
Black Hills Utility Holdings, Inc.

Cost Allocation Manual

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**Black Hills Utility Holdings, Inc. Cost Allocation Manual
Table of Contents**

1.	Introduction	3
2.	BHUH Organization	3
3.	Direct Costs versus Indirect Costs	3
4.	Transaction Coding	4
	a. General Ledger Business Unit	
	b. Operating Unit	
	c. Department	
	d. Account	
	e. Product	
	f. Resource	
	g. Project	
5.	Timekeeping	7
6.	Allocation Factors	7
7.	Changing Allocation Factors	8
8.	Allocating Fixed Assets	9
9.	Allocating Inventory	9
10.	Appendix 1 – BHUH Departments	10
11.	Appendix 2 – Allocation Factors	20

Introduction

The purpose of this cost allocation manual is to document the allocation processes of Black Hills Utility Holdings, Inc. (“BHUH”), from recording the original transaction through the allocation of costs to entities receiving services from BHUH. Various topics to be addressed include the organization of BHUH, the recording of transactions, calculating and assigning allocation factors, and recording allocation transactions.

BHUH began formal operations in July 2008. The company was formed in anticipation of the purchase of certain gas and electric utility operating companies from Aquila, Inc. BHUH is a wholly owned subsidiary of Black Hills Corporation. BHUH is the parent company of each of the five acquired Aquila operating companies. In addition, BHUH also holds certain departments that support the operations of the five acquired Aquila operating companies and other utility operating companies, together the “operating companies”. These costs are allocated to the operating companies requesting service using formal cost allocation methodologies. Departments that provide support services to the five acquired Aquila operating companies as well as other Black Hills Corporation subsidiaries are held at Black Hills Service Company, LLC (“BHSC”). BHSC cost allocation methodologies are discussed in a separate cost allocation manual.

BHUH Organization

BHUH is organized into departments based upon the services that those departments provide to the operating companies. A list of each department, as well as a brief description of the services they provide, is attached hereto as Appendix 1.

Direct Costs versus Indirect Costs

A key issue in distributing BHUH 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 operating company or group of identified operating companies. This means that it is known exactly to which operating company or group of operating companies these costs relate. Here are some examples:

- Advertising is prepared for a new energy efficiency campaign in the state of Nebraska. The advertising costs incurred are specifically associated with an identified operating company. Therefore, this would be a direct cost.
- The Vice President of Gas Utilities attends a meeting on the proposed budget for the state of Iowa. The labor costs incurred in attending this meeting are specifically associated with an identified operating company. Therefore, this would be a direct cost.
- An IT Field Services Technician travels to various Black Hills Kansas Gas field offices to install new hardware. These travel costs are specifically associated with an identified operating company. Therefore, this would be a direct cost.

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

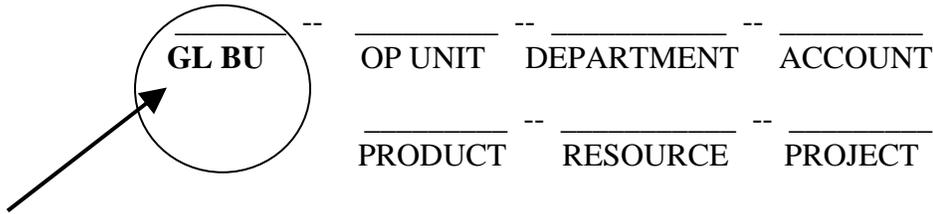
- Advertising is prepared for all customers to inform them of changes to electronic payment processes. These advertising costs incurred apply to all operating companies. Therefore, this would be an indirect cost.
- The Vice President of Gas Utilities attends a meeting to present the consolidated budget for all gas utilities to the Board of Directors. The labor costs incurred in attending this meeting are not specifically associated with an identified operating company. Therefore, this would be an indirect cost.
- An IT Field Services Technician travels to Lincoln to install new hardware for the customer service center. These travel costs are specifically associated with BHUH. 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 that are coded to a specific operating company or group of operating companies be substantiated, and (2) Can it be substantiated that a utility-based subsidiary is not subsidizing the operations of a non-utility based subsidiary 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.

