Montana Distribution System Infrastructure Project (DSIP)

As part of our commitment to maintain high level reliability and system performance we continue to evaluate the condition of our distribution assets to address aging infrastructure through our asset management process. The primary goals of our infrastructure investment are to reverse the trend in aging infrastructure, maintain reliability, proactively manage safety, build capacity into the system, and prepare our network for the adoption of new technologies. We are working on various solutions taking a proactive and pragmatic approach to replace these assets while also evaluating the implementation of additional technologies to prepare the overall system for smart grid applications. We formed an Infrastructure Stakeholder Group to assist us as we considered possible future scenarios for investment in our distribution system and evaluated the potential impacts of different scenarios to rates and future service quality.

Based on discussions with this Infrastructure Stakeholder Group and our assessments of necessary improvements to our system, during 2011 we developed a technical plan detailing recommended actions and estimated costs of implementing the DSIP. While we were preparing the technical plan, we requested and received MPSC approval of an accounting order to defer certain incremental operating and maintenance expenses. The accounting order allows us to defer up to $16.9 million of expenses incurred during 2011 and 2012 and amortize these expenses associated with the phase-in portion of the DSIP over five years beginning in 2013. As of December 31, 2011 we have deferred incremental expenses of approximately $4.9 million and incurred approximately $15.2 million of DSIP-related capital expenditures.

We presented the technical plan during an informational meeting to the MPSC on October 31, 2011. Based on the technical plan, we are currently estimating incremental DSIP expenses of approximately $12.0 million (which will be deferred under the accounting order) and approximately $18.2 million of DSIP capital expenditures during 2012. In addition, we are projecting approximately $72.0 million of incremental DSIP expenses and approximately $253.0 million of DSIP capital expenditures over a five-year time span beginning in 2013. Based on our current forecast, along with the MPSC's approval of the accounting order, we believe DSIP-related expenses and capital expenditures will be recovered in base rates through annual or biennial general rate cases.

Supply Investments

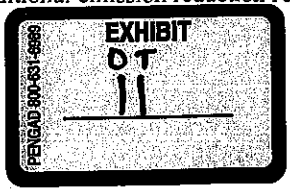
Wind Generation

In April 2011, we executed an agreement to purchase a wind project in Judith Basin County in Montana to be developed and constructed by Spion Kop Wind, LLC, a wholly-owned subsidiary of Compass Wind Projects, LLC that would provide approximately 40 MW of capacity, with an estimated cost for the total project of approximately $86 million. We filed an application for pre-approval with the MPSC during the second quarter of 2011 to include the project in regulated rate base as an electric supply resource. Both the energy and associated renewable energy credits would be placed into the electric supply portfolio to meet future customer loads and renewable portfolio standards obligations. In November 2011, we filed a joint stipulation with the MCC, proposing an authorized rate of return of 7.40%, which was computed using a 10.00% return on equity, a 5.00% estimated cost of debt and a capital structure consisting of 52% debt and 48% equity. The stipulation also provided that we will include the Spion Kop project in our next full general rate case, so that its cost of capital and capital structure can be determined on a consolidated basis with the rest of our Montana electric utility operations. An uncontested hearing was held in December 2011. In February 2012, the MPSC held a work session and verbally approved the project. The approval includes a condition that would reduce our revenue requirement if the average production failed to meet a minimum threshold for the first three years. We expect a final written order to be issued during the first quarter of 2012, and will evaluate our options. If the MPSC fails to grant approval to the satisfaction of both parties on or before April 1, 2012, then either party may terminate this agreement. Material construction would not commence until we receive a favorable ruling from the MPSC. Assuming satisfactory approval by April 1, 2012, commercial operation is projected to begin by December 31, 2012.

South Dakota Electric

During 2011, we began construction on a 60 MW peaking facility located in Aberdeen, South Dakota, which we expect to achieve commercial operation before the 2013 summer season. This facility will provide peaking reserve margin necessary to comply with capacity reserve requirements. As of December 31, 2011, we have capitalized approximately $17.1 million associated with this project and we expect additional capital expenditures of approximately $44.4 million during 2012.

The Big Stone and Neal #4 facilities are subject to additional emission reduction requirements. We are working with the joint



owners of the facilities to evaluate options. Based upon current engineering estimates, capital expenditures for these environmental related technologies are estimated to be approximately $490 million for Big Stone (our share is 23.4%) and approximately $270 million for Neal #4 (our share is 8.7%). Neal #4 began incurring such costs in 2011 and the costs are