

# Black Hills Service Company

## Cost Allocation Manual

Effective Date: July 14, 2008

Amended: January 1, 2010

Amended: August 1, 2010

## **Black Hills Service Company Cost Allocation Manual Table of Contents**

1. Introduction	3
2. Service Company Organization	3
3. Direct and Indirect Costs	4
4. Transaction Coding	5
a. GLBU	
b. Operating Unit	
c. Department	
d. Account	
e. Resources	
f. Product	
5. Timekeeping	8
6. Loadings	8
7. Allocation Factors	9
8. Changing Allocation Factors	9
9. Subsidiary Payments for Direct and Indirect Charges	10
10. Allocating Fixed Assets	10
Appendix 1 - BHSC Departments	12
Appendix 2 – Allocation Factors	17

## **Introduction**

The purpose of this cost allocation 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 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 In August of 2005, this law was repealed and replaced by the Public Utility Holding Company Act of 2005, which is administered by the Federal Energy Regulatory Commission (FERC).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 project 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. A list of each department, as well as a brief description of the services they provide, is attached as Appendix 1.

## 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 Denver to complete audits for Enserco and Black Hills Exploration and Production. 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, one meal to Enserco, the next meal to BHEP, etc.
- 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 BHC consolidated, 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 to consider two things when determining if a cost is a direct cost or an indirect cost: (1) Can the costs that are coded to a specific company or group of companies be substantiated; 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 expenses that follow these rules:

Always considered direct costs:

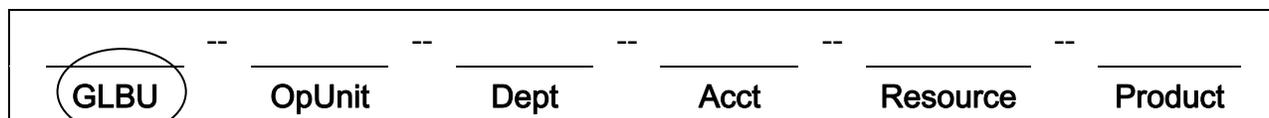
- Capitalized costs for non-BHSC projects (including capitalized labor)
- Corporate development project costs
- Retiree healthcare costs

Always considered indirect costs:

- PTO and Holiday labor (they are included as a component of overhead)
- Corporate-wide bonuses and other similar 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

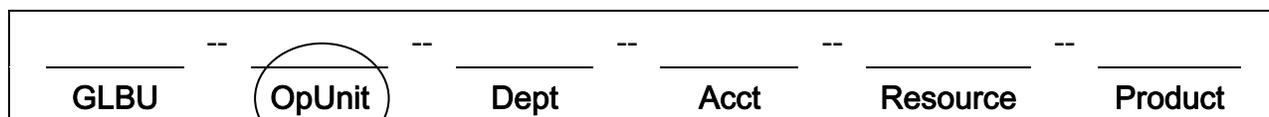
## **Transaction Coding**

The Service Company uses an accounting software system to accumulate and distribute both direct costs and indirect costs. It is important to have costs properly classified as direct or indirect. Direct costs will be directly charged to the subsidiaries, while indirect costs will be allocated to the subsidiaries using pre-defined allocation factors. Below is a description of the coding.



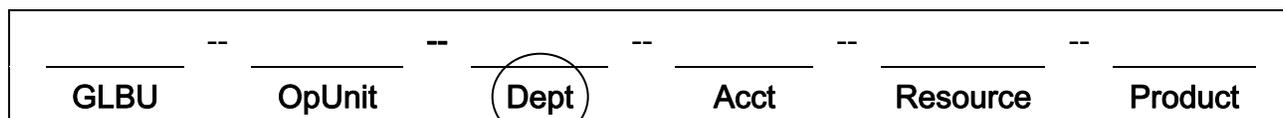
**General Ledger Business Unit (GLBU):**

- Five (5) character numeric field.
- The GLBU is used to identify the company that will be receiving the charges.
- The GLBU is required on all accounting transactions.
- The GLBU is auto-populated by default when the OpUnit is entered.



**Operating Unit (OpUnit):**

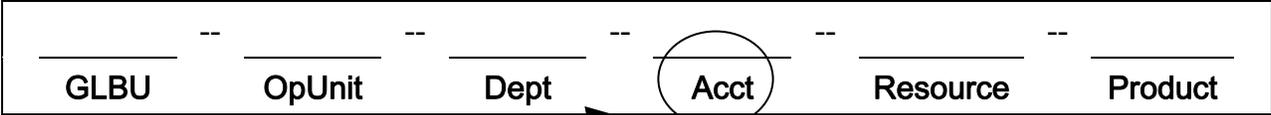
- Six (6) character numeric field.
- The OpUnit field is used to identify the account code block as either a direct cost or an indirect cost.
- If the cost is a direct cost, the OpUnit field will be populated using the OpUnit code for the company being directly charged.
- If the cost is an indirect cost, the OpUnit field will be populated using the general Service Company OpUnit 701600. Indirect costs also include costs directly related to the Service Company.



