the design, construction, installation, testing, sales, operation and maintenance of new and retrofit heating, ventilating, and air conditioning, electrical and power systems, alarm, security, access control and warning systems, motors, pumps, lighting, water, water-purification and plumbing systems, building automation and temperature controls, installation and maintenance of refrigeration systems, building infrastructure wiring supporting voice, video, data and controls networks, environmental monitoring and control, ventilation system calibration and maintenance, piping and fire protection systems, and design, sale, engineering, installation, operation and maintenance of emergency or distributed power generation systems, and related structures, in connection with energy-related needs; and

outside of the United States. To the extent that operations outside the U.S. involve additional or different risks than U.S. operations, Black Hills states that it will evaluate and seek to mitigate those risks in a manner similar to the manner in which it evaluates and addresses EWG and FUCO investments, described below. The Commission has authorized these activities in other recent instances.²⁷

2. Additional Investments in Energy-Related Assets (\$300 Million)

Black Hills also requests authority, directly or indirectly through Nonutility Subsidiaries, to invest in nonutility energy assets that are incidental and related to its business as an electricity and energy commodities marketer and broker²⁸ (“Energy-

the provision of services and products designed to prevent, control, or mitigate adverse effects of power disturbances on a customer’s electrical systems. Black Hills states that, in the event it proposes to acquire an Energy Management Services business that owns distribution power generation systems that would constitute “utility assets” under the Act, Black Hills will, as necessary, seek any required approvals from the Commission.

²⁶ Applicants define Consulting Services to include technical and consulting services involving technology assessments, power factor correction and harmonics mitigation analysis, meter reading and repair, rate schedule design and analysis, environmental services, engineering services, billing services (including consolidation or centralized billing, bill desegregation tools and bill inserts), risk management services, communications systems, information systems/data processing, system planning, strategic planning, finance, general management consulting including training activities, feasibility studies, and other similar related services.

²⁷ See, e.g., Exelon Corporation, Holding Co. Act Release No. 27545 (June 27, 2002); Emera, Inc., Holding Co. Act Release No. 27445 (October 1, 2001); Progress Energy, Inc., Holding Co. Act Release No. 27297 (December 12, 2000).

²⁸ Black Hills defines Energy-Related Assets to include oil and natural gas production, gathering, processing, storage and transportation facilities and equipment, liquid oil reserves and storage facilities, and associated facilities that will be incidental to and assist Black Hills’ Nonutility Subsidiaries in connection with their marketing, brokering and trading activities. American Electric Power Company, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998). Black Hills further defines Energy-Related Assets to exclude additional investments in EWGs or FUCOs. Black Hills also states that Energy-Related Assets will not include the acquisition and ownership of any assets that would cause any subsidiary to be or become an “electric-

Related Assets”) in an amount of up to \$300 million (“Energy-Related Assets Financing Limit”). We have concluded, as Black Hills requests, that Black Hills’ existing investments in Energy-Related Assets should be disregarded for purposes of calculating the dollar limitation upon investment in energy-related companies under rule 58.²⁹

3. Additional Investment in EWGs and FUCOs (\$1.4 Billion)

Applicants also seek financing authority in an aggregate amount of up to \$1.4 billion for investments in EWGs and FUCOs (including Black Hills existing EWG investments as of September 30, 2004, of \$718 million) during the Authorization Period (“Aggregate EWG/FUCO Investment Limit”).³⁰ The proposed investment limit represents approximately 448% of Black Hills’ “average consolidated retained earnings,” as defined in rule 53(a)(1), for the four quarterly periods ending September 30, 2004.

Black Hills states that it is able to satisfy Commission requirements for its proposed Aggregate EWG/FUCO Investment Limit by meeting the statutory requirements of sections 32 and 33 of the Act, as well as standards provided by rule 53(c).³¹ In addition, Black Hills states that the proposed Aggregate EWG/FUCO

utility company” or “gas-utility company,” as defined in sections 2(a)(3) and 2(a)(4) of the Act.

²⁹ Rule 58(a)(1)(ii) provides that investments by a registered holding company in energy-related companies, as defined in rule 58(b)(1), may not exceed 15% of the consolidated capitalization of the registered holding company. The Commission has reached this conclusion in previous similar matters involving exempt holding companies (which are not subject to the same restrictions on nonutility activities as registered holding companies are) that were to become registered. See CP&L Energy, Inc., Holding Co. Act Release No. 27874 (November 27, 2000); Exelon Corporation, Holding Co. Act Release No. 27256 (October 19, 2000).

³⁰ Black Hills has no FUCOs at this time.

³¹ Rule 53(a) provides a partial safe harbor, which Applicants are not able to utilize with this request and rule 53(b) is not relevant.

Investment Limit compares favorably with other EWG/FUCO investment limits authorized by the Commission.³²

Black Hills states that there have been significant changes to the electric utility industry in recent years and, further, that one profound change has been the divestiture by many traditional vertically integrated utilities of their generation assets. Generation has developed as a viable business, which may, but need not be, associated with transmission and distribution companies. Key to Black Hills' overall business strategy is the continued growth of its generation business through additional investment in EWGs and large dollar investments are required to participate in larger, more energy-efficient operating projects, as compared to the investment capacity available under rule 53. Black Hills is of the view that the ability to bid on the full range of available opportunities in both regulated and deregulated generation markets, especially in the larger, more significant transactions, is vital to Black Hills' growth strategies, just as it is for Black Hills' competitors. In order to compete effectively, Black Hills states that it must be on an equal footing with its competitors with authority well in excess of the rule 53(a) partial

³² More recently the Commission has authorized EWG and FUCO investment in amounts greater than 400% of consolidated retained earnings. See, e.g., Dominion Resources, Inc., Holding Co. Act Release No. 27630 (December 30, 2002) (authority to invest up to 475% of consolidated retained earnings); E.ON AG, Holding Co. Act Release No. 27539 (June 14, 2002) (authority to invest up to 619% of consolidated retained earnings); Emera, Inc., Holding Co. Act Release No. 27445 (October 1, 2001) (authority to invest up to 1000% of consolidated retained earnings). Initially addressing similar facts, in a series of earlier cases, the Commission authorized aggregate investments in EWGs and FUCOs of up to 100% of consolidated retained earnings (sometimes referred to as the "100% orders"). See, e.g., The Southern Company, Holding Co. Act Release No. 26501 (April 1, 1996).

safe harbor.

3.a. Rule 53 Analysis of Black Hills' Proposed EWG/FUCO Investments

EWG and FUCO investments by a registered holding company are subject to, among other things, rule 53 and sections 32 and 33 of the Act. Rule 53(c) provides standards to consider in connection with a proposal by a registered holding company that is unable to satisfy the requirements of rule 53(a) and to which rule 53(b) does not apply, to issue and sell securities to finance an investment in any EWG, or to guarantee the securities of any EWG. Rule 53(c) states, among other things, that a registered holding company must “affirmatively demonstrate” that the proposal to issue securities to finance the acquisition of an EWG or the guarantee of a security of an EWG: “(1) will not have a substantial adverse impact upon the financial integrity of the registered holding company system; and (2) will not have an adverse impact on any utility subsidiary of the registered holding company, or its customers, or on the ability of state commissions to protect such subsidiary or customers.” As discussed below, Black Hills states that it satisfies each of these prongs of the rule 53(c) standard.

3.a.1. Impact of Investments in EWGs and FUCOs on Financial Integrity of Black Hills Holding Company System

Black Hills states that additional investments in EWGs and FUCOs, and financing for that purpose, will not have a substantial adverse impact on the financial integrity of the Black Hills System. The lack of any “substantial adverse impact” on Black Hills’ financial integrity can be demonstrated in several ways, including an analysis of historic trends in Black Hills existing EWG investment, its consolidated capitalization ratios and retained earnings and the market view of Black Hills’ securities.

(a) Black Hills' Existing EWG Investment. Black Hills made its existing investments in EWGs when it was not subject to the Act and its existing investments in EWGs, as of September 30, 2004, exceed 229% of its retained earnings. Black Hills states that its EWG investments have a history of positively affecting Black Hills' operating results. From January 1, 2003, to December 31, 2003, Black Hills' EWG investments produced operating earnings of \$69,129,000, and from January 1, 2004, to September 30, 2004, Black Hills' EWG investments produced earnings of \$36,766,000. Black Hills also states that it has a low risk profile when considering investments in EWGs because Black Hills typically will consider investments only in EWGs that have long-term off-take agreements for the capacity and output of the facility with creditworthy counterparties or load-serving utilities with state utility commission-approved contracts.

(b) Size of Black Hills' Proposed EWG Investment. Black Hills states that its proposed Aggregate EWG/FUCO Investment Limit would represent a reasonable commitment of capital for a company the size of Black Hills, particularly in light of the Commission's recent approval of EWG and FUCO investment authority of over 400% of consolidated retained earnings for other holding companies.³³ The Aggregate EWG/FUCO Investment Limit sought by Black Hills, as noted previously, would be equal to approximately 448% of Black Hills' year-to-date September 30, 2004, consolidated retained earnings, which falls within the range of investment authority granted by the Commission in the recent past. \$1.4 billion would equal 92%, 344%,

³³ See, e.g., Dominion Resources, Inc., Holding Co. Act Release No. 27630 (December 30, 2002) (authorizing investment up to 475% of consolidated retained earnings).

69%, and 145%, respectively, of Black Hills' consolidated capitalization, consolidated net utility plant, total consolidated assets and market value of outstanding stock as of September 30, 2004.³⁴

(c) Black Hills' Consolidated Capitalization Ratio. Black Hills' consolidated capitalization ratio, as of September 30, 2004, was 47.5% equity and 52.5% debt. This ratio exceeds the Commission's 30% common equity ratio requirement.

(d) Black Hills' Credit Ratings. Black Hills has investment grade credit ratings from Moody's and Standard and Poor's, both nationally recognized rating agencies. The Black Hills Corporation Issuer rating from Moody's is Baa3 and Standard and Poor's is BBB-.

(e) Black Hills' Retained Earnings Growth. Black Hills states that its consolidated retained earnings have grown steadily over the past three years. Black Hills Corporation's consolidated retained earnings in 2001 were \$250.5 million; in 2002 were \$280.6 million and in 2003 were \$304.6 million.

Black Hills' consolidated retained earnings at September 30, 2004, were approximately \$313 million, and Black Hills' expects that its retained earnings will continue to increase steadily during the Authorization Period as a result of a conservative payout ratio.

(f) Other Financial Ratios. Black Hills states that its financial strength is further reflected in its current price/earnings ("P/E") ratio and market to book ratio. Black Hills'

³⁴ Black Hills states that these percentages are generally comparable to the percentages recently permitted other holding companies, which requested authority levels in excess of the rule 53(a) partial safe harbor. See, e.g., E. ON AG, Holding Co. Act Release No. 27539 (June 14, 2002) (authorizing EWG/FUCO investments of 114%, 63%, and 182%

P/E ratio, as of December 6, 2004, was 21.8 compared to the average for utilities in the Standard and Poor's Electric Utility Index of 15.3. Black Hills' market to book ratio is currently 1.39, based on a pro forma book value of \$21.90 per share, as of September 30, 2004, and, as of December 23, 2004, an assumed market price is \$30.39 per share.

(g) Black Hills Management Controls and Investment Review Process. Black Hills' Board of Directors has established oversight levels for its investment in capital expenditures, mergers, acquisitions, new businesses, divestitures and contracts. Black Hills states that it has a comprehensive development, review and approval process for investments, including specific review and approval by the Board of certain investments and certain delegations from the Board to specified corporate officers, which it refers to as its "Investment Review Process." The Investment Review Process requires potential investments in projects to be reviewed by the senior management team, including, among others, Black Hills' Chief Risk Officer, General Counsel and Senior Vice President of Corporate Development. Black Hills indicates that the senior management review is intended to ensure completeness of the analysis and adherence to corporate valuation standards in advance of presentation of a project to the Board of Directors.³⁵ The process requires development of a business case. A committee reviews the assumptions, analysis and strategic fit of each proposal several times. A committee (with representatives from various functional areas (i.e., legal, tax, accounting, treasury, corporate development and

of E. ON AG's consolidated capitalization, total consolidated assets and market value of outstanding stock).

³⁵ The Investment Review Process requires acquisitions above \$30 million to be reviewed and approved by the Board. Those below \$30 million are reviewed by senior management and approved by Black Hills' Chief Executive Officer under Board-delegated authority (they also may be brought to the Board in senior management's discretion).

information systems)) provides a report to senior management indicating any open issues or areas of concern regarding the investment. When considering potential investments in FUCOs, the Investment Committee will consider additional relevant factors, including currency risk and country-specific risk (such as political risk or economic performance risk).

3.a.2. Rule 53(c)(2) - Impact of Investments in EWGs and FUCOs on Black Hills' Utility Subsidiary, Customers and on the Ability of State Commissions to Protect Them

The second prong of rule 53(c) requires that the investments “not have an adverse impact on any utility subsidiary of the registered holding company, or its customers, or on the ability of state commissions to protect such subsidiary or customers.” Black Hills states that its proposed Aggregate EWG/FUCO Investment Limit will not have an adverse impact on Black Hills Power or its customers, or on the ability of the South Dakota Commission, the Wyoming Commission, or the Montana Commission to protect Black Hills Power and its customers because of the insulation of (1) Black Hills Power and its customers from potential direct adverse effects of Black Hills' investments in EWGs and FUCOs; (2) Black Hills Power's current financial health, and (3) the proven effectiveness of state commission oversight over Black Hills Power.

(a) Insulation from Risk. All of Black Hills' investments in EWGs and FUCOs are, and will remain, segregated from Black Hills Power and any future Utility Subsidiary of Black Hills by, among other things, being held in separate corporate entities within the Black Hills System. In addition, Black Hills commits that no Black Hills Utility Subsidiary will provide financing for, extend credit to, or sell or pledge its assets directly or indirectly to any EWG in which Black Hills owns any interest; the indebtedness of any

Black Hills EWG project will not otherwise be recourse to any Black Hills Utility Subsidiary; and there will be no contractual relationship between any Black Hills EWG and any Black Hills Utility Subsidiary other than as permitted by law. Black Hills acknowledges that rules 46(a) and 42 limit Black Hills' ability to make equity distributions from capital surplus without Commission approval.

Moreover, to the extent that EWG and FUCO investments may have an indirect effect on Black Hills (for example, on Black Hills' cost of capital), Black Hills states that the state commissions have broad discretion to set the cost of capital for any utility subject to their jurisdiction, with a variety of means available to them, and are able to exclude costs caused by EWGs and FUCOs and prevent those costs from being passed on to utility customers. Black Hills commits that it will not seek recovery in retail rates of any Black Hills Utility Subsidiary for any failed investment in, or inadequate returns from, an EWG or FUCO investment.

Black Hills also states that no Utility Subsidiary will increase staffing levels to support the operations of any EWG or FUCO. Development of new EWG or FUCO projects will be conducted through Black Hills Energy or one or more of its Subsidiaries.³⁶

(b) Financial Health of Black Hills Power. Black Hills states that its Utility Subsidiary, Black Hills Power, has stable earnings and cash flows and sound investment grade ratings from the major nationally recognized rating agencies. At September 30,

³⁶ Black Hills also states that it will comply with the other conditions of rule 53(a) that provide specific protections to customers of utilities, including those of rule 53(a)(2) regarding preparation and making available of books, records and financial reports regarding EWGs and FUCOs, and of rule 53(a)(4) requiring filing of copies of applications and reports with other regulatory commissions.

2004, Black Hills Power's common equity ratio was 45%. In addition, Black Hills has committed that it will, and it will cause its Utility Subsidiary to, adhere to the Commission's 30% common equity ratio requirement. See section III.D., above.