Transaction Coding

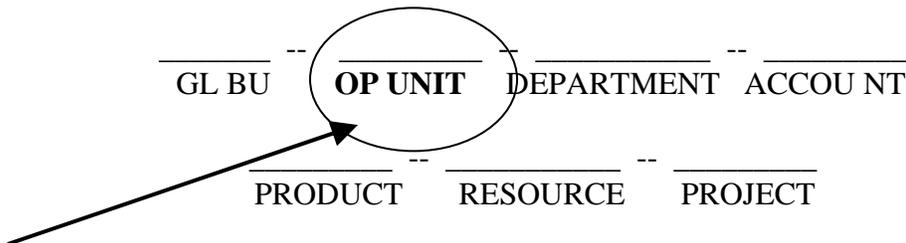
BHUH utilizes the PeopleSoft software system. PeopleSoft provides a variety of fields to create account coding logic, or code block. The account coding string consists of seven fields. It is important to understand the intended purpose of each field within the account coding string. In addition, the system also handles the distribution of both direct and indirect costs to the operating companies.

All transactions will use the account coding string listed below. The coding is comprised of seven separate fields, each representing an important characteristic of the underlying transaction.



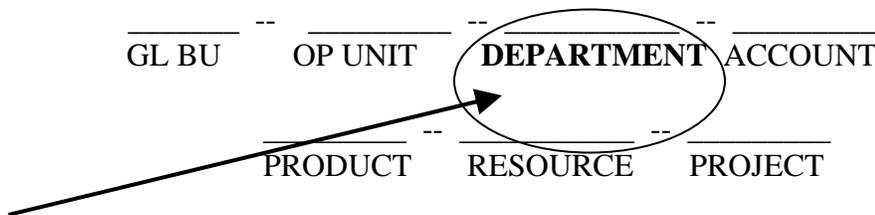
General Ledger Business Unit (“GL BU”):

- Five (5) character alpha field.
- The business unit field is used to identify the company that will be receiving the charges, either as a direct cost or an indirect cost.
- The business unit will default based on the operating unit (Op Unit), as described below.



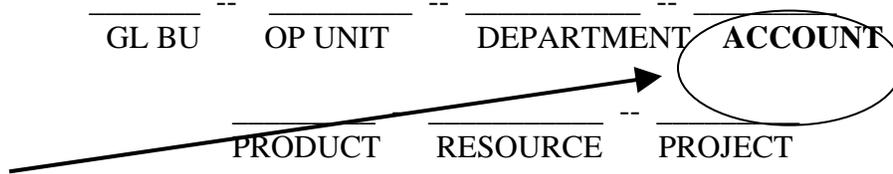
Operating Unit (“Op Unit”):

- Six (6) character numeric field.
- The operating unit allows for the grouping of multiple departments.
- The operating unit will default based on the department, as described below.
- The operating unit field is used to create direct charges to GL BUs by overriding the default operating unit for that department.



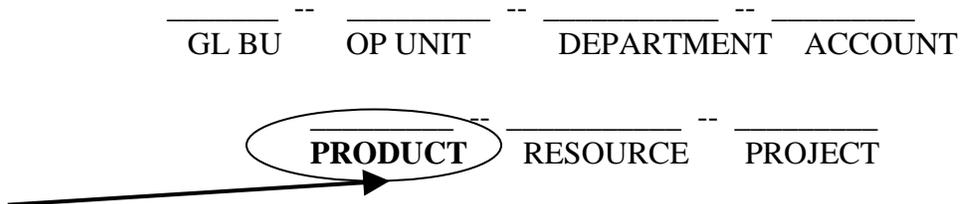
Department:

- Four (4) character numeric field
- The department represents a functional group or cost center
- The department will default the operating unit
- Each employee has been assigned to a department