Black Hills also states that its current and proposed investments in EWGs and FUCOs will not have any negative impact on Black Hills Power's ability to fund operations and growth. It states that current projections indicate that Black Hills Power will continue to fund operations and construction expenditures primarily from internal sources of cash and credit facilities. Moreover, Black Hills states that Black Hills Power can access capital markets as needed, although its ability to issue debt and preferred equity securities in the future depends upon market factors at the time such securities are issued.

(b) Utility Subsidiary Credit Ratings. Black Hills Power's Issuer ratings are: Baa2 (Moody's) and BBB- (Standard and Poor's). Its senior secured debt ratings are: Baa1 (Moody's) and BBB (Standard and Poor's). Black Hills Power's pollution control revenue bond ratings are: Baa2 (Moody's) and No Rating (Standard and Poor's).

(c) Adequacy of State Commission Oversight. Three state commissions have jurisdiction over the operations of the Black Hills Power -- the South Dakota Commission, the Wyoming Commission and the Montana Commission. Black Hills believes that these state commissions are able to protect utility customers of their states. The Commission solicited the views of each of the state commissions regarding their ability to protect the ratepayers of their states from the proposed transactions and none of

the state commissions opposed the proposal.

4. Investment in Development Activities and Administrative Activities

Black Hills and its Subsidiaries also request authority to invest, using a “revolving fund” concept described below, an amount of up to \$100 million, in (i) Development Activities³⁷ and (ii) Administrative Activities³⁸ related to EWGs, FUCOs, Rule 58 Subsidiaries, Energy-Related Assets and Non-U.S. Energy-Related Subsidiaries. Development Activities will be designed to result in nonutility investments, eventually, such as EWGs, FUCOs, Rule 58 Subsidiaries, Energy-Related Assets or Non-U.S. Energy-Related Subsidiaries.

Black Hills proposes a “revolving fund,” which would provide that, to the extent that funds are expended for Development Activities (or Administrative Activities, as the case may be) and result in an EWG, FUCO, or a Rule 58 Subsidiary, or other authorized investment, the amount will cease to be allocable to the Development Activities financing limit of \$100 million, but will then be allocable to the particular, applicable investment limit related to the investment. For example, Development Activities expenditures that

³⁷ Development Activities will include due diligence and design review; market studies; preliminary engineering; site inspection; preparation of bid proposals, including, in connection with these activities, posting of bid bonds; application for required permits and/or regulatory approvals; acquisition of site options and options on other necessary rights; negotiation and execution of contractual commitments with owners of existing facilities, equipment vendors, construction firms, power purchasers, thermal “hosts,” fuel suppliers and other project contractors; negotiation of financing commitments with lenders and other third-party investors; and such other preliminary activities as may be required in connection with the purchase, acquisition, financing or construction of facilities or the acquisition of securities of, or interests in, new businesses. See Scottish Power plc, et al., Holding Co. Act Release No. 27831 (April 1, 2004).

³⁸ Administrative Activities will include personnel, accounting, engineering, legal, finance and other support activities necessary to manage Black Hills and its Subsidiaries’ investments in nonutility subsidiaries. See Scottish Power plc, et al., Holding Co. Act Release No. 27831 (April 1, 2004).

result in an EWG would count against the Aggregate EWG/FUCO Financing Limit (described in section V.J.3., above) and expenditures resulting in a Rule 58 Subsidiary would count against the limitation on investment in rule 58, or expenditures resulting in an Energy-Related Asset would count against the Energy-Related Assets Financing Limit (described in section V.J.2., above), or any other applicable limitation.³⁹

J. Changes in Capital Stock of Subsidiaries

Applicants request authority to change the terms of any wholly owned Subsidiary's authorized capital stock capitalization or other equity interests by an amount deemed appropriate by Black Hills or another intermediate parent company, as needed to accommodate transactions and future issuances. Applicants propose that a wholly owned Subsidiary be able to change the par value, or change between par value and no-par stock, without additional Commission approval.⁴⁰

Black Hills also states that the Utility Subsidiary would only take this action upon receipt of necessary approvals from interested state commissions. Black Hills also requests that the Commission reserve jurisdiction over these transactions by partially owned Subsidiaries, pending completion of the record.

K. Nonutilities' Payment of Dividends Out of Capital and Unearned Surplus

Black Hills Energy and Black Hills FiberCom also request that they be permitted, directly or indirectly through their Nonutility Subsidiaries, to pay dividends, from time to

³⁹ See also Exelon Corporation, Holding Co. Act Release No. 27545 (June 27, 2002); Progress Energy, Inc., Holding Co. Act Release No. 27297 (December 12, 2000); AGL Resources, Inc., Holding Co. Act Release No. 27243 (October 5, 2000).

⁴⁰ Applicants state that they cannot ascertain at this time how a Subsidiary's financing may be effected under rule 52, including, for example, what portion may be a sale of capital securities (i.e., common or preferred stock) to Black Hills or an intermediate

time, out of capital and unearned surplus (including revaluation reserve), to the extent permitted under applicable state corporate law, during the Authorization Period.

Applicants state that Black Hills and its Nonutility Subsidiaries will not declare or pay any dividend out of capital or unearned surplus unless it: (1) has received excess cash as a result of the sale of some or all of its assets; (2) has engaged in a restructuring or reorganization and/or (3) is returning capital to an associate company.

L. Intermediate Subsidiaries

Black Hills requests authority to acquire, directly or indirectly through Nonutility Subsidiaries, the securities of one or more corporations, trusts, partnerships, limited liability companies or other entities to be created and organized exclusively for the purpose of acquiring, holding and/or financing or facilitating the acquisition or disposition of investments ("Intermediate Subsidiaries").⁴¹ Black Hills states that, to the extent that it provides funds to an Intermediate Subsidiary for investment in an EWG, FUCO or a Rule 58 Subsidiary or other investment, the amount will be included in Black Hills' Aggregate EWG/FUCO Financing Limit or other applicable financing limit, as the case may be. Black Hills states that the transactions will not involve the sale, transfer, or other disposition of any utility assets of any Utility Subsidiary to any other person. The

parent or whether it may exceed then-authorized capital stock or whether capital stock with no par value may be used.

⁴¹ Black Hills states that there are various legal and business reasons for using Intermediate Subsidiaries. Limited purpose subsidiaries are often necessary or desirable to facilitate financing the acquisition and ownership of a FUCO, an EWG or other enterprise. The laws of some foreign countries may require that a bidder in a privatization program be organized in that country. Using one or more Intermediate Subsidiaries may allow Black Hills to secure more favorable U.S. and foreign tax treatment and achieve tax efficient corporate structures, minimizing state or federal taxes. Intermediate Subsidiaries may also isolate business risks and facilitate adjustments to ownership interests or raising debt or equity capital in domestic or foreign markets.

transactions will also not involve any change in the corporate ownership of, or involve any restructuring of, the Utility Subsidiaries.

M. Internal Corporate Reorganizations

Applicants request authority to undertake internal reorganizations of Nonutility Subsidiaries and businesses. Internal reorganizations may be accomplished through a contribution, sale, distribution, assignment or other transfer from one entity, and the acquisition by another entity, of the securities, assets or interests in an entity.

To effect a consolidation or other reorganization, Black Hills or a Nonutility Subsidiary may wish to either contribute the equity securities of one Nonutility Subsidiary to another Nonutility Subsidiary (including a newly formed Intermediate Subsidiary) or sell (or cause a Nonutility Subsidiary to sell) the equity securities or all or part of the assets of one Nonutility Subsidiary to another one. These transactions may also take the form of a Nonutility Subsidiary selling or transferring the equity securities of a subsidiary or all or part of that subsidiary's assets as a dividend to an Intermediate Subsidiary or to another Nonutility Subsidiary, and the acquisition, directly or indirectly, of the equity securities or assets of that subsidiary, either by purchase or by receipt of a dividend. The purchasing Nonutility Subsidiary in any transaction structured as an intrasystem sale of equity securities or assets may execute and deliver its promissory note evidencing all or a portion of the consideration given. Black Hills also requests that it be permitted, following direct or indirect acquisition of securities of Nonutility Subsidiaries, to transfer securities or assets of Nonutility Subsidiaries to other Subsidiaries using any

of these methods or to liquidate or merge Nonutility Subsidiaries.

N. Proposed Service Company and Certain Intrasystem Transactions

The companies will engage in a variety of affiliate transactions for the provision of goods, services and construction. Certain of these intrasystem transactions are described below. The transactions will be carried out in accordance with the requirements of rules 87, 90 and 91 under section 13(b) of the Act, unless otherwise authorized by the Commission by order or rule. With respect to the requested exemptions to the at-cost requirement, described below, for an interim period following Black Hills registration, Black Hills commits that within 12 months of its receipt of an order in connection with this Application, all transactions subject to the requested interim exemptions will be priced at cost in accordance with the requirements of section 13(b) of the Act and rules 90 and 91.

1. Black Hills Services

Following the registration, Black Hills Services will provide to Black Hills Subsidiaries various corporate, administrative, management and support services, including services relating to electric and gas plant operations.⁴² Black Hills requests the Commission to find under rule 88(b) that Black Hills Services "is so organized and conducted, or to be so conducted, as to meet the requirements of section 13(b) of the Act with respect to reasonable assurance of efficient and economical performance of services

⁴² These operations may include, e.g., management of bulk power and natural gas supply, fuels procurement, coordination of electric and natural gas distribution systems, maintenance, construction and engineering work; customer bills and related matters; materials management; facilities; real estate; rights of way; human resources; finance; accounting; internal auditing; information systems; corporate planning and research; public affairs; corporate communications; legal; environmental matters; and executive services. Black Hills Services will have total equity capital of not more than \$10,000.

or construction or sale of goods for the benefit of associate companies, at cost fairly and equitably allocated among them (or as permitted by [rule] 90).”

Black Hills Services proposes to enter into a Services Agreement with its Utility Subsidiary and one with its Nonutility Subsidiaries. The proposed Services Agreements are structured to comply with the requirements of section 13 of the Act and related rules. Charges for services provided by Black Hills Services to system utilities will be at cost, in compliance with rules 90 and 91 under the Act. Except for certain exceptions discussed below, services to associate nonutilities will be at cost.

Black Hills states that no change in the organization of Black Hills Services, the type and character of the companies that will receive services, the factors for allocating costs to associate companies, or the broad categories of services to be rendered shall be made unless and until Black Hills Services has first given the Commission written notice of the proposed change not less than 60 days prior to the proposed effective date of the change. If, upon the receipt of any such notice, the Commission shall notify Black Hills Services within the 60-day period that a question exists whether the proposed change is consistent with the provisions of section 13 of the Act and related rules or orders, the proposed change shall not become effective unless and until Black Hills Services shall have filed an appropriate declaration regarding the proposed change and the Commission shall have permitted the declaration to become effective.

Black Hills anticipates that Black Hills Services will be formed and partially operational within 60 days after Black Hills' receipt of an order in connection with this Application. However, to allow time for the development of all required systems, Applicant requests authority to delay the full implementation of all services and systems that are

relevant under the Act for an interim period of not longer than 12 months following receipt of an order in connection with this Application.⁴³ No later than October 1, 2005, Black Hills will file a post-effective amendment in this filing describing the required accounting systems and cost allocation methodologies and requesting a supplemental order of the Commission. Black Hills will file as exhibits to the amendment the documents necessary to demonstrate compliance with the Act.

2. Other Affiliate Transactions

The Utility Subsidiary may provide services incidental to its utility businesses, such as infrastructure services and storm outage emergency repairs, to another Black Hills utility subsidiary company, in the future, and other associate companies in accordance with rules 87, 90 and 91. In accordance with these rules also, a utility may provide certain goods, through a leasing arrangement or otherwise, to one or more associate companies, and may use certain assets for the benefit of one or more associate companies.

Black Hills Services and the Nonutility Subsidiaries will provide certain construction, goods or services at fair market value, under certain circumstances, to certain associate nonutility companies. Black Hills requests an exemption under section 13(b) of the Act from the at-cost standards of rules 90 and 91 with respect to transactions involving:

⁴³ Black Hills states that the transition period is necessary to accommodate the complexities of the formation of the services company. Black Hills states that, first, appropriate personnel from Black Hills and its Subsidiaries will be transferred to Black Hills Services' employ, subject to requirements associated with the transfer employees' benefit, health and pension plans, contracts, licenses and permits to Black Hills Services, and subject to approvals and consents from regulators, counterparties and vendors.

- (1) a FUCO or an EWG that derives no part of its income, directly or indirectly, from the generation, transmission, or distribution of electric energy for sale within the United States;
- (2) an EWG that sells electricity at market-based rates which have been approved by the FERC or other appropriate state public utility commission, provided that the purchaser of the EWG's electricity is not an affiliated public-utility or an affiliate that resells such power to an affiliated public utility;
- (3) a QF under PURPA that sells electricity exclusively at rates negotiated at arm's length to one or more industrial or commercial customers purchasing such electricity for their own use and not for resale, or to an electric utility company other than an affiliated electric utility at the purchaser's "avoided cost" determined under PURPA;
- (4) an EWG or a QF that sells electricity at rates based upon its costs of service, as approved by the FERC or any state public-utility commission having jurisdiction, provided that the purchaser of the electricity is not an affiliated public-utility; or
- (5) an energy-related company under rule 58 or any other nonutility subsidiary that (a) is partially owned, provided that the ultimate purchaser of goods or services is not a public-utility subsidiary, (b) is engaged solely in the business of developing owning, operating and/or providing services or goods to nonutility companies described in (1) through (4) above, or (c) does not derive, directly or indirectly, any part of its income from sources within the U.S. and is not a public-utility company operating within the U.S.

In addition, under section 13(b) of the Act, the Commission will grant Black Hills approval to retain an existing affiliate arrangement in which Wyodak Resources Development Corporation ("Wyodak Resources") sells delivered coal produced at its Wyodak coal mine to Black Hills Power under a cost-based pricing formula methodology. Black Hills Power uses the coal procured from Wyodak Resources to fuel its coal-fired generating facilities, some of which are mine-mouth plants located at the

Wyodak mine site.

VI. Retention

Black Hills is engaged in nonutility businesses through Subsidiaries and investments in business ventures, including: (1) EWGs and QFs, (2) energy-related businesses involving exploration and production, transmission and distribution and cogeneration, among other things; and (3) telecommunication activities. These various nonutility interests are described, and the legal bases for their retention are explained, in Appendix A to this order.

VII. Conclusion

We have examined the Application under the applicable standards of the Act and have concluded that the proposed transactions are consistent with those standards. We have reached those conclusions on the basis of the complete record before us.

Except as described above, no state regulatory commission and no federal regulatory commission, other than this Commission, has jurisdiction over any of the proposed transactions. Black Hills expects to pay or incur approximately \$250,000 in aggregate fees, commissions, and expenses, directly or indirectly, in connection with the proposed transactions.

Due notice of the filing of the Application has been given in the manner prescribed by rule 23 under the Act and no hearing has been requested of, or ordered by, the Commission. Based on the facts in the record, the Commission finds that the applicable standards of the Act are satisfied and that no adverse findings are necessary.

IT IS ORDERED that, except as to those matters over which jurisdiction is reserved, the Application is granted and permitted to become effective immediately,

subject to the terms and conditions prescribed in rule 24 and provided that Applicants file reports on a quarterly basis, for the periods ended March 31, June 30, September 30 and December 31 of each year (such reports to be submitted within 60 days after the end of each calendar quarter and 90 days after the end of the last calendar quarter, commencing with the first calendar quarter following the date of the Commission's order in this proceeding (unless otherwise stated below)) including:⁴⁴

- (a) The sales of any Common Stock or Preferred Securities and the purchase price per share and the market price per share at the date of the agreement of sale;
- (b) The total number of share of Common Stock issued or issuable under options granted during the quarter under employee benefit plans and dividend reinvestment plans (including any later adopted employee benefit plans or dividend reinvestment plans);
- (c) If Common Stock has been transferred to a seller of securities of a company being acquired, the number of shares so issued, the value per share and whether the shares are restricted in the hands of the acquirer;
- (d) If a guarantee is issued during the quarter, the name of the guarantor, the name of the beneficiary of the guarantee and the amount, terms and purpose of the guarantee;
- (e) The amount and terms of any Black Hills indebtedness issued during the quarter;
- (f) The amount and terms of any Short-Term Debt issued by any Utility Subsidiary during the quarter;

⁴⁴Black Hills will integrate its 34 Act and Securities Act of 1933 ("33 Act") reports with reports filed under the Act to eliminate duplication of Commission filings. To effect such integration, the portion of the 1933 Act and 1934 Act reports containing or reflecting disclosures of transactions authorized in this proceeding will be incorporated by reference in its rule 24 certificates of notification. The certificates will also contain all information required by rule 24 (including the certification that each transaction being reported on had been carried out in accordance with the terms and conditions of and for the purposes represented in this Application). A copy of relevant document (e.g., underwriting agreements, indentures, bank agreements) for the relevant quarter will be filed with, or incorporated by reference from, 33 Act or 34 Act filings in rule 24 reports.

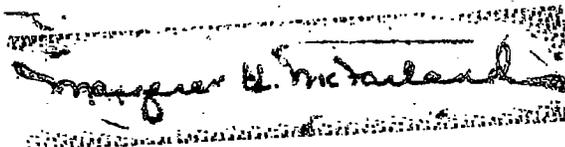
- (g) The amount and terms of any financings consummated by any Nonutility Subsidiary not exempt under rule 52;
- (h) The notional amount and principal terms of any Hedge Instruments or Anticipatory Hedges entered into during the quarter and the identity of the counterparties;
- (i) The name, parent company and amount invested in any Intermediate Subsidiary or Financing Subsidiary during the quarter and the amount and terms of any securities issued by those Subsidiaries during the quarter;
- (j) A list of U-6B-2 forms filed with the Commission during the quarter, including the name of the filing entity and the date of filing;
- (k) Consolidated balance sheets as of the end of the quarter and separate balance sheets as of the end of the quarter for each company that has engaged in jurisdictional financing transactions during the quarter;
- (l) A table showing, as of the end of the quarter, the dollar and percentage components of the capital structure of Black Hills on a consolidated basis and of the Utility Subsidiary;
- (m) A retained earnings analysis of Black Hills on a consolidated basis and of the Utility Subsidiary detailing gross earnings, goodwill amortization, dividends paid out of each capital account and the resulting capital account balances at the end of the quarter;
- (n) Future registration statements filed under the 33 Act for securities subject to the Application will be filed or incorporated by reference as exhibits to the next certificate filed under rule 24; and
- (o) Black Hills' rule 53 undertakings addressing:
 - (1) a computation in accordance with rule 53(a) setting forth Black Hills' "aggregate investment" in all EWGs and FUCOs, its "consolidated retained earnings," and a calculation of the amount remaining under the Aggregate EWG/FUCO Limit as then in effect;
 - (2) a breakdown showing Black Hills' aggregate investment in each individual EWG/FUCO project under the Aggregate EWG/FUCO Limit;
 - (3) consolidated capitalization ratio of Black Hills as of the end of that quarter, with consolidated debt to include all Short-Term Debt and non-recourse debt of all EWGs and FUCOs;

- (4) the market-to-book ratio of Common Stock;
- (5) identification of any new EWG/FUCO project under the Aggregate EWG/FUCO Limit in which Black Hills has invested or committed to invest during the preceding quarter;
- (6) analysis of the growth in consolidated retained earnings which segregates total earnings growth of EWGs and FUCOs from that attributable to other Subsidiaries of Black Hills; and
- (7) a statement of revenues and net income for each EWG and FUCO for the twelve months ending as of the end of that quarter.

IT IS FURTHER ORDERED that jurisdiction is reserved over (1) an additional \$250 million in authority under the Aggregate Additional Financing Limit; (2) Energy Marketing outside the United States, Mexico and Canada; (3) issuance of any securities that fail to meet the Investment Grade Condition; (4) (a) addition of participants to the Nonutility Money Pool and (b) the use of short-term debt securities rated AAA by Standard and Poor's, Aaa by Moody's, or AAA by Fitch, or short-term debt securities issued or guaranteed by an entity rated AAA by Standard and Poor's, AAa by Moody's, or AAA by Fitch, as short-term investments for excess money pool funds, (5) changes in

capital stock of partially owned Subsidiaries, (6) the retention of entities for which EWG or QF or ETC status is not yet determined, all pending completion of the record.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

A handwritten signature in cursive script, appearing to read "Margaret H. McFarland", is written over a horizontal line. The signature is dark and somewhat stylized.

Margaret H. McFarland
Deputy Secretary

APPENDIX A

RETENTION OF BLACK HILLS CORPORATION'S NONUTILITY BUSINESSES

The following is a description of the nonutility businesses in which Black Hills Corporation ("Black Hills") and its subsidiaries are engaged and the legal bases that support the Securities and Exchange Commission's ("Commission's") authorization of Black Hills to retain these businesses following its registration as a public-utility holding company under the Public Utility Holding Company Act of 1935, as amended ("Act").

A. Nonutility Business of Black Hills Power, Inc.

Black Hills Power, Inc. ("Black Hills Power"), is a direct wholly owned subsidiary of Black Hills and a South Dakota corporation headquartered in Rapid City, South Dakota. Black Hills Power is a public utility engaged in the generation, transmission, distribution and sale of electricity to approximately 60,000 customers in eleven counties in Western South Dakota, Eastern Wyoming, and Southwestern Montana. Black Hills Power is currently Black Hills' only regulated public-utility subsidiary.

Black Hills Power engages in various "energy-related" activities which are permissible under rule 58, including the sale of products and services providing for protection from electrical surges resulting from lightning strikes and other surge anomalies and the sale and servicing of home appliances and home heating and cooling devices. Black Hills Power earned revenues of approximately \$357,000 in these "energy-related" activities in 2003, representing approximately 0.21% of Black Hills Power's revenues in 2003.¹

B. Black Hills Energy, Inc.

Black Hills Energy, Inc. ("Black Hills Energy"), is a direct wholly owned subsidiary of Black Hills and a South Dakota corporation headquartered in Golden, Colorado. Black Hills Energy is an intermediate holding company for subsidiaries primarily engaged in the generation and sale of electricity through exempt wholesale generators, as defined in section 32 under the Act ("EWGs") and qualifying facilities as defined in the Public Utility Regulatory Policies Act of 1978, as amended ("PURPA") ("QFs"), the production, marketing and transportation of natural gas, oil and coal and

¹ The Commission has previously permitted utility subsidiaries to retain businesses in marketing electrotechnology products and services, including surge protection equipment under rule 58(b)(1)(vii). See, e.g., CP&L Energies, Inc., Holding Co. Act Release No. 27284 (November 27, 2000) (citing New Century Energies, Inc., Holding Co. Act Release No. 26748 (August 1, 1997)).

other “energy-related” activities.² The businesses of these Black Hills Energy subsidiaries, both direct and indirect, are described below.

1. Black Hills Exploration and Production, Inc.

Black Hills Exploration and Production, Inc. (“BHEP”) is a direct wholly owned subsidiary of Black Hills Energy and is a Wyoming corporation headquartered in Golden, Colorado. BHEP engages in oil and natural gas exploration and production in Wyoming, Montana, North Dakota, Nebraska, Colorado, California, Texas, Oklahoma and Louisiana.³ BHEP also owns subsidiaries engaged in oil and natural gas and pipeline activities.

a. Black Hills Gas Holdings Corp.

Black Hills Gas Holdings Corp. (“BHGasHC”) is a direct wholly owned subsidiary of BHEP and is a Colorado corporation. BHGasHC is an intermediate holding company for Black Hills’ ownership of Black Hills Gas Resources, Inc.⁴

i. Black Hills Cabresto Pipeline, LLC

Black Hills Cabresto Pipeline, LLC (“BHCP”) is a direct wholly owned subsidiary of BHGasHC and is a Delaware limited liability company. BHCP owns and operates a 12-mile natural gas pipeline located in the San Juan Basin of New Mexico.⁵

² See, e.g., CP&L Energies, Inc., Holding Co. Act Release No. 27284 (November 27, 2000) (authorizing retention of intermediate holding company involved in similar activities).

³ See, e.g., WGL Holdings, Inc., Holding Co. Act Release No. 26856 (April 14, 1998) (authorizing retention of oil and gas exploration subsidiary).

⁴ The Commission has authorized the retention of, or investment in, energy-related assets, including oil and natural gas production, gathering, processing, storage and transportation facilities and equipment, liquid oil reserves and storage facilities, and associated facilities that will be incidental to and assist applicants and their subsidiaries in connection with their marketing, brokering and trading activities. See American Electric Power, Inc., et al., Holding Company Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998). See also Progress Energy, Inc., Holding Co. Act Release No. 27297 (December 12, 2000); Exelon Corporation, Holding Co. Act Release No. 27545 (June 27, 2002).

⁵ American Electric Power, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) (authorizing retention of, or investment in, energy-related assets, including oil and natural gas production, gathering, processing, storage and transportation facilities and equipment, liquid oil reserves and storage facilities, and associated facilities that will be incidental to and assist applicants and their affiliates in connection with their marketing, brokering, and trading activities); CP&L Energy, Inc., Holding Co. Act Release No. 27284 (November 27, 2000) (authorizing subsidiary formed to acquire extend an existing intrastate pipeline) (citing New Centuries, Inc., Holding Co.

ii. Black Hills Gas Resources, Inc.

Black Hills Gas Resources, Inc. ("BHGasR"), a direct wholly owned subsidiary of BHGasHC, is a Colorado corporation. BHGasR owns and operates oil and natural gas wells on leased oil and gas reserves located primarily in the San Juan Basin of New Mexico, operates an exploration and production program on those reserves and is constructing a natural gas gathering pipeline in furtherance of its gas exploration and production program (it is not engaged in the pipeline construction business).⁶

2. Black Hills Generation, Inc.

Black Hills Generation, Inc. ("BHGeneration") is a direct wholly owned subsidiary of Black Hills Energy and is a Delaware corporation headquartered in Golden, Colorado. Through its direct and indirect subsidiaries, BHGeneration holds investments in hydroelectric and natural gas-fired electric generating facilities located in California, Colorado, Massachusetts and Nevada that are QFs or are owned by EWGs.⁷ BHGeneration also owns interests in funds that have investments in QFs and EWGs throughout the U.S. and interests in other business related to the ownership and operation of QFs and EWGs.

a. California EWG and QF

i. Harbor Cogeneration Company, LLC

Harbor Cogeneration Company ("Harbor Cogen") is an indirect wholly owned subsidiary of BHGeneration and an EWG and a California general partnership that owns a 98 MW generating facility in Los Angeles County, California.⁸

ii. Black Hills Ontario, LLC

Act Release No. 26748 (August 1, 1997) and SCANA Corporation, Holding Co. Act Release No. 27133 (February 9, 2000)).

⁶ American Electric Power, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) (authorizing retention of, or investment in, energy-related assets, including oil and natural gas production, gathering, processing, storage and transportation facilities and equipment, liquid oil reserves and storage facilities, and associated facilities that will be incidental to and assist applicants and their affiliates in connection with their marketing, brokering, and trading activities); WGL Holdings, Inc., Holding Co. Act Release No. 26856 (April 14, 1998) (authorizing retention of oil and gas exploration subsidiary). See also rule 58(b)(1)(ix).

⁷ See, e.g., New Centuries Energy, Inc., Holding Co. Act Release No. 27212 (August 16, 2000) (allowing retention of interests in several businesses holding electric generating EWGs).

⁸ Harbor Cogeneration Company, 86 FERC ¶62,188 (1999).

Black Hills Ontario, LLC, is a subsidiary of BHGeneration and a Delaware limited liability company with operations in Ontario, California. BHGeneration holds, directly and indirectly, 50% of the membership interests in Black Hills Ontario, LLC, and manages the company. Black Hills Ontario, LLC, owns and operates a natural gas-fired cogeneration facility that is a QF in Ontario, California.⁹

b. Colorado EWGs

i. Black Hills Colorado, LLC

Black Hills Colorado, LLC (“Black Hills Colorado”) is a direct wholly owned subsidiary of BHGeneration and is a Delaware limited liability company headquartered in Golden, Colorado. Black Hills Colorado is an EWG that owns and operates natural gas-fired electric generating facilities located at the Arapahoe Power Station in Denver, Colorado, and the Valmont Power Station in Boulder, Colorado, with a combined generating capacity of 210 MW.¹⁰

A. Black Hills Valmont Colorado, Inc.

Black Hills Valmont Colorado, Inc., is a wholly owned subsidiary of BHGeneration through Black Hills Colorado, is a Delaware corporation headquartered in Golden, Colorado. The company acted as financing agent during the construction phase of the Black Hills Colorado, LLC, an EWG expansion project.¹¹

ii. Black Hills Fountain Valley, LLC

Black Hills Fountain Valley, LLC (“BHFV”), is a direct wholly owned subsidiary of BHGeneration and a Delaware limited liability company headquartered in Golden, Colorado. BHFV holds the investment of BHGeneration in Fountain Valley Power, LLC, an EWG.¹²

iii. Black Hills Fountain Valley II, LLC

⁹ See rule 58(b)(1)(viii).

¹⁰ See *Indeck Colorado, LLC*, 91 FERC ¶62,131 (2000).

¹¹ The Commission has previously authorized registered holding companies to create and own intermediate subsidiaries to hold or acquire energy-related companies, EWGs and QFs. See, e.g., *Energy East Corporation, Holding Co.* Act Release No. 27228 (September 12, 2000); *Interstate Energy Corporation, Holding Co.* Act Release No. 27069 (August 26, 1999).

¹² See, e.g., *New Centuries Energy, Inc., Holding Co.* Act Release No. 27212 (allowing retention of interests in several businesses owning gas-fired EWGs).

Black Hills Fountain Valley II, LLC (“BHFVII”) is a direct wholly owned subsidiary of BHGeneration and a Colorado limited liability company headquartered in Golden, Colorado. BHFVII was formed to purchase real property on and adjacent to the Fountain Valley Power project. The adjacent property is undeveloped. It currently serves as a buffer zone around the Fountain Valley Power generating facility and could serve as a site for future expansion of the Fountain Valley Power facility or the development of a new generating facility.¹³

A. E-Next A Equipment Leasing Company, LLC

E-Next A Equipment Leasing Company, LLC, is an indirect wholly owned subsidiary of BHGeneration through BHFV and a Delaware limited liability company. It owns and leases certain equipment, including gas turbines and transformer packages, used at Fountain Valley Power LLC’s generation facility.¹⁴

B. Fountain Valley Power, LLC

Fountain Valley Power, LLC (“Fountain Valley Power”), is an indirect wholly owned subsidiary of BHGeneration through BHFV and a Delaware limited liability company headquartered in Golden, Colorado. Fountain Valley Power is an EWG.¹⁵ Fountain Valley Power owns and operates a 240 MW gas-fired electric generation facility located south of Colorado Springs, Colorado.

c. Massachusetts EWG

i. Black Hills Pepperell Power Associates, LLC

Black Hills Pepperell Power Associates, LLC (“Pepperell”), is a direct wholly owned subsidiary of BHGeneration, incorporated in Delaware with its principal business in Golden, Colorado. Pepperell is an EWG that owns a 38 MW generating facility located in Pepperell, Massachusetts, near the James River Pepperell, Inc., paper mill.¹⁶

d. Nevada QFs and EWGs

i. Black Hills Southwest, LLC

¹³ See rule 58(b)(1)(viii). See also New Century Energies, Inc., Holding Co. Act Release No. 27212 (August 16, 2000) (permitting retention of business engaged in ownership of real property adjacent to generating facilities).