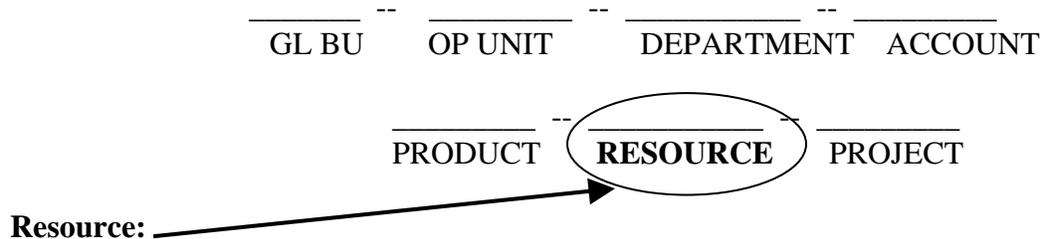
Account:

- Six (6) character numeric field
- Based on the FERC Chart of Accounts



Product:

- Three (3) character numeric field
- Identifies the product line
- Examples of product line include electric, gas, non-regulated



Resource:

- Four (4) character numeric field
- Represents the type of cost
- Examples include labor, meals, office supplies, etc.

Service - Rapid City department indirect costs is customers. Therefore, the indirect costs will be allocated based upon the Customer Count Factor.

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. This factor equally weights three different general factors: Gross Margin, Net Plant, and Payroll Dollars. These factors were chosen to be included in the General Allocator Factor because they best allocate costs based on the diverse nature of BHUH operations.

A list of all allocation factors, including a brief description of the factor, the basis for the calculation of the factor, and the department to which that factor has been assigned, is attached hereto as Appendix 2.

Changing Allocation Factors

Allocation factors are set at the first of the year, based upon financial information from the prior year ending December 31st. The factors for Net Plant, Employee Count, and Customer Count are based on values as of the previous period ending December 31st. The factors for Gross Margin, Payroll Dollars, and Net Energy Sales 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 BHUH 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 BHUH to not recalculate all allocation factors. Rather, allocation 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 dollars 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 dollars for the other companies will not be changed. However, the factors will change because the base against which the factors are calculated will change. Operating companies would normally see decreased factor values with acquisitions, and increased factor values with divestitures. Changes will be effective as of the beginning of the month, and will apply to all transactions for the month.

Any changes to indirect allocation factors are initiated by one member of the allocations staff and reviewed by another member of the allocations staff. All changes are documented in memo format, with the supporting documentation maintained. Allocation factors loaded into the system are reviewed by someone other than who input the factors into the system.

Allocating Fixed Assets

BHUH maintains certain fixed assets that are used by and benefit all operating companies. These fixed assets primarily consist of computer hardware and software and shared office facilities. Because these fixed assets support all operating companies, they are allocated monthly as part of the month-end close process, along with the allocation of these assets' accumulated depreciation and the related deferred tax. Construction or Work in Process balances are not allocated.

After all fixed asset and depreciation journal entries and reconciliations for month-end are completed, a journal entry is prepared to allocate the fixed assets, accumulated depreciation, and deferred tax. This journal entry debits fixed assets and deferred tax and credits accumulated depreciation on the general ledger of each operating company, and credits fixed assets and deferred tax and debits accumulated depreciation at BHUH. This journal entry is set to auto-reverse so that balances will be restored to BHUH as of the first of the following month. This allows fixed asset additions, dispositions, depreciation, and deferred tax to be managed at BHUH, with only ending balances allocated to the operating companies.

The allocation factor used to allocate assets, accumulated depreciation, and deferred tax will vary depending on the type of asset being allocated, and will be based on the function the asset is serving. For instance, customer service software is allocated based on the Customer Count Factor, while general office space is allocated using the General Allocator Factor.

Allocating Inventory

As noted above, the gas metershop is a BHUH department. This department serves gas utility operating companies. As gas meters are purchased, they are recorded as inventory by BHUH. When gas meters are placed into service, they are issued out of inventory to the specific operating company that will install the meter and they become a fixed asset for that operating company. At month-end, a manual journal entry is prepared to allocate the inventory balance of BHUH. The Customer Count Factor is used for this allocation.