¹⁴ The Commission previously has authorized retention of infrastructure services. See, e.g., Exelon Corporation, Holding Co. Act Release No. 27256 (October 19, 2000); GPU, Inc., Holding Co. Act Release No. 27165 (April 14, 2000).

¹⁵ See Fountain Valley Power, LLC, 95 FERC ¶62,099 (2001).

¹⁶ Pepperell Power Associates, LP, 62 FERC ¶61,182 (1993).

Black Hills Southwest, LLC (“BHS”), is a direct wholly owned subsidiary of BHGeneration and a Delaware limited liability company headquartered in Golden, Colorado. Through its direct and indirect subsidiaries, it holds an investment in a 53 MW natural gas-fired cogeneration facility that is a QF and owns an adjacent 224 MW natural gas-fired electric power generation facility, both of which are located in North Las Vegas, Nevada.¹⁷

A. Black Hills Nevada, LLC

Black Hills Nevada, LLC (“BHN”), is an indirect wholly owned subsidiary of BHGeneration and a Delaware limited liability company. Through its direct and indirect subsidiaries, it holds an investment in a 53 MW natural gas-fired cogeneration facility that is a QF and owns an adjacent 224 MW natural gas-fired electric power generation facility, both of which are located in North Las Vegas, Nevada.¹⁸

(1) Black Hills Nevada Real Estate Holdings, LLC

Black Hills Nevada Real Estate Holdings, LLC, is an indirect wholly owned subsidiary of BHN and a Delaware limited liability company. It owns and leases the land on which Las Vegas Cogeneration Limited Partnership’s 53 MW natural gas-fired cogeneration facility, Las Vegas Cogeneration II, LLC’s 224 MW natural gas-fired electric power generation facility and Sunco Ltd., LLC’s greenhouse facility are all located.¹⁹

(2) Desert Arc I, LLC

Desert Arc I, LLC, is 50%-owned indirectly by BHGeneration and a Delaware limited liability company. It is an 85% general partner in Las Vegas Cogeneration Limited Partnership, a Nevada limited partnership, which owns a 53 MW natural gas-fired cogeneration QF located in North Las Vegas, Nevada.²⁰

(3) Desert Arc II, LLC

Desert Arc II, LLC, is 50%-owned by BHN, a subsidiary of BHGeneration, and is a Delaware limited liability company. Desert Arc II, LLC, is a 15%-limited partner in

¹⁷ See, e.g., New Centuries Energy, Inc., Holding Co. Act Release No. 27212 (allowing retention of interests in businesses holding gas-fired QFs).

¹⁸ See *supra* note 17.

¹⁹ See rule 58(b)(1)(viii). See also New Century Energies, Inc., Holding Co. Act Release No. 27212 (August 16, 2000) (permitting retention of business engaged in ownership of real property adjacent to generating facilities).

²⁰ See *supra* note 17.

Las Vegas Cogeneration, LP, a Nevada limited partnership, which owns a 53 MW natural gas-fired cogeneration QF located in North Las Vegas, Nevada.²¹

(a) Las Vegas Cogeneration Limited Partnership

Las Vegas Cogeneration Limited Partnership is a Nevada limited partnership. BHGeneration indirectly owns a 42.5% general partnership interest and a 7.5% limited partnership interest in this partnership. The partnership owns a 53 MW natural gas-fired cogeneration QF located in North Las Vegas, Nevada.²²

(4) Las Vegas Cogeneration II, LLC

Las Vegas Cogeneration II, LLC (“LVCII”), an indirect wholly owned subsidiary of BHGeneration, is a Delaware limited liability company. LVCII is an EWG that owns and operates a 224 MW natural gas-fired electric power generation facility in the North Las Vegas, Nevada.²³ LVCII is administered in Golden, Colorado. LVCII holds a 100% ownership interest in another EWG, Las Vegas Cogeneration Energy Financing, LLC, which owns certain facilities and equipment and which it leases to LVCII.

(a) Las Vegas Cogeneration Energy Financing Company, LLC

Las Vegas Cogeneration Energy Financing Company, LLC (“LVCEFC”), is an indirect wholly owned subsidiary of BHGeneration and a Delaware limited liability company. LVCEFC is an EWG that owns and leases certain equipment used at LVCII’s 224 MW natural gas-fired electric power generation facility in North Las Vegas, Nevada.²⁴

ii. Black Hills Nevada Operations, LLC

Black Hills Nevada Operations, LLC, is a direct wholly owned subsidiary of BHGeneration and a Delaware limited liability. The company operates the 53 MW natural gas-fired cogeneration facility owned by Las Vegas Cogeneration Limited Partnership and the 224 MW natural gas-fired electric power generation facility owned by Las Vegas Cogeneration II, LLC, both located in North Las Vegas, Nevada.²⁵

iii. Black Hills Ivanpah, LLC

²¹ See *supra* note 17.

²² See *supra* note 17.

²³ Las Vegas Cogeneration II, LLC, 99 FERC ¶62,182 (2002).

²⁴ Las Vegas Cogeneration Energy Financing Company, LLC, 99 FERC ¶62,148 (2002).

²⁵ See rule 58(b)(1)(vi) and (viii). See, e.g., Exelon Corporation, Holding Co. Act Release No. 27256 (October 19, 2000) (authorizing retention of subsidiary that leases equipment for cogeneration facilities and related activities).

Black Hills Ivanpah, LLC (“Black Hills Ivanpah”), is a direct wholly owned subsidiary of BHGeneration and a Delaware limited liability company headquartered in Golden, Colorado. Black Hills Ivanpah was established to hold BHGeneration’s 49.5% limited partnership interest in a 500 MW generating facility project under development (but not yet constructed or operational) in southern Nevada. Black Hills states that it anticipates that the project partnership will qualify as an EWG.

iv. Black Hills Ivanpah GP, LLC

Black Hills Ivanpah GP, LLC (“Black Hills Ivanpah GP”), is a direct wholly owned subsidiary of BHGeneration and a Delaware limited liability company headquartered in Golden, Colorado. Black Hills Ivanpah GP was established to hold BHGeneration’s 0.5% general partnership interest in a 500 MW generating facility project under development (but not yet constructed or operational) in southern Nevada. Black Hills states it anticipates that the project partnership will qualify as an EWG.

e. Investment Funds

i. EIF Investors, Inc.

EIF Investors, Inc., is a direct wholly owned subsidiary of BHGeneration and a Delaware corporation headquartered in Golden, Colorado. The corporation holds BHGeneration’s investments in Energy Investors Fund, LP, Energy Investors Fund II, LP, and Energy Investors Fund III, LP, which in turn hold investments in numerous electric generating facilities that are either QFs or are owned by EWGs in the U.S. and elsewhere.²⁶

f. Other Businesses Related to QFs and EWGs

i. Black Hills Idaho Operations, LLC

Black Hills Idaho Operations, LLC, is an indirect wholly owned subsidiary of BHGeneration and a Delaware limited liability company headquartered in Golden, Colorado. The company is engaged in the business of providing plant operating services to two natural gas-fired QFs located in the cities of Rupert and Glenns Ferry, Idaho.²⁷

ii Sunco Ltd., LLC

Sunco Ltd., LLC (“Sunco”), is an indirect wholly owned subsidiary of BHGeneration and a Nevada limited liability company. Sunco owns and operates a 12-acre greenhouse facility used to grow organic tomatoes. The greenhouse facility serves

²⁶ See supra note 17.

²⁷ See, e.g., CP&L Energies, Inc., Holding Co. Act Release No. 27284 (November 27, 2000) (allowing retention of various businesses engaged in maintenance and repair services).

as the thermal host required by Las Vegas Cogeneration Limited Partnership to maintain its QF status. Las Vegas Cogeneration Limited Partnership supplies the greenhouse with thermal energy produced by the QF.²⁸

iii. West Cascade Energy, LLC

West Cascade Energy, LLC, a direct wholly owned subsidiary of BHGeneration, is a Delaware limited liability company. West Cascade Energy, LLC, is currently exploring the development of an EWG facility in Oregon.²⁹

3. Wyodak Resources Development Corporation

Wyodak Resources Development Corporation (“Wyodak”) is a direct wholly owned subsidiary of Black Hills Energy and a Delaware corporation headquartered in Rapid City, South Dakota. Its principal place of business is in Gillette, Wyoming. Wyodak owns and operates a surface coalmine in the Powder River Basin of Wyoming and produces and markets coal to several unrelated third parties. Wyodak also supplies coal to Black Hills Power. Wyodak makes approximately 60% of its coal sales to unaffiliated customers and the remainder to Black Hills Power.³⁰

The following direct and indirect subsidiaries of Wyodak are engaged in the businesses of generating and selling electricity, producing and marketing coal, oil and natural gas and other energy-related activities.

a. Black Hills Wyoming, Inc.

Black Hills Wyoming, Inc. (“Black Hills Wyoming”), is a direct wholly owned subsidiary of Wyodak and a Wyoming corporation headquartered in Rapid City, South Dakota. Black Hills Wyoming is an EWG and operates a 90 MW coal-fired electric generation facility located near Gillette, Wyoming, at the Wyodak coalmine (“Wygen Plant”).³¹ The company leases the facility from Wygen Funding, LLC, an unaffiliated Delaware limited partnership owned by the project financiers. Black Hills Wyoming also

²⁸ See rule 58(b)(1)(viii).

²⁹ See, e.g., New Century Energies, Inc., Holding Co. Act Release No. 27212 (August 16, 2002) (citing Interstate Energy Corporation, Holding Co. Act Release No. 27069 (August 26, 1999)). See also rule 58(b)(1)(v).

³⁰ See, e.g., E.ON AG, Holding Co. Act Release No. 27539 (June 14, 2002) (citing Vectren Corporation, Holding Co. Act Release No. 27150 (March 8, 2000)); New Century Energies, Inc., Holding Co. Act Release No. 27212 (August 16, 2002) (citing to Interstate Energy Corporation, Holding Co. Act Release No. 27069 (August 26, 1999); Progress Energy, Inc., Holding Co. Act Release No. 27740 (October 21, 2003) (permitting retention of acquired coal mining subsidiaries).

³¹ Black Hills Generation, Inc., 95 FERC ¶62,025 (2001).

owns and operates a 40 MW combustion turbine (the Neil Simpson Complex CT #2) near Gillette, Wyoming.

b. Daksoft, Inc.

Daksoft, Inc. ("Daksoft"), is a direct wholly owned subsidiary of Wyodak and a South Dakota company headquartered in Rapid City, South Dakota. Historically, Daksoft was engaged in developing and marketing computer software, but it has exited that line of business and now is engaged primarily in providing information technology support to Black Hills and its subsidiaries. Black Hills states that, following formation of Black Hills' services company, Black Hills Service, Inc. ("Black Hills Services"), Daksoft's functions and personnel will be transferred to Black Hills Services, with the exception of a small number of personnel who will be employed by certain other Black Hills subsidiaries to provide internal information technology support to those subsidiaries. After the transfer of functions and employees, Daksoft will be merged or dissolved out of existence.

c. Enserco Energy Inc.

Enserco Energy Inc. ("Enserco") is a direct wholly owned subsidiary of Wyodak and a South Dakota corporation. Enserco is headquartered in Golden, Colorado. Enserco is engaged in the business of marketing natural gas on a wholesale basis in the Mid-Continent, Rocky Mountain and Pacific Coast regions of the U.S. and in Canada.³²

4. Black Hills Energy Resources, Inc.

Black Hills Energy Resources, Inc. ("BHEnergy Resources") is a wholly owned subsidiary of Black Hills Energy and a South Dakota corporation headquartered in Rapid City, South Dakota. BHEnergy Resources engages, directly and through its subsidiaries, in the marketing and transportation of oil in Texas.³³

³² See rule 58(b)(1)(v).

³³ American Electric Power, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1)(v) and (ix). Black Hills states that the ownership and operation of oil pipelines and other oil transportation, storage and handling facilities is an integral part of the oil brokering and marketing business conducted by BHEnergy Resources and its subsidiaries, as these assets enable them to engage in financially advantageous trading strategies (such as asset-backed transactions) relying on these resources and minimizing the need for additional guarantees, counterparty assurances or firm contracts with other suppliers. As adopted, rule 58(b)(1)(v) encompasses brokering and marketing of energy commodities, including, but not limited to, combustible fuels such as oil. 62 Fed. Register 7900, 7906, note 62 (February 20, 1997). As Black Hills previously noted, the Commission has allowed the retention or acquisition of interests in gas pipelines, coalmines and other similar "energy-related" assets to facilitate gas and coal brokering and marketing businesses. See generally Progress Energy, Inc., Inc., Holding Co. Act Release Nos. 27740 (October 21,

a. Black Hills Energy Pipeline, LLC

Black Hills Energy Pipeline, LLC, is a direct wholly owned subsidiary of BHEnergy Resources and a Delaware limited liability company headquartered in Houston, Texas. The company is a 99% limited partner in Millennium Pipeline Company, LP, a Texas limited partnership that owns and operates an oil pipeline in the Gulf Coast region of Texas.³⁴

b. Black Hills Millennium Pipeline, Inc.

Black Hills Millennium Pipeline, Inc., a direct wholly owned subsidiary of BHEnergy Resources, is a South Dakota corporation headquartered in Houston, Texas. The company is a 1% general partner in Millennium Pipeline Company, LP, a Texas limited partnership that owns and operates an oil pipeline in the Gulf Coast Region of Texas.³⁵

i. Millennium Pipeline Company, LP

Millennium Pipeline Company, LP, an indirect subsidiary of BHEnergy Resources, is a Texas limited partnership that owns and operates an oil pipeline in the Gulf Coast region of Texas.³⁶

c. Black Hills Energy Terminal, LLC

Black Hills Energy Terminal, LLC, a direct wholly owned subsidiary of BHEnergy Resources, is a South Dakota limited liability company headquartered in Houston, Texas. The company is a 99% limited partner in Millennium Terminal

2003) and 27297 (December 12, 2000); Exelon Corporation, Holding Co. Act Release No. 27545 (June 27, 2002). Further, Black Hills notes that the Commission previously has allowed a combination electric- and gas-utility holding company to retain foreign oil transportation facilities. See generally Keyspan Corporation, Holding Co. Act Release No. 27271 (November 7, 2000).

³⁴ American Electric Power, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

³⁵ American Electric Power, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

³⁶ American Electric Power, Inc., et al., Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

Company, LP, a Texas limited partnership that owns and operates an oil terminal and storage facility.³⁷

d. Black Hills Millennium Terminal, Inc.

Black Hills Millennium Terminal, Inc., a direct wholly owned subsidiary of BHEnergy Resources, is a South Dakota corporation headquartered in Houston, Texas. The company is a 1% general partner in Millennium Terminal Company, LP, a Texas limited partnership that owns and operates an oil terminal and storage facility.³⁸

i. Millennium Terminal Company, LP

Millennium Terminal Company, LP, an indirect wholly owned subsidiary of BHEnergy Resources, is a Texas limited partnership that owns and operates an oil terminal and storage facility.³⁹

e. Black Hills Kilgore Energy Pipeline, LLC

Black Hills Kilgore Energy Pipeline, LLC ("BHKEP"), a direct wholly owned subsidiary of BHEnergy Resources, is a Delaware limited liability company. BHKEP is a 99% limited partner in Black Hills Kilgore Pipeline Company, LP, a Texas limited partnership that owns and operates an oil pipeline in the eastern and Gulf Coast regions of Texas.⁴⁰

f. Black Hills Kilgore Pipeline, Inc.

Black Hills Kilgore Pipeline, Inc. ("BHKP"), a direct wholly owned subsidiary of BHEnergy Resources, is a Delaware corporation. BHKP is a 1% general partner in

³⁷ American Electric Power, Inc., *et al.*, Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33

³⁸ American Electric Power, Inc., *et al.*, Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

³⁹ American Electric Power, Inc., *et al.*, Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

⁴⁰ American Electric Power, Inc., *et al.*, Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

BHKPC, a Texas limited partnership that owns and operates an oil pipeline in the eastern and Gulf Coast regions of Texas.⁴¹

i. Black Hills Kilgore Pipeline, LP

Black Hills Kilgore Pipeline Company, LP (“BHKPC”), an indirect wholly owned subsidiary of BHEnergy Resources, is a Texas limited partnership that owns and operates an oil pipeline in the Eastern and Gulf Coast regions of Texas.

g. Black Hills Operating Company, LLC

Black Hills Operating Company, LLC (“BHOC”), a direct wholly owned subsidiary of BHEnergy Resources, is a Delaware limited liability company headquartered in Houston, Texas. BHOC is an operating and management company for oil terminals and pipelines in the eastern and Gulf Coast regions of Texas.⁴²

C. **Black Hills Fiber Systems, Inc.**

Black Hills Fiber Systems, Inc. (“Black Hills Fiber”), a direct wholly owned subsidiary of Black Hills, is a South Dakota Corporation headquartered in Rapid City, South Dakota. Through its subsidiaries, Black Hills Fiber is engaged in telecommunications and related businesses that Black Hills anticipates will qualify as exempt telecommunications companies under section 34 of the Act (“ETCs”).

1. Black Hills FiberCom, LLC

Black Hills FiberCom, LLC (“Black Hills FiberCom”), a direct wholly owned subsidiary of Black Hills Fiber, is a South Dakota limited liability company, headquartered in Rapid City, South Dakota. Black Hills FiberCom is engaged in providing cable television, internet, broadband and other communications services in the Black Hills region of western South Dakota. Black Hills FiberCom anticipates it will qualify for ETC status.⁴³

2. BHFC Publishing, LLC

⁴¹ American Electric Power, Inc., *et al.*, Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

⁴² American Electric Power, Inc., *et al.*, Holding Co. Act Release Nos. 27842 (April 30, 2004) and 26933 (November 2, 1998) and rule 58(b)(1) (v) and (ix). See also supra note 33.

⁴³ See section 34 of the Act. Black Hills states that, on August 2, 2004, Black Hills FiberCom submitted an application to the Federal Communications Commission (“FCC”) requesting a determination of ETC status and Black Hills will notify the Commission of the FCC’s determination.

BHFC Publishing LLC (“BHFC Publishing”), a direct wholly owned subsidiary of Black Hills Fiber, is a Delaware limited liability company, headquartered in Rapid City, South Dakota. BHFC Publishing is engaged in the business of publishing a telephone directory for the Black Hills region of western South Dakota. BHFC Publishing anticipates it will qualify for ETC status.⁴⁴

3. Black Hills Publishing Montana, LLC

Black Hills Publishing Montana, LLC (“Black Hills Publishing Montana”), a direct wholly owned subsidiary of Black Hills Fiber, is a Delaware limited liability company, headquartered in Rapid City, South Dakota. Black Hills Publishing Montana is engaged in the business of publishing a telephone directory for the Billings, Montana region. Black Hills Publishing Montana anticipates it will qualify for ETC status.⁴⁵

D. Inactive Subsidiaries

Black Hills indirectly owns interests in a number of subsidiaries that remain in existence but no longer are active. These inactive subsidiaries are listed below.

<u>Subsidiary</u>	<u>Corporate Form/Place of Organization</u>	
Adirondack Hydro Development Corporation	corporation	Delaware
Acquisition Partners, LP	limited partnership	New York
NHP, LP	limited partnership	New York
VariFuel, LLC	limited liability company	South Dakota

⁴⁴ See section 34 of the Act. Black Hills states that, on August 2, 2004, BHFC Publishing LLC submitted an application to the FCC requesting a determination of ETC status and Black Hills will notify the Commission of the FCC’s determination.

⁴⁵ See section 34 of the Act. Black Hills states that, on August 2, 2004, Black Hills Publishing Montana submitted an application to the FCC requesting a determination of ETC status and Black Hills will notify the Commission of the FCC’s determination.

**SERVICE AGREEMENT
(Utility)**

This Service Agreement (the “**Agreement**”) is made effective the 1st day of January, 2005, by and between Black Hills Power, Inc. (“**Client Company**”) and Black Hills Service Company, LLC. (“**Service Company**”).

WITNESSETH

WHEREAS, the Securities and Exchange Commission (the “**SEC**”) has approved and authorized as meeting the requirements of Section 13(b) of the Public Utility Holding Company Act of 1935 (the “**Act**”) the organization and conduct of the business of Service Company, in accordance herewith, as a wholly-owned subsidiary service company of Black Hills Corporation (“**Black Hills**”).

WHEREAS, Client Company is a utility operating company subsidiary of Black Hills and an affiliate of Service Company:

WHEREAS, Service Company and Client Company have entered into this Service Company whereby Service Company agrees to provide and Client Company agrees to accept and pay for various services as provided herein at cost, with cost determined in accordance with applicable rules and regulations under the Act, which require Service Company to fairly and equitably allocate costs among all associate companies to which it renders services, including Client Company.

NOW THEREFORE, in consideration of the premises and the mutual agreements herein contained, the parties to this Agreement covenant and agree as follows:

**ARTICLE 1
SERVICES**

Section 1.1 Service Company shall furnish to Client Company, as requested by Client Company, upon the terms and conditions hereinafter set forth, such of the services described in Appendix 1 hereto, at such times, for such periods and in such manner as Client Company may from time to time request and that Service Company concludes it is able to perform. Service Company shall also provide Client Company with such special services, in addition to those services described in Appendix 1 hereto, as may be requested by Client Company and that Service Company concludes it is able to perform. Service Company shall use its best efforts to maintain a staff trained and experienced in the design, construction, operation, maintenance, and management of public utility properties, and shall keep itself and its personnel available to provide services to Client Company so long as it is authorized to do so by the appropriate federal and state regulatory agencies. In supplying such services, Service Company may arrange, where it deems appropriate, for the services of such experts, consultants, advisers, and other persons with necessary qualifications as are required for or pertinent to the provision of such services.

Section 1.2 Client Company shall take from Service Company such of the services described in Section 1.1, and such additional general or special services, whether or not now

contemplated as are requested from time to time by Client Company and that Service Company concludes it is able to perform.

Section 1.3 The services described herein or contemplated to be performed hereunder shall be directly assigned, distributed or allocated by activity, project, program, work order or other appropriate basis. Client Company shall have the right from time to time to amend, alter or rescind any activity, project, program or work order provided that (i) any such amendment or alteration that results in a material change in the scope of the services to be performed or equipment to be provided is agreed to by Service Company, (ii) the cost for the services covered by the activity, project, program or work order shall include any expense incurred by Service Company as a direct result of such amendment, alteration or rescission of the activity, project program or work order, and (iii) no amendment, alteration or rescission of any activity, project, program or work order shall release Client Company from liability for all costs already incurred by or contracted for by Service Company pursuant to the activity, project, program or work order, regardless of whether the services associated with such costs have been completed.

ARTICLE 2 COMPENSATION

Section 2.1 As compensation for the services to be rendered hereunder, Client Company shall pay to Service Company all costs which reasonably can be identified and related to particular services performed by Service Company for or on Client Company's behalf (except as may otherwise be permitted by the SEC). The methods for assigning or allocating Service Company costs to Client Company, as well as to other associate companies, are set forth in Appendix 1.

Section 2.2 The methods of assignment, distribution or allocation of costs described in Appendix 1 shall be subject to review annually, or more frequently if appropriate. Such methods of assignment, distribution or allocation of costs may be modified or changed by Service Company; provided, however, that no changes will be made to the methods of assignment, distribution, or allocation set forth herein or in Appendix 1 hereto unless first authorized by the SEC in accordance with the procedures specified in Section 2.3. Service Company shall advise Client Company from time to time of such changes.

Section 2.3 No change in the organization of the Service Company, the type and character of the companies to be serviced, the methods of allocating costs to associate companies, or in the scope or character of the services to be rendered that are subject to Section 13 of the Act, or any rule, regulation or order thereunder, shall be made (i) unless and until Service Company shall first have given the SEC written notice of the proposed change or (ii) such change is otherwise permitted by SEC rule or practice. If, upon the receipt of any such notice, the SEC shall notify Service Company within the 60-day period that a question exists as to whether the proposed change is consistent with the provisions of Section 13 of the Act, or of any rule, regulation or order thereunder, the proposed change shall not become effective unless and until Service Company shall have filed with the SEC an appropriate declaration regarding such proposed change and the SEC shall have permitted such declaration to become effective.

Section 2.4 Service Company shall render a monthly statement to Client Company that shall reflect the billing information necessary to identify the costs charged for that month. By the [twentieth (20th)] day of each month, Client Company shall remit to Service Company all charges billed to it.

Section 2.5 It is the intent of this Agreement that the payment for services rendered by Service Company to Client Company under this Agreement shall cover all the costs of Service Company doing business (less the costs of services provided to affiliated companies not a party to this Agreement and to other non-affiliated companies, and credits for any miscellaneous items), including, but not limited to, salaries and wages, office supplies and expenses, outside services employed in rendering the services hereunder, property insurance, injuries and damages, employee pensions and benefits, miscellaneous general expenses, rents, maintenance of structures and equipment, depreciation and amortization, and compensation for use of capital as permitted by Rule 91 of the SEC's regulations under the Act.

ARTICLE 3 TERM

Section 3.1 This Agreement shall become effective on the date of Client Company's receipt of required regulatory approval, and shall continue in force until terminated by Service Company or Client Company, upon not less than one year's prior written notice to the other party. This Agreement shall also be subject to termination or modification at any time, without notice, if and to the extent performance under this Agreement may conflict with the Act or with any rule, regulation or order of the SEC adopted before or after the date of this Agreement.

ARTICLE 4 LIMITATION OF LIABILITY AND INDEMNIFICATION

Section 4.1 In performing the services hereunder, Service Company will exercise due care to assure that the services are performed in an appropriate manner, meet the standards and specifications set forth in any applicable request for service and comply with the applicable standards of law and regulation. However, failure to meet these obligations shall in no event subject Service Company to any claims by or liabilities to Client Company other than to reperform the services and be reimbursed at cost for such reperformance. Service Company makes no other warranty with respect to its performance of the services, and Client Company agrees to accept such services without further warranty of any nature.

Section 4.2 To the fullest extent allowed by law, Client Company shall and does hereby indemnify and agree to save harmless and defend Service Company, its agents and employees from liabilities, taxes, losses, obligations, claims, damages, penalties, causes of action, suits, costs and expenses or judgments of any nature, on account of, or resulting from the performance and prosecution of any services performed on behalf of Client Company pursuant to this Agreement, whether or not the same results or allegedly results from the claimed or actual negligence or breach of warranty of, or willful misconduct by, Service Company or any of its employees, agents, clients, or contractors or its or their subcontractors or any combination thereof.

**ARTICLE 5
MISCELLANEOUS**

Section 5.1 All accounts and records of Service Company shall be kept in accordance with the Uniform System of Accounts Prescribed for Public Utilities and Licensees subject to the Provisions of the Federal Power Act promulgated by the Federal Energy Regulatory Commission, as each is in effect from and after the date hereof.

Section 5.2 New direct or indirect non-utility subsidiaries of Black Hills, which may come into existence after the effective date of this Agreement, may become additional client companies of Service Company and subject to a service agreement with Service Company, or an existing client company may wish to obtain additional services from Service Company. Likewise, an existing direct or indirect subsidiary of Black Hills may cease to be a client company or cease to take individual services from Service Company. In either event, the parties hereto shall make such changes in the scope and character of the services to be rendered and in the method of assigning, distributing or allocating costs of such services as specified in Appendix 1, subject to the requirements of Section 2.3, as may become necessary to achieve a fair and equitable assignment, distribution, or allocation of Service Company costs among all associate companies.

Section 5.3 In the event Client Company changes the scope of services that it takes from Service Company (as provided in Section 1.2 and subject to Section 1.3) or terminates this Agreement (pursuant to Section 3.1), the Service Company may bill such Client Company a charge that reflects a proportionate share of any significant residual fixed costs (i.e. incurred costs or commitments to incur costs) that were incurred or committed to incur in contemplation of providing such Client Company service prior to the notice of termination. Examples of fixed costs include, but are not limited to, costs to upgrade computer hardware and software systems to meet Client Company's specifications.

Section 5.4 Service Company shall permit Client Company access to its accounts and records, including the basis and computation of allocations; provided that the scope of access and inspection is limited to accounts and records that are related to Service Company's transactions with Client Company.

Section 5.5 Appendix 1 is expressly incorporated herein and made a part hereof.

Section 5.6 It is the intent of the parties hereto that the determination of the costs as used in this Agreement shall be consistent with, and in compliance with, the rules and regulations of the SEC, as they are now read or hereafter may be modified by the SEC.

Section 5.7 This Agreement and the rights hereunder may not be assigned without the mutual written consent of all parties hereto.

* * * * *

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date and year first above written.

BLACK HILLS SERVICE COMPANY, LLC.

By: 
Name: Steven J. Helmers
Title: SVP + General Counsel

BLACK HILLS POWER, INC.

By: 
Name: Linden R. Evans
Title: President + COO

Appendix 1

DESCRIPTION OF SERVICES TO BE PROVIDED BY BLACK HILLS SERVICE COMPANY, LLC AND DETERMINATION OF CHARGES FOR SUCH SERVICES TO THE OPERATING COMPANIES AND OTHER AFFILIATES

Description of Services Provided

A description of the services provided by Black Hills Service Company, LLC is detailed below. Identifiable costs will be directly assigned to the utility company subsidiaries (the “**Operating Companies**”) and other affiliates of Black Hills. For costs that are for services of a general nature and cannot be directly assigned, the method of allocation is described below for each service provided.

a) *Accounting Systems*

Description – Maintains the accounting systems.

Method of Allocation – Accounting Systems indirect costs will be allocated using the Blended Ratio.

b) *Accounts Payable*

Description – Processes payments to vendors and prepares 1099s and applicable documentation.

Method of Allocation – Accounts Payable indirect costs will be allocated using the Blended Ratio.

c) *Corporate Communications and Governmental Affairs*

Description – Provides corporate communications. Provides advertising and branding development for the companies within Black Hills. Manages and tracks all contributions made on behalf of Black Hills and its subsidiaries. Monitors, reviews and researches government legislation.

Method of Allocation – Corporate Communications and Governmental Affairs indirect costs will be allocated using the Blended Ratio.

d) *Corporate Development and Strategic Planning*

Description – Facilitates development of corporate strategy, prepares strategic plans, and evaluates business opportunities.

Method of Allocation – All corporate development costs will be direct charged to the Holding Company or the applicable Operating Company. Strategic Planning indirect costs will be allocated using the Holding Company Blended Ratio.

e) *Corporate Governance*

Description – Develops and enforces corporate governance policies and procedures in accordance with applicable laws and regulations.