Appendix 1

BHUH Departments

Gas Supply Services Administration (2301)

Description: Provides for the development and execution of the gas supply portfolio plans for all gas distribution and gas supply needs for power plants. This plan includes purchasing strategies for the commodity and optimization and procurement of pipeline capacity and services.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Gas Supply Services Cost Management (2309)

Description: Validates and pays all gas supply and transportation-related invoices. Insures proper allocation of these costs to the various operating companies.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Gas Supply Services Planning and Forecasting (2318)

Description: Provides for the development and execution of the gas supply portfolio plans for all gas distribution and gas supply needs for power plants. This plan includes purchasing strategies for the commodity and optimization and procurement of pipeline capacity and services.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Gas Supply Services Operations (2319)

Description: Provides for the development and execution of the gas supply portfolio plans for all gas distribution and gas supply needs for power plants. This plan includes purchasing strategies for the commodity and optimization and procurement of pipeline capacity and services.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Corporate Services - Omaha (4015)

Description: Provides corporate services to the Omaha facilities, including utilities, maintenance and lease expense.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Security Services - Omaha (4026)

Description: Provides for security services for the Omaha facilities.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Environmental (4090)

Description: 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: Indirect costs of this department are allocated using the General Allocator Factor.

BHUH Benefits (4402)

Description: Utilized for charging out benefits, including medical costs, to the operating companies.

Method of Allocation: Indirect costs of this department are allocated using the Budgeted Labor Factor.

BHUH Accounting Accruals (4474)

Description: Created to facilitate the accrual of certain charges not related to specific departments or not significant enough to allocate to each department.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Network Gas Standards and Safety Training (5254)

Description: Establishes and monitors network-wide gas standards and coordinate mapping activities for all gas service states.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Net Ops Work Management (5305)

Description: Researches, builds and implements work management solutions for the benefit of electric and gas network operations. This department also supports STORMS, FAME and network requests.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Meter shop General (5490)

Description: Manages and provides gas measurement support to field operations located in gas service states.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Utility Accounting (5670)

Description: Assists in the compliance with regulatory accounting requirements. Assists in the preparation of budgets for the operating companies. Prepares various operating and financial reporting for utility management. Assists with the regulatory strategy for the operating companies.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Safety (5672)

Description: Develops and implements safety planning activities and provides employee safety education. Assists with the administration of the corporate safety program. Assists with compliance with DOT, OSHA, and MSHA regulations.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Customer Service Executive Management (5674)

Description: Provides general direction and supervision of customer service activities. Encourages the safe, efficient and economical use of the utilities services.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

IT Business Applications (5678)

Description: Manages, maintains, and supports the primary business applications of the regulated utilities, primarily CIS+.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

IT Infrastructure Services (5680)

Description: Manages, maintains, and supports data center operations, infrastructure servers, storage, system software, enterprise architecture, and corporate databases of the regulated utilities.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Electric Executive Management (5682)

Description: Provides guidance, direction and management to overall electric utility activities.

Method of Allocation: Indirect costs of this department are allocated using the Net Energy Sales Factor.

Gas Utility Services (5688)

Description: Provides gas business and planning services, including gas marketing. Searches for competitive business opportunities and energy solutions.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Gas Executive Management (5690)

Description: Provides guidance, direction and management to overall gas utility activities.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Customer Service Center - Lincoln (5701)

Description: Answers and resolves customer inquiries for both regulated and non-regulated customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Customer Account Services - Omaha (5702)

Description: Assists customers with billing, payment and collection issues.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Customer Service Support - Rapid City (5703)

Description: Provides support to customer services areas through training, revenue assurance analysis, quality analysis, business analysis and customer and community communication.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Customer Account Services – Rapid City (5704)

Description: Assists customers with billing, payment and collection issues.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Customer Service – Rapid City (5705)