Method of Allocation – Corporate Governance costs for activities specifically related to the holding company will be assigned directly to the holding company. Corporate Governance indirect costs will be allocated using the Blended Ratio.

f) *Environmental*

Description – Provides environmental services. Establishes policies and procedures for compliance with environmental laws and regulations. Researches emerging environmental issues and monitors compliance with environmental requirements. Oversees environmental clean up projects.

Method of Allocation – Environmental indirect costs will be allocated using the Asset Cost Ratio.

g) *Executive Management Services*

Description – Represents charges for Black Hills executive management and services, including, but not limited to, officers of Black Hills.

Methods of Allocation – Executive Management Services indirect costs will be allocated using the Holding Company Blended Ratio.

h) *Finance and Treasury*

Description – Coordinates activities related to securities issuance, including maintaining relationships with financial institutions, cash management, investing activities and monitoring the capital markets.

Method of Allocation – Finance and Treasury indirect costs will be allocated using the Holding Company Blended Ratio.

i) *Financial Reporting*

Description – Prepares financial and statistical reports.

Method of Allocation – Financial Reporting costs for activities specifically related to the holding company will be assigned directly to the holding company. Financial Reporting indirect costs will be allocated using the Holding Company Blended Ratio.

j) *General Accounting*

Description – Maintains the books and records. Provides accounting oversight activities.

Method of Allocation – General Accounting indirect costs will be allocated using the Blended Ratio.

k) *Human Resources*

Description – Establishes and administers policies related to employment, compensation and benefits. Coordinates the bargaining strategy and labor agreements with union employees. Provides technical and professional development training and general HR support services.

Methods of Allocation – Human Resources indirect costs will be allocated using the Employee Ratio. Healthcare costs for active CLFP employees will be direct charged to CLFP. Healthcare costs for all other active employees will be allocated using the Holding Company Employee Ratio.

l) *Information Technology*

Description – Provides various communications and electronic data processing services including but not limited to, development and support of mainframe computer software applications, procurement and support of personal computers, operation of a data center and installation and operation of a communications system.

Method of Allocation – Information technology indirect costs will be allocated using the Blended Ratio.

m) *Insurance*

Description – Facilitates physical risk management strategies through the purchase and evaluation of various types of insurance coverage. Provides claims management services.

Method of Allocation – Insurance indirect costs will be allocated using the Blended Ratio. Director and Officer's insurance will be allocated using the Holding Company Blended Ratio.

n) *Internal Audit*

Description – Reviews internal controls and procedures to ensure assets are safeguarded and transactions are properly authorized and recorded. Evaluates contract risks.

Method of Allocation – Internal Audit indirect costs will be allocated using the Blended Ratio.

o) *Investor Relations*

Description – Provides communications to investors and the financial community.

Methods of Allocation –Investor Relations indirect costs will be allocated using the Holding Company Blended Ratio.

p) *Legal*

Description – Provides legal services related to labor and employment law, litigation, contracts, rates and regulation, environmental matters, real estate and other legal matters.

Method of Allocation – Legal indirect costs will be allocated using the Blended Ratio.

q) *Payroll*

Description – Processes payroll including but not limited to time reporting, calculation of salaries and wages, payroll tax reporting and compliance reports.

Method of Allocation – Payroll indirect costs will be allocated using the Employee Ratio.

r) *Power Delivery Management*

Description – Performs resource planning, power delivery management, strategic planning, and construction management.

Method of Allocation – Power Delivery Management indirect costs will be allocated using the Power Generation Capacity Ratio.

s) *Rates and Regulation*

Description – Determines the Operating Companies' regulatory strategy, revenue requirements and rates for electric and gas customers. Coordinates the regulatory compliance requirements and maintains relationships with the regulatory bodies.

Method of Allocation – Rates and Regulation indirect costs will be allocated using the Retail Blended Ratio.

t) *Retail Accounting Operations*

Description – Maintains the books and records of the retail Operating Companies and retail affiliate companies. Provides management, operational services, and accounting oversight to the retail Operating Companies and retail affiliate companies.

Method of Allocation – Retail Management and Accounting Operations indirect costs will be allocated using the Retail Blended Ratio.

u) *Retail Property Accounting*

Description – Maintains the records for retail property, plant, and equipment.

Method of Allocation – Retail Property Accounting indirect costs will be allocated using the Retail Asset Cost Ratio.

v) *Risk Management and Analysis*

Description – Provides risk management, risk evaluation, and risk analysis services.

Method of Allocation – Risk Management and Analysis indirect costs will be allocated using the Blended Ratio

w) *Safety*

Description – Develops and implements safety planning activities and provides employee safety education. Administers the self-funded worker's compensation plan.

Method of Allocation – Safety indirect costs will be allocated using the Employee Ratio.

x) *Shareholder Services*

Description – Provides various recordkeeping and administrative services related to shareholder services.

Method of Allocation – Shareholder Services indirect costs will be allocated using the Holding Company Blended Ratio.

y) *Tax*

Description – Prepares tax filings and ensures compliance with applicable laws and regulations.

Method of Allocation – Tax indirect costs will be allocated using the Blended Ratio.

Allocation Ratios

The following ratios will be utilized as outlined above. All ratios will be determined annually, or at such time as may be required due to significant changes.

Asset Cost Ratio – Based on the total cost of assets as of December 31 for the prior year, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies. Assets are limited to property, plant, and equipment.

Blended Ratio – A composite ratio comprised of an average of the Asset Cost Ratio, the Payroll \$ Ratio, and the Gross Margin Ratio.

Holding Company Blended Ratio – 5% of costs allocated to the Holding Company, with the remaining 95% of costs allocated using a composite ratio comprised of an average of the Asset Cost Ratio, the Payroll \$ Ratio, and the Gross Margin Ratio.

Employee Ratio – Based on the total number of employees at the end of the prior year ending December 31, the numerator of which is for an applicable Operating Company or

affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies.

Holding Company Employee Ratio – Based on the total number of employees at the end of the prior year ending December 31, the number of which is for an applicable Operating Company or affiliate company that participates in the BHC self-funded health insurance pool and the denominator of which is for all applicable Operating Companies and affiliate companies that participate in the BHC self-funded health insurance pool.

Gross Margin Ratio – Based on the total annual gross margin for the prior year ending December 31, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies.

Payroll \$ Ratio – Based on the total annual payroll \$ for the prior year ending December 31, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies.

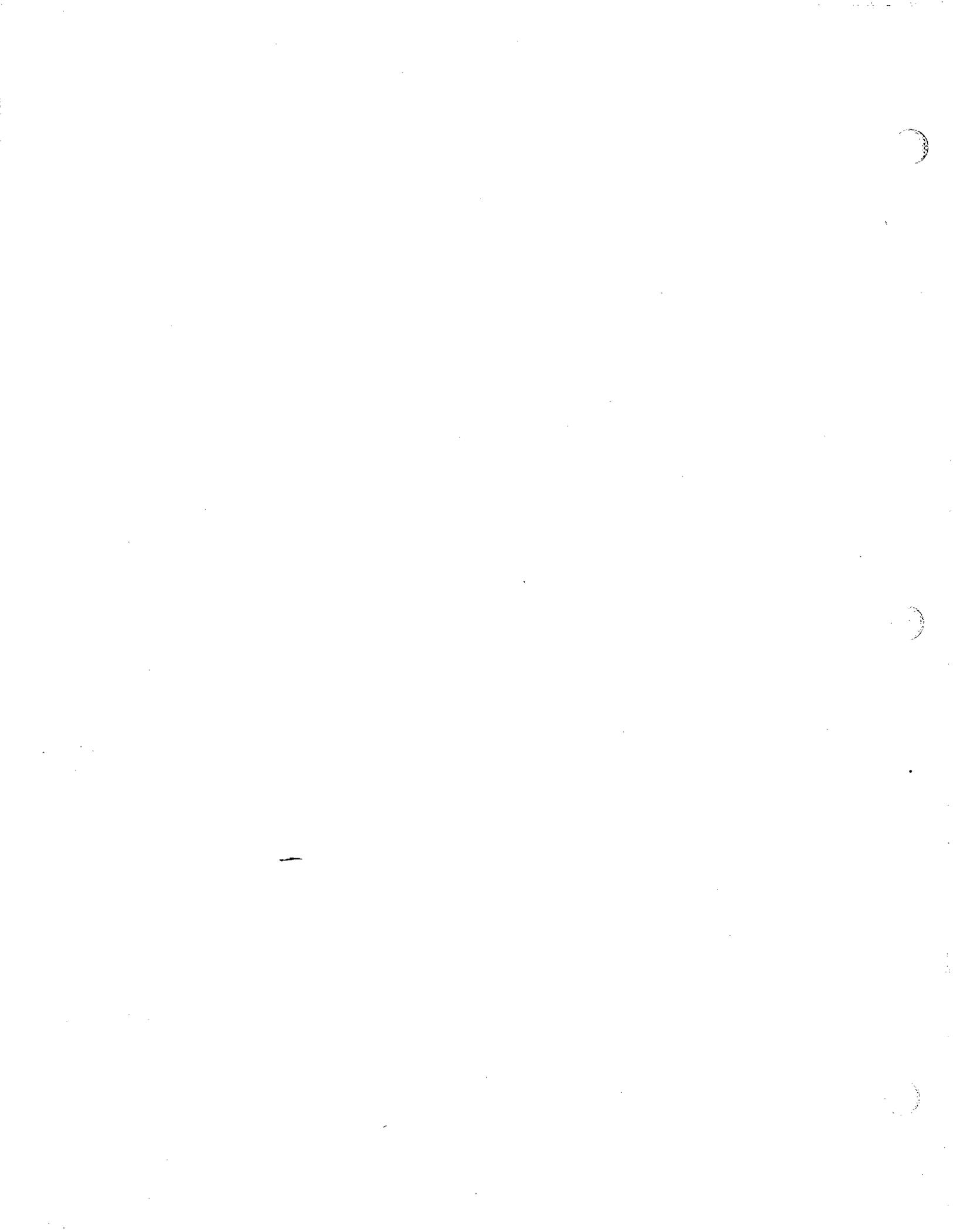
Power Generation Capacity Ratio – Based on the total power generation capacity at the end of the prior year ending December 31, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies.

Retail Asset Cost Ratio – Based on the total cost of retail assets as of December 31 for the prior year, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies. Retail assets are limited to retail property, plant, and equipment.

Retail Blended Ratio – A composite ratio comprised of an average of the Retail Asset Cost Ratio, the Retail Payroll \$ Ratio, and the Retail Gross Margin Ratio.

Retail Gross Margin Ratio – Based on the total annual retail gross margin for the prior year ending December 31, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies.

Retail Payroll \$ Ratio – Based on the total annual retail payroll \$ for the prior year ending December 31, the numerator of which is for an applicable Operating Company or affiliate company and the denominator of which is for all applicable Operating Companies and affiliate companies.



Black Hills Service Company

Cost Accounting Manual

Black Hills Service Company Cost Accounting Manual

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Introduction

The purpose of this cost accounting manual is to document the allocation processes of Black Hills Service Company, from recording the original transaction through the allocation of costs to Black Hills Corporation subsidiaries. Various topics to be addressed include the organization of the Service Company, the recording of transactions, calculating and assigning allocation factors, and recording and reconciling allocation transactions.

Black Hills Service Company (the Service Company) was formed on December 30, 2004, and was fully implemented and operational as of January 1, 2006. The Service Company was formed as required by the Public Utility Holding Company Act of 1935, which was administered by the Securities and Exchange Commission (SEC). Service companies were required of all registered holding companies under this law. Service companies coordinate corporate support functions and distribute costs to registered holding company subsidiaries using pre-defined allocation methodologies that had to be approved by the SEC.

Black Hills Corporation became a registered holding company at the end of 2004, and through a transition period and various amendments to the registered holding company filings, established the date of January 1, 2006 to fully implement the Service Company. In August of 2005, this law was repealed and replaced by the Public Utility Holding Company Act of 2005, which is administered by the Federal Energy Regulatory Commission (FERC). This new law was effective in February of 2006. Although certain administrative and reporting requirements changed as a result of the repeal, Black Hills Corporation did not change its implementation plan.

The Service Company is a wholly owned subsidiary of Black Hills Corporation (the Holding Company), and is a separate legal entity. The majority of operations and all employees were transferred out of the Holding Company on the effective date of implementation. The only transactions that remain at the Holding Company are transactions pertaining to long-term debt and related deferred finance costs, corporate credit facility and related deferred finance costs, and the administration of money pool transactions for both the utility money pool and the non-utility money pool. In addition, as will be discussed in greater detail later, certain corporate costs are allocated directly to the Holding Company. The most notable of these types of costs are corporate development costs.

Service Company Organization

The Service Company is organized into operating departments based upon the services that those departments provide to Black Hills Corporation subsidiaries. Below is a list of each department, as well as a brief description of the services they provide.

1. *Accounting Systems* – Maintains the corporate wide accounting systems of Black Hills Corporation, most notably the general ledger and financial statement preparation systems.
2. *Accounts Payable* – Processes payments to vendors and prepares 1099s and applicable documentation for Black Hills Power, Cheyenne Light Fuel & Power, Black Hills Service Company, Wyodak Resources Development Corporation, and Black Hills Wyoming.
3. *Corporate Communications and Governmental Affairs* – Provides oversight to the corporate communications processes. Provides advertising and branding development for the companies within Black Hills Corporation. Manages and tracks all contributions made on behalf of Black Hills and its subsidiaries, as well as Black Hills Corporation Foundation. Monitors, reviews and researches government legislation and acts as a liaison with legislators. Assists in the preparation of the annual report.
4. *Corporate Development and Strategic Planning* – Facilitates the development of the corporate strategy, prepares strategic plans, and evaluates potential business opportunities.
5. *Corporate Governance* – Develops and enforces corporate governance policies and procedures in accordance with applicable laws and regulations. Provides oversight of compliance with Securities and Exchange Commission rules and regulations. Oversees the administrative duties to the Board of Directors.
6. *Tax* – Prepares quarterly and annual tax provisions of all Black Hills Corporation subsidiaries. Maintains and reconciles all current and deferred income tax general ledger accounts. Prepares tax filings and ensures compliance with applicable laws and regulations. Oversees various tax planning projects.
7. *Risk Management and Analysis* – Provides risk management, risk evaluation, and risk analysis services. Provides support to the Executive Risk Committee.
8. *Legal* – Provides legal services related to labor and employment law, litigation, contracts, rates and regulation, Securities and Exchange Commission compliance, environmental matters, real estate and other legal matters. Oversees the hiring and administration of external counsel. Provides legal support to various corporate development projects.
9. *Environmental* – Establishes policies and procedures for compliance with environmental laws and regulations. Researches emerging environmental issues and monitors compliance with environmental requirements. Oversees environmental clean up projects.

10. *Executive Management Services* – Provides overall oversight of Black Hills Corporation subsidiaries. Guides the preparation of strategic plans and advises on potential corporate development opportunities. Provides the Board of Directors information for decision making purposes. Oversees communication with shareholders and the investor community.
11. *Safety* – Develops and implements safety planning activities and provides employee safety education. Administers the self-funded worker's compensation plan in South Dakota. Administers the corporation's wellness program.
12. *Finance and Treasury* – Coordinates activities related to securities issuance, including maintaining relationships with financial institutions, cash management, debt compliance, investing activities and monitoring the capital markets. Oversees the administration of corporate pension and 401(k) plans.
13. *Financial Reporting* – Oversees the corporate consolidation of subsidiary financial statements. Prepares monthly internal financial reports for management. Prepares quarterly and annual financial reports to the Securities and Exchange Commission. Researches emerging accounting issues and assists with the compliance of new accounting rules and regulations.
14. *General Accounting* – Provides overall oversight for the maintenance of accounting records. Researches emerging accounting issues. Assists in the compliance of all accounting rules and regulations. Provides accounting support to the Service Company and the Holding Company. Oversees the accumulation of subsidiary financial budgets and the consolidation of the corporate wide budget.
15. *Human Resources* – Establishes and administers policies related to employment, compensation and benefits. Coordinates the bargaining strategy and labor agreements with union employees. Provides technical and professional development training and general HR support services. Oversees the self-insured medical benefits plans and provides support to the third party administrators of the plans.
16. *Information Technology* – Provides various communications and electronic data processing services including but not limited to, development and support of mainframe computer software applications, procurement and support of personal computers, operation of a data center, operation of a help desk, development of information technology-related training resources, and installation and operation of a communications system.
17. *Insurance* – Facilitates physical risk management strategies through the purchase and evaluation of various types of insurance coverage. Provides claims management services.
18. *Internal Audit* – Reviews internal controls and procedures to ensure assets are safeguarded and transactions are properly authorized and recorded. Oversees the Sarbanes Oxley compliance efforts. Evaluates contract risks.