Description: Answers and resolves customer inquiries for both regulated and non-regulated customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Billing - Omaha (5706)

Description: Manages and maintains regulated and non-regulated sales and billing of gas to large volume customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Accounts Receivable Management (5708)

Description: Prepares monthly metrics reporting, performs compliance testing and performs other general business analysis tasks for the Customer Service groups.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Customer Communication - Stakeholder Outreach (5711)

Description: Prepares and distributes customer communication for regulated and non-regulated activities for all states. These communications include customer notifications, advertising and promotional information.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Bill Processing (5712)

Description: Prepares, assembles, inserts and distributes customer mailings for both regulated and non-regulated customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Field Resource Center - Lincoln (5715)

Description: Schedules and dispatches premise service activities to both regulated and non-regulated customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Field Resource Center - Rapid City (5717)

Description: Schedules and dispatches premise service activities to both regulated and non-regulated customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Service Guard Materials Management (5718)

Description: Manages and maintains requirements for non-regulated appliance service activities.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Communications (5721)

Description: Provides advertising and branding development for the companies within Colorado, Iowa, Kansas and Nebraska. Responsible for media relations. Works in conjunction with the corporate Communication group.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Supply Chain (5724)

Description: Provides purchasing and strategic sourcing services. Manages contracts, including drafting, negotiating, reviewing and interpreting contracts. Provides fleet management services. Provides oversight of the materials management functions for the utility operating companies.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Service Guard Central Marketing (6005)

Description: Provides and manages product development for consumer marketing with the primary focus on appliance options business for non-regulated customers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Customer Services Training (6016)

Description: Oversees training in all customer service centers.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Process Improvement (6134)

Description: Helps identify solutions to improve work processes, maximize business performance and add value for customers and stakeholders.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

PS Engineering/Generation Services (6162)

Description: Provides power supply engineering and generation services to Black Hills Colorado Electric.

Method of Allocation: Indirect costs of this department are allocated using the Net Energy Sales Factor.

Headquarters - KS/CO Gas (6183)

Description: Manages the gas transmission and distribution activities for the states of Kansas and Colorado.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Customer Relations – KS/CO Gas (6184)

Description: Works directly with customers in the areas of builder relations, economic development and customer relations.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

KS/CO Gas Business Operations (6198)

Description: Assists with the management of the gas transmission and distribution activities for the states of Kansas and Colorado.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

NE Lincoln Ops Facility and CSC (6313)

Description: Provides corporate services to the Lincoln Call Center, including utilities, maintenance and lease expense.

Method of Allocation: Indirect costs of this department are allocated using the Customer Weighted Square Footage Factor.

Human Resources Networks (6327)

Description: Responsible for providing human resources functions, which include compensation, benefits administration, sourcing (recruitment), and employee relations.

Method of Allocation: Indirect costs of this department are allocated using the Employee Count Factor.

HR Central Safety (6328)

Description: Assists with the administration of the corporate safety program.

Method of Allocation: Indirect costs of this department are allocated using the Employee Count Factor.

Appliance Technical Training (6331)

Description: Designs and implements safety programs and incentives, incident investigation, hazard identification and problem solving, and appliance repair technical skill training.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

IT Business Services (6348)

Description: General administration associated with the development of information technology solutions supporting all utility operating companies.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

IT Field Support (6357)

Description: Assists with the implementation of information technology solutions through on-site and remote field support.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

IT Customer Service Applications (6360)

Description: Responsible for maintaining volume forecasting, marketing and billing production applications, including charges for operations management, systems maintenance, and systems support.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Regulatory Administration (6370)

Description: Assists with the regulatory, legislative and environmental services provided to the gas operating companies.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Regulatory Services - Gas (6372)

Description: Supports and manages all gas regulatory filings, rate cases, and regulatory issues.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Regulatory Legislative Services - KS/CO (6377)

Description: Monitors and communicates legislative activities affecting utility and business operations in Kansas and Colorado.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Regulatory Accounting Services – Gas (6384)

Description: Prepares and manages all gas regulatory filings and commission requests for all gas operating companies. Manage non-regulated review and reporting. Files Cost Allocation Manuals as required. Performs PGA analysis and filings for all gas entities.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

IT Networks Telecom (6397)

Description: Provides IT telecommunication support to customer call center networks.