19. *Investor Relations* – Provides communications to investors and the financial community. Assists in the preparation of the annual report.
20. *Shareholder Services* – Provides various recordkeeping and administrative services related to shareholder services. Assists in the administration of equity-based compensation plans.
21. *Payroll* – Processes payroll for all Black Hills Corporation subsidiaries including but not limited to time reporting, calculation of salaries and wages, payroll tax reporting and compliance reports.
22. *Power Delivery Management* – Performs resource planning, power delivery management, strategic planning, and construction management for the corporation's power generation assets.
23. *Rates and Regulation* – Determines the regulatory strategy for the corporation's utility subsidiaries, including revenue requirements and rates for electric and gas customers. Coordinates the regulatory compliance requirements and maintains relationships with the regulatory bodies.
24. *Retail Accounting Operations* – Maintains the accounting records of the retail subsidiaries of the corporation. Assists in the compliance with regulatory accounting requirements. Prepares required filings with the Federal Energy Regulatory Commission and with applicable state commissions. Assists in the preparation of budgets for the retail subsidiaries of the corporation. Prepares various operating and financial reporting for retail management. Assists with the regulatory strategy for the utility subsidiaries.
25. *Retail Property Accounting* – Maintains the records for retail property, plant, and equipment for the retail subsidiaries of the corporation. Assists in the preparation of required filings with the Federal Energy Regulatory Commission and with applicable state commissions. Assists in the preparation of property tax returns for retail property. Assists in the preparation of various operating and financial reporting for retail management.

Direct Costs versus Indirect Costs

A key issue in distributing Service Company costs is distinguishing between direct costs and indirect costs. The account coding will change depending on whether the cost is a direct or indirect cost. Below is a summary of each of these types of costs and examples of these costs.

Direct costs are those costs that are specifically associated with an identified subsidiary or group of identified subsidiaries. This means that it is known exactly to which subsidiary or group of subsidiaries these costs relate. Here are some examples:

- A Payroll Processor is processing the payroll for Enserco. The labor costs incurred in processing payroll are specifically associated with an identified subsidiary. Therefore, this would be a direct cost.
- An Internal Auditor travels to Golden to complete audits for Enserco, Black Hills Exploration and Production and Black Hills Generation. The time associated with completing the audits would be charged to each company based on the time worked for each specific company project. The travel expenses could either be coded to each company based on time worked or coded using a combination of spreading those charges equally and charging costs specifically to one of the companies each day worked. For example, the airline ticket might be split evenly between the three subsidiaries, while the first meal might be charged to Enserco, while the next meal is charged to BHEP. Materiality is an important factor in determining how to charge costs in these instances, as it would not be cost-beneficial to split a \$10 meal three ways.
- The Human Resources department incurs costs to bring an employment candidate on-site to Gillette for an interview with Wyodak. These travel costs incurred in bringing the employee in for the interview are specifically associated with an identified subsidiary. Therefore, this would be a direct cost.
- A Help Desk technician orders a replacement computer monitor for an employee at Black Hills Power. This hardware cost incurred is specifically associated with an identified subsidiary. Therefore, this would be a direct cost.

Indirect costs are those costs that are not associated with an identified subsidiary. This means that the costs indirectly support all companies or directly support the operation of the Service Company. In other words, costs that would be directly charged to the Service Company using the definition and examples above would be classified as indirect costs. Here are some examples:

- A Payroll Processor attends training on year-end payroll updates. The labor costs incurred in attending this training are not specifically associated with an identified subsidiary. Therefore, this would be an indirect cost.
- The Internal Audit department is completing a BHC consolidated financial statement audit. Since all entities indirectly affect the financial statements of consolidated BHC, this charge would be considered an indirect cost.
- An Environmental representative wishes to take Paid-Time-Off (PTO). This charge can not be directly attributable to any specifically identified company; therefore, this charge would be considered an indirect cost.

- A Help Desk technician orders a replacement computer monitor for an employee of the Service Company. This hardware cost incurred is specifically associated with the Service Company. Therefore, this would be an indirect cost.

It is important that when determining if a cost is a direct cost or an indirect cost to consider two things. (1) Can the costs be substantiated that are coded to a specific company or group of companies and (2) Can it be substantiated that a utility-based entity is not subsidizing the operations of non-utility based company with the time and expenses that have been charged to them. As can be seen from above, a certain level of judgment will be involved when deciding whether a particular cost should be directly charged or indirectly allocated.

There are certain costs that will always be considered direct or indirect costs, no matter the circumstances. Below is a list of significant Service Company expense that follow these rules:

Always considered direct costs:

- Capitalized costs (including capitalized labor)
- Corporate development project costs
- Corporate development department costs
- Professional fees related to pension plans paid to third parties
- Retiree healthcare costs

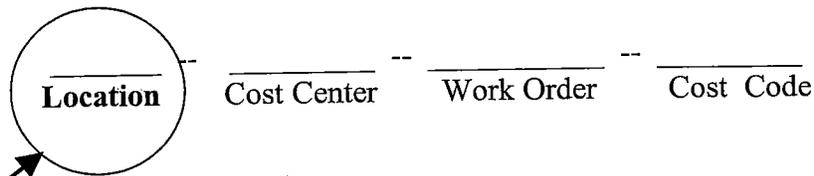
Always considered indirect costs:

- PTO and Holiday labor (they are included as a component of overhead)
- Corporate-wide bonuses and other methods of compensation that are included as a component of overhead
- Payroll taxes and 401(k) match expenses (they are included as components of overhead)
- Short or long-term disability expenses
- Board of Directors' fees and expenses
- General Office rent
- Depreciation
- Directors' and officers' insurance
- Investor relations expenses
- Shareholder expenses
- Intercompany interest expense and income

Transaction Coding

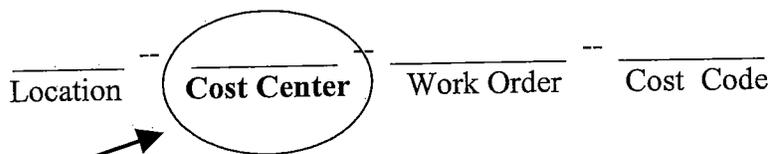
In addition to the normal general ledger software, the Service Company also utilizes the Project Tracking software system. Project Tracking allows for the accumulation and tracking of all Service Company income statement transactions. In addition, the system also handles the distribution of both direct and indirect costs to Black Hills Corporation subsidiaries.

All income statement transactions will use the coding as described below. The coding is comprised of four separate fields, each representing an important characteristic of the underlying transaction. Balance sheet transactions may either use this coding as well, or they may be recorded directly to the balance sheet, depending on the nature of the transaction.



Location:

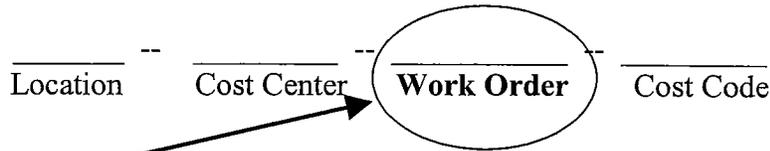
- Three (3) character numeric field.
- The location field is used to identify the transaction as either a direct cost or an indirect cost.
- If the cost is a direct cost, the location field will be populated using the location code for the company being directly charged. For example, the location code for Enserco is 017, the location code for BHEP is 025, and the location code for BHP is 005.
- If the cost is an indirect cost, the location field will be populated using the location code of 999. Please remember that indirect costs also include costs directly related to the Service Company.



Cost Center:

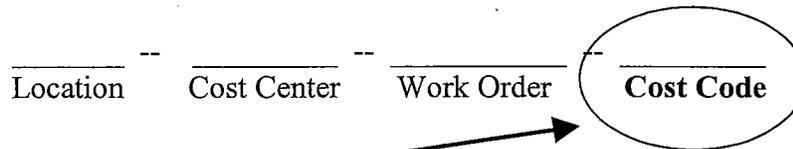
- Two (2) character numeric field.
- The cost center field is used to identify the department in which the costs originated.
- Each employee will use his or her department's unique cost center code when completing the account coding for costs they are initiating. If completing the account code on behalf of another individual, that individual's department's cost center code would be used instead. For example, if an administrative assistant is responsible for initiating invoices for a variety of cost centers, the account coding would include the cost centers for those departments and not the administrative assistant's own cost center.
- For the most part, when an employee completes a timesheet or codes an invoice, the cost center used will always be the same.

- Examples of cost center codes include 17 for Payroll, 15 for Human Resources, and 16 for Information Technology.



Work Order:

- Five (5) character numeric field.
- The work order field is used to identify the specific nature of the costs incurred. In essence, a work order is a cost pool to accumulate similar costs.
- Work orders can be used to track various types of costs required by departments or employees. For example, the Payroll department might have a work order to track costs for Payroll Processing, the Human Resources department might have a work order to track costs of Hiring/Recruiting, and the IT department might have a work order to track costs of providing IT User Support.
- For departmental budget-to-actual comparisons, it is important to use work orders to which departments have budget dollars assigned. This will require communication from department supervisors so that the correct work orders are used. The exception to this rule will be special projects that arise during the year.



Cost Code:

- Two (2) character numeric field.
- The cost code field is used to identify the general nature of the costs incurred. The cost code is loosely equivalent to financial statement expense accounts, and is the primary driver in deciding which income statement account to which the transaction is recorded.
- For instance, when a Payroll Processor is processing payroll and codes her timesheet, she will use cost code 31, for Labor-A&G. When the HR department codes travel costs for on-site interviews, they may use costs code for Travel-Airfare (37), Lodging (07), and Meals (04).

To further understand how the account coding string is completed for each transaction, please see the following examples:

- An Accounts Payable processor processes an A/P check run for Wyodak and needs to code her timesheet. This would be a direct charge because it is specifically associated with an identified subsidiary. The location code for Wyodak is 019, so that would be the first piece of the coding string. The Accounts Payable processor is part of the Accounts Payable department, whose cost center is 02. Let's say this department has a work order for Processing A/P Runs with a work order number of 30005. Lastly, the processor is

coding her timesheet, so a cost code of 31 would be used, which relates to Labor A&G. Here's how the completed string would look:

<u>019</u>	--	<u>02</u>	--	<u>30005</u>	--	<u>31</u>
Location		Cost Center		Work Order		Cost Code

- A non-company specific invoice is received for external financial statement audit fees. This would be an indirect cost because it is not associated with a specific company. Therefore, the location would be 999. This invoice would be initiated for payment by the General Accounting department, with a cost center of 14. Say the work order for Financial Statement Audits is 30125. Lastly, the cost code would be 10, for Audit Fees. Here's the string:

<u>999</u>	--	<u>14</u>	--	<u>30125</u>	--	<u>10</u>
Location		Cost Center		Work Order		Cost Code

- The Human Resources department incurs various consulting costs on changes to employee benefit plans. The location would be 999 because these costs are not associated with a specific company. Cost center 15 would be used for the Human Resources department. This department has work order 30168 for Human Resources Benefit Services. The cost code for Consulting/Professional Fees is 09. The coding string is:

<u>999</u>	--	<u>15</u>	--	<u>30168</u>	--	<u>09</u>
Location		Cost Center		Work Order		Cost Code

Recording Transactions to the General Ledger/Chart of Accounts

All Service Company income statement transactions must run through a Project Tracking account coding string. Project Tracking, however, is a separate system from the General Ledger. All transactions that are recorded through Project Tracking are simultaneously recorded to the General Ledger through a process referred to as "FERC-ing."

All work orders must be assigned a "FERC" relationship. All transactions that are recorded to that work order will be recorded to a General Ledger account based on the "FERC" relationship that is set-up. The work order, along with the cost center and cost code, decides which General Ledger account the transaction will hit. The location field will not have an impact on the General Ledger.

As new work orders are established, "FERC" relationships must also be established for all potential combinations of cost centers, work orders, and cost codes. Normally, for Service Company transactions, the key driver to the General Ledger is the cost code. The general rule is that all transactions recorded to the same cost code will be recorded to the same General Ledger account. There may be occasions where this general rule does not hold true, and in these cases, the work order will also help designate the General Ledger account used. For Service Company transactions, the cost center rarely affects the General Ledger account used, meaning that any transactions recorded to a work order/cost code combination will be recorded to the same General Ledger account no matter what cost center is used in the account coding string. However, the system does require that the "FERC" relationship include cost center, along with the work order and cost code.

At various times during the month, as well as at the end of the month after all transactions are posted, the Project Tracking system is balanced against the General Ledger. The purpose of this balancing is to ensure that transactions are properly reflected in both systems. Any differences are researched and corrected, or documented if the differences are acceptable.

The Service Company uses the Federal Energy Regulatory Commission's Uniform System of Accounts, as required by the Public Utility Holding Company Act of 2005. This chart of accounts prescribes which accounts are to be used for specific types of transactions. Because this is the same chart of accounts that a public utility uses, there are several groups of accounts that are not applicable to a service company. On the income statement, the primary group of accounts that is used are the Administrative and General Expenses accounts.

Timekeeping

All Service Company employees are required to complete a timesheet for each two week pay period, whether they are an employee paid hourly or an employee paid a salary. Timesheets are due by noon on Tuesday following the end of the pay period every other Sunday. Timesheets of all hourly employees must be approved by their supervisor. Timesheets of salaried employee are not required to be approved by their supervisor, but it is encouraged.

Timesheets are completed using a web-based program. Employees must complete the coding string, as previously discussed, for each time record. The timesheet will default the cost code field to the cost code for administrative and general labor, and the employee can skip the completion of this field. The only other allowable cost code on the timesheet is the cost code for capitalized labor. However, if the employee's activities can be capitalized, the employee will need to manually complete the cost code field. In addition, a pay code must also be designated for each time record. The pay code designates the time as such classifications as regular time, overtime, holiday time, or paid time off.

Employees are encouraged to enter their time in one half hour increments, although they may use smaller increments if they so choose. Employees are also encouraged to keep their timesheets updated on a regular basis, so that they don't have to enter two weeks worth of time on the last day of the pay period. It is best if they enter their time on a daily basis.

Overhead

Certain benefits that are provided to employees become an inherent cost of labor. To account for these benefits and allow for them to be charged to the appropriate subsidiary, they become part of an overhead rate that is added on to each payroll dollar. The Service Company utilizes two different overhead rates. A general overhead rate is added on to all payroll dollars, while a supplemental overhead rate is added on to payroll dollars of executive officers. The supplemental overhead rate is necessary because certain benefits are limited to executive officers, and including those benefits in an overhead rate for all employees would not fairly distribute benefit costs.

As payroll is processed, the overhead rates are calculated on the payroll dollars and follow the same location, cost center, and work order as the labor was coded to on the timesheet. The one difference is the cost code. Normal labor is coded to cost code 31, while capitalized labor is coded to cost code 39. Normal labor overhead is then coded to cost code 32, while capitalized labor overhead is coded to cost code 40. The General Ledger impact is that salary expense is grossed up for overhead, with a corresponding credit entry to Labor Overhead Offset, which is a contra expense. This means the net impact to the income statement will be zero. The one exception is capitalized labor overhead, which is added to capitalized labor on the balance sheet, with the offset recorded as a credit to the income statement, thereby reducing overall expenses.

The overhead rates are calculated at the beginning of the year based upon budgeted benefit expenses and budgeted labor. These rates are loaded into Project Tracking and used for payroll processing throughout the year. Adjustments to the rates may be made during the year if material changes occur or are expected to occur to employee benefits. Below is a list of components of the overhead rates:

General overhead:

- PTO and Holiday pay
- FICA, FUTA, and SUTA taxes
- Medical/health benefits for active employees
- Pension accruals for the defined benefit plan
- Retiree healthcare accruals
- Gainshare/results compensation bonus accruals
- Short-term incentive plan bonus accruals for non-officers
- Stock option expense

Supplemental overhead:

- Restricted stock expense
- Non-qualified pension accruals (PEP and SERP)
- Short-term incentive plan bonus accruals for officers
- Performance plan bonus accruals

At the end of each month, overhead calculated on payroll using the overhead rates must be trueed up against actual employee benefit costs. The purpose for this true-up is due to the fact that the Service Company's income statement must net to zero, meaning there can be no net income

or net loss remaining at the Service Company. Overhead calculated on payroll is based on an estimated rate and budgeted benefits, so differences between actual benefits will be inherent to this process. The two main reasons for the difference is the employee benefit costs differ from the budget, or that payroll differs from budget. After the difference is calculated and reviewed for reasonableness, it is allocated to cost centers based upon payroll for the month. A separate work order is used to track the overhead true-up adjustments, and these adjustments are indirectly allocated to Black Hills Corporation subsidiaries.

Allocation Factors

As previously stated, Service Company costs are either directly charged to a subsidiary, or indirectly allocated when the cost is not associated with a specific subsidiary. Indirect costs are allocated out using one of several pre-defined allocation factors. Each cost center has been assigned one of these allocation factors. All indirect costs of that cost center are then allocated using that factor. When determining which allocation factor should be assigned to each cost center, a factor was selected based on the specific cost driver of that cost center. For instance, the expenses incurred by the Human Resources department are primarily related to their support of all company employees. In this example, the cost driver for the Human Resources department indirect costs is employees. Therefore, their indirect costs will be allocated based upon the Employee ratio.

For certain cost centers, a specific cost driver may not be clearly identifiable or the driver may not be cost efficient to compute on a continuing basis. In these instances, a three-pronged general allocation factor is used, which is referred to as the Blended ratio. This ratio equally weights three different general ratios: Gross Margin, Asset Cost (limited to PP&E), and Payroll Dollars. These factors were chosen to be included in the Blended ratio because they best allocate costs based on the diverse nature of BHC operations.

In addition, some cost centers utilize a Holding Company Blended ratio. The difference between the Blended Ratio and the Holding Company Blended ratio is that the Holding Company Blended Ratio allocates a percentage of costs to BHC Holding Company. For example, the Corporate Governance department will allocate indirect costs using the Holding Company Blended ratio because certain costs incurred, such as New York Stock Exchange fees and Board of Directors costs, relate to both the Holding Company and the subsidiary companies. It should also be noted that Corporate Development costs will be directly charged to the Holding Company and will not be allocated to the subsidiaries.

One additional item to note is that health care costs are allocated differently due to the self-insurance pool. Black Hills Corporation has chosen to pool all health care costs and spread the risk amongst all subsidiaries equally. The one exception is Cheyenne Light Fuel and Power, which has its own health care plan that is substantially different than Black Hills Corporation's health care plan. As a result, CLFP does not pool its costs with BHC, but rather pays directly all medical costs incurred. All other medical costs of BHC are paid by the Service Company and allocated to subsidiaries based on employee counts.

The following is a list of all allocations factors, including a brief description of the factor, the basis for the calculation of the factor, and the cost centers to which that factor has been assigned. Any asset factors and employee count factors are calculated as of period-end dates, while revenue and expense factors are calculated for twelve months ended as of period-end dates.

Asset Cost Ratio – Based on the total cost of assets as of December 31 for the prior year, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Assets are limited to property, plant, and equipment, and include construction or work in process. Assets are also reported at their

GAAP value, meaning that assets for the utility subsidiaries will include the eliminations that are done to bring their FERC financial statements into compliance with GAAP. FERC requires that acquired fixed assets be recorded at their gross value with accumulated depreciation, while GAAP requires that acquired fixed assets be recorded at their net value. An elimination journal entry is used to eliminate the gross-up for preparation of GAAP financial statements, and this elimination journal entry is factored into the calculation of the Asset Cost Ratio.

The Environmental cost center utilizes this ratio, and it is a component in both the Blended Ratio and the Holding Company Blended Ratio.

Gross Margin Ratio – Based on the total gross margin for the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Gross margin is defined as revenue less cost of sales. Certain intercompany transaction may be excluded from gross margin if they would not have occurred if the revenue relationship was with a third party instead of a related party.

No cost centers utilize this ratio, but it is a component in both the Blended Ratio and the Holding Company Blended Ratio.

Payroll \$ Ratio – Based on the total payroll \$ for the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Payroll \$ include all bonuses and compensation paid to employees, but do not include items that are only included on an employee's W-2 for gross-up and income tax purposes, such as life insurance premiums over \$50,000.

No cost centers utilize this ratio, but it is a component in both the Blended Ratio and the Holding Company Blended Ratio.

Blended Ratio – A composite ratio comprised of an average of the Asset Cost Ratio, the Payroll \$ Ratio, and the Gross Margin Ratio. These factors are equally weighted. This factor is sometimes referred to as the general allocation factor.

Cost centers that utilize this ratio include Accounting Systems, Accounts Payable, Corporate Communications and Governmental Affairs, General Accounting, Information Technology, Insurance, Internal Audit, Legal, Risk Management and Tax.

Holding Company Blended Ratio – 5% of costs allocated to the Holding Company, with the remaining 95% of costs allocated using a composite ratio comprised of an average of the Asset Cost Ratio, the Payroll \$ Ratio, and the Gross Margin Ratio. These factors are equally weighted.

Cost centers that utilize this ratio include Corporate Governance, Executive, Finance and Treasury, Financial Reporting, Investor Relations, and Shareholder Services.

In addition, directors and officer's insurance expense incurred through the Insurance cost center is allocated using the Holding Company Blended Ratio, as well as strategic planning costs of the Corporate Development cost center.

Employee Ratio – Based on the number of employees at the end of the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries.

Cost centers that utilize this ratio include Payroll, Safety, and Human Resources.

Power Generation Capacity Ratio – Based on the total power generation capacity at the end of the prior year ending December 31, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries. Power generation includes only capacity in service and does not include capacity under construction.

The Power Delivery Management cost center utilizes this ratio.

Retail Asset Cost Ratio – Based on the total cost of retail assets as of December 31 for the prior year, the numerator of which is for an applicable BHC retail subsidiary and the denominator of which is for all applicable BHC retail subsidiaries. Retail assets are limited to property, plant, and equipment, and include construction or work in process. Retail assets are also reported at their GAAP value, meaning that retail assets for the utility subsidiaries will include the eliminations that are done to bring their FERC financial statements into compliance with GAAP. FERC requires that acquired fixed assets be recorded at their gross value with accumulated depreciation, while GAAP requires that acquired fixed assets be recorded at their net value. An elimination journal entry is used to eliminate the gross-up for preparation of GAAP financial statements, and this elimination journal entry is factored into the calculation of the Retail Asset Cost Ratio.

No cost centers utilize this ratio, but it is a component in the Retail Blended Ratio.

Retail Gross Margin Ratio – Based on the total retail gross margin for the prior year ending December 31, the numerator of which is for an applicable BHC retail subsidiary and the denominator of which is for all applicable BHC retail subsidiaries. Retail gross margin is defined as revenue less cost of sales. Certain intercompany transaction may be excluded from retail gross margin if they would not have occurred if the revenue relationship was with a third party instead of a related party.

No cost centers utilize this ratio, but it is a component in the Retail Blended Ratio.

Retail Payroll \$ Ratio – Based on the total retail payroll \$ for the prior year ending December 31, the numerator of which is for an applicable BHC retail subsidiary and the denominator of which is for all applicable BHC retail subsidiaries. Retail payroll \$ include all bonuses and compensation paid to employees, but do not include items that

are only included on an employee's W-2 for gross-up and income tax purposes, such as life insurance premiums over \$50,000.

No cost centers utilize this ratio, but it is a component in the Retail Blended Ratio.

Retail Blended Ratio – A composite ratio comprised of an average of the Retail Asset Cost Ratio, the Retail Payroll \$ Ratio, and the Retail Gross Margin Ratio. These factors are equally weighted.

The cost centers that utilize this ratio include Retail Accounting, Retail Property Accounting, and Rates.

Changing Allocation Factors

Allocation factors are set at the first of the year, based upon financial information from the prior year ending December 31st. Assets, retail assets, employee counts, and power generation capacity are based on values as of the previous period ending December 31st. Gross margin, retail gross margin, payroll \$, and retail payroll \$ are based on values for the 12 months ended December 31st.

Certain events may occur during the year that are deemed to be significant to Black Hills Corporation that will require corresponding adjustments made to the allocation factors. Examples of these types of events include acquisitions, divestitures, new generation, significant staffing changes or new, significant revenue streams.

When these events occur, indirect allocation factors will be adjusted. When adjusting allocation factors, it is the policy of the Service Company to not recalculate all allocation factors. Rather, allocations factors will be adjusted with pro forma changes. For example, if an acquisition occurs during the middle of the year, pro forma values will be loaded. Asset values at the time of the acquisition would be used, as well as pro forma gross margin and payroll \$ for a 12 month period. It should be noted that estimations may be required, especially when significant additions or changes are expected as a result of the acquisition.

It should also be noted that asset values, gross margin, and payroll \$ for the other companies will not be changed. However, the ratios will change because the base against which the ratios are calculated will change. Subsidiary companies would see decreased ratio values with acquisitions, and increased ratio values with divestitures. Changes will be effective as of the beginning of the month, and will apply to all transactions for the month.

Running Direct and Indirect Charges

After all journal entries are posted and general ledger accounts are reconciled for the month, Service Company direct and allocated charges are run. The direct and allocated charge processing commands each have their own menu options within Project Tracking. The first step is to run these processing commands in "Error Only" mode to check and correct any errors. The main reason for errors is that Service Company account coding does not have a corresponding account to be mapped to on the subsidiaries' general ledgers. Mapping tables must be maintained for both direct charges and allocated charges. Any account coding combination that is used for Service Company transactions must be mapped to an account code combination for all subsidiaries that could receive those charges. This can be complex because when a charge is coded as indirect, it may be allocated to all BHC subsidiaries (depending on the allocation factor assigned to the cost center in which the charge originated), and coding must be set-up on each of the subsidiaries to receive these charges. In simplified terms, the system looks at the account coding string of each charge, and uses the mapping table to determine where it should be recorded on the subsidiaries' general ledger.

As previously noted, there are four fields to the account coding string. When determining where to map costs to the subsidiaries, three of these four fields are used: location, work order, and cost code. The location field determines to which subsidiary the charge is going, and the work order and cost code determine to what account on the subsidiaries' general ledgers the charge is going. Cost center is not relevant to the mapping process. For all locations except BHP and CLFP, the charge goes directly to the general ledger. Because BHP and CLFP are also Project Tracking companies, charges to them must be recorded to a Project Tracking account coding string.

Both the direct and allocated mapping tables work in the same manner, and for the most part, a Service Company charge will be recorded on the subsidiaries' general ledgers to the same account whether or not the charge was direct or indirect. However, separate tables must still be maintained. For allocated charges, the system will see that a charge has been given a location of 999, and use the cost center to determine the appropriate allocation factor and the companies associated with that allocation factor. For each company that has a portion of the ratio, the system will reference the allocation table and use the location code to determine the appropriate subsidiary coding.

It should be noted that not all charges are mapped to subsidiary general ledgers. The exception is actual overhead expenses. As previously discussed, an overhead rate is applied to all payroll dollars. Therefore, it is not appropriate to also bill out actual overhead expenses. Instead, these expenses remain at the Service Company, and are trued up against calculated overhead, as previously noted.

All overhead expenses are coded to location 999 when transactions occur. To prevent these expenses from being allocated, all work orders that accumulate overhead expenses are grouped together (referred to as projects), and the project is assigned a skip code to skip the direct and allocated charge process. This means that the system will note that all charges to any work orders in a project with a skip code will not need to be direct charged or allocated.

Once all mapping errors are cleared and the direct and allocated programs can be run in error only mode with no results, a reconciliation is completed to ensure that the revenue generated from the costs being charged out will match the actual costs being charged out. Service Company revenue is generated upon running direct and allocated programs. The Service Company is required to have a net income of zero, so revenues must equal expenses. This reconciliation consists of determining what revenue will be by running the direct and allocated programs in "Edit" mode and subtracting out capital. This needs to match what the current net loss is in the Service Company's general ledger. Subtracting capital is necessary because running direct capital charges does not generate revenue. Rather, these costs are originally recorded to a clearing account on the balance sheet, and when direct charges are run, this account is cleared out and will be zero. If the reconciliation does not net to zero, research is done to determine the cause, and corrections are made.

After the reconciliation is completed, the direct and allocated programs are run in "Update" mode. This generates interface files for all subsidiary companies. These interface files are then pulled into the general ledger (or Project Tracking for BHP and CLFP) and posted. Before these files are posted, the system validates that all account coding is correct. Although coding was first checked before direct and allocated programs were run, the system only made sure that there was necessary coding in the mapping tables. There is a chance that errors could exist in the mapping tables, or that general ledger accounts aren't activated on the subsidiaries' general ledgers. Any errors must be corrected before the system will post the transactions.

Reconciling Direct and Indirect Charges

After all direct and allocated charges have been posted, a reconciliation is completed to ensure that direct and allocated charges were properly recorded. One item to note is that when these charges are posted, they are posted in a manner that allows them to be segregated from other expenses of the companies. For all Lawson-based companies, a separate accounting unit is used to house Service Company costs. For all Project Tracking companies, a separate location/cost center combination is used, and for Artesia companies, a separate department is used. This allows for reports to be run to that will summarize Service Company charges after they have been posted. These reports are then tied back to Service Company direct and allocated reports, ensuring that costs were recorded as expected.

The final step in the process is to prepare an elimination entry. For consolidation purposes, Service Company revenue is eliminated against the Service Company expenses recorded on subsidiaries' general ledgers. This leaves original Service Company expenses on the consolidated financial statements. The entire amount of Service Company revenue is eliminated (it is recorded to only one revenue account), and each expense line item is eliminated at the subsidiary level. It should be noted that any capitalized costs that were first recorded by the Service Company are not eliminated and do not remain at the Service Company.

Subsidiary Payment for Direct and Indirect Charges

It is the policy of the Service Company to initiate the subsidiary payments for direct and allocated charges. The reason for this is to prevent the subsidiaries from protesting charges and withholding payment. All payments for direct and allocated charges must be remitted to the Service Company by the end of the following month. To initiate payment, the Service Company prepares payment authorizations, with appropriate back-up, and provides them directly to the accounts payable departments of the subsidiary companies. These payment authorizations may then be approved according to subsidiary payment approval policies. The Service Company will monitor payments received during the month to ensure that all subsidiary companies make payment in a timely manner.