Method of Allocation: Indirect costs of this department are allocated using the Customer Count Factor.

Black Hills Service Company Charges (9401)

Description: Created to facilitate the allocation of certain corporate charges, not related to specific departments, to the appropriate operating companies.

Method of Allocation: Indirect costs of this department are allocated using the General Allocator Factor.

Appendix 2

Allocation Factors

Any asset factors and employee and customer 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.

Net Plant Factor – Based on the total net plant, defined as gross plant less accumulated depreciation, as of December 31 for the prior year, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies. Net plant is limited to property, plant, and equipment, and includes construction or work in process.

No departments utilize this factor, but it is a component in the General Allocator Factor.

Gross Margin Factor – Based on the total gross margin for the prior year ending December 31, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies. Gross margin is defined as revenue less cost of sales.

No departments utilize this factor, but it is a component in the General Allocator Factor.

Payroll Dollar Factor – Based on the payroll dollars for the prior year ending December 31, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies.

No departments utilize this factor, but it is a component in the General Allocator Factor.

General Allocator Factor – A composite factor comprised of an average of the Net Plant Factor, the Payroll Dollar Factor, and the Gross Margin Factor. These factors are equally weighted.

Departments that utilize this factor include:

- Utility Accounting
- Black Hills Service Company Charges
- Corporate Services - Omaha
- Security Services - Omaha
- Environmental
- Safety
- Process Improvement
- Regulatory Administration
- Headquarters – KS/CO Gas
- KS/CO Gas Business Operations
- IT Infrastructure Services

- Supply Chain
- Gas Utility Services
- Gas Executive Management
- Regulatory Services - Gas
- Regulatory Accounting Services - Gas
- Service Guard Materials Management
- Appliance Technical Training
- Regulatory Legislative Services - KS/CO
- IT Business Services
- IT Field Support.
- BHUH Accounting Accruals

Employee Count Factor – Based on the number of employees at the end of the prior year ending December 31, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies.

Departments that utilize this factor include:

- Human Resources Networks
- HR Central Safety

Customer Weighted Square Footage Factor – Based on the customer weighted square footage at the end of the prior year ending December 31, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies.

Departments that utilize this factor include:

- NE Lincoln Ops Facility and CSC

Customer Count Factor – Based on the number of customers at the end of the prior year ending December 31, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies.

Departments that utilize this factor include:

- Gas Supply Services Administration
- Gas Supply Services Cost Management
- Gas Supply Services Planning and Forecasting
- Gas Supply Services Operations
- Network Gas Standards and Safety Training
- Service Guard Central Marketing
- Billing - Omaha
- Metershop General
- Communications
- Customer Service Support – Rapid City
- Customer Account Services – Rapid City
- Customer Service - Rapid City

- Customer Service Center – Lincoln
- Customer Account Services – Omaha
- Accounts Receivable Management
- Bill Processing
- Customer Services Training
- Customer Service Executive Management
- IT Business Applications
- IT Customer Service Applications
- IT Networks Telecom
- Customer Communication – Stakeholder Outreach
- Field Resource Center - Lincoln
- Net Ops Work Management
- Customer Relations – KS/CO Gas
- Field Resource Center - Rapid City

Net Energy Sales Factor – Based on the net energy sales for the prior year ending December 31, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies.

Departments that utilize this factor include:

- PS Engineering/Generation Services
- Electric Executive Management

Budgeted Labor Factor – Based on the budgeted labor for the current period budget, the numerator of which is for an applicable operating company and the denominator of which is for all applicable operating companies.

Departments that utilize this factor include:

- BHUH Benefits