**Department (Dept):**

- Four (4) character numeric field.
- The Dept field is used to identify where the cost(s) originated.

- The Dept field is required on all income statement and capital transactions.
- Every Dept is assigned to a GLBU.



**Account (Acct)**

- Six (6) character numeric field.
- The Account field is required on all accounting transactions.
- All companies will use the same Chart of Accounts though some values will be specific to certain companies.



**Resource (PS Resc):**

- Four (4) character numeric field.
- A Resource is used to indentify types of costs.
- The Resource field is required on all income statement and capital accounting transactions.



**Product (Prod):**

- Three (3) character numeric field.
- A Product code is used to identify business lines.

## **Timekeeping**

All Service Company employees are required to complete a timesheet for each two week pay period. Timesheets of all employees must be approved by a supervisor.

Employees must complete the code block, as previously discussed, for each time record. The timesheet will default the employees' payroll department and resource. However, the employee is responsible for providing the remainder of the code block. Employees are encouraged to enter their time in one half hour increments, although they may use smaller increments if they so choose.

## **Loadings**

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 a loading rate that is added on to each payroll dollar.

The loading rates are calculated at the beginning of the year based upon budgeted benefit expenses and budgeted labor and are reviewed monthly and updated as needed. These rates are loaded into the accounting system. Below is a list of components of the loading rates:

### **General loadings:**

- Compensated Absences: including PTO, Holiday, Jury duty, Funeral pay, United Way day and Annual Physical appointment.
- Payroll Taxes: including FICA, FUTA SUTA and city taxes
- Employee Benefits: including health and medical, 401K match and fees, Pension, Retiree healthcare and associated fees and Pension audit fees
- Incentives: including Non-officer bonus plans, Restricted Stock and Stock Option expense

### **Supplemental loadings:**

- Officer bonus plans
- Long-term disability
- Officer pension benefits

At the end of each month, loadings calculated on payroll using the loading rates must be true-ed 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. Loadings calculated on payroll are based on an estimated rate and budgeted benefits, so differences between actual benefits will be inherent to this process. The main reasons for the difference is the employee benefit costs differ from the budget payroll differs from budget or timing. After the difference is calculated and reviewed for reasonableness, it is recorded to a separate department, and 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 using one of several pre-defined allocation factors. Each department has been assigned one of these allocation factors. All indirect costs of that department 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 department. For instance, the expenses incurred by a 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 departments 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.

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. All medical costs of BHC are paid by the Service Company and allocated to subsidiaries based on employee counts.

Appendix 2 includes a list of all allocation factors, including a brief description of the factor, the basis for the calculation of the factor, and the departments 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.

## **Changing Allocation Factors**

Allocation factors are set at the first of the year, based upon financial information from the prior year ending December 31<sup>st</sup>. Assets, utility assets, employee counts, and power generation capacity are based on values as of the previous period ending

December 31<sup>st</sup>. Gross margin, utility gross margin, payroll dollars, and utility payroll dollars are based on values for the 12 months ended December 31<sup>st</sup>.

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, allocation factors will be adjusted with pro forma adjustments. 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 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.

Any changes to indirect allocation factors are initiated by one member of the allocations staff and reviewed by the Financial Manager of the Service Company. Allocation factors loaded into the system are reviewed by someone other than who input the factors into the system.

### **Subsidiary Payment for Direct and Indirect Charges**

It is the policy of the Service Company to insure payments are made by the subsidiary companies for direct and indirect charges. All payments for direct and indirect charges must be remitted to the Service Company by the end of the following month. Payment requests will be provided directly to the accounts payable departments of the subsidiary companies. The Service Company will monitor payments received during the month to insure that all subsidiary companies make payment in a timely manner.

### **Allocating Fixed Assets**

The Service Company maintains certain fixed assets that are used by and benefit multiple Black Hills Corporation subsidiaries. These fixed assets primarily consist of computer hardware and software that form the corporate-wide information technology network. Because these fixed assets support multiple Black Hills Corporation subsidiaries, they are allocated to the appropriate subsidiaries monthly as part of the

month-end close process, along with the allocation of these assets' accumulated depreciation.

Allocated assets and accumulated depreciation are maintained in separate general ledger accounts at the subsidiary level so that they are not intermingled with regular subsidiary fixed assets, and for ease of reconciliation.

The allocation factor used for fixed assets and accumulated depreciation is the Blended Ratio, except as otherwise noted. Depreciation expense is allocated using the same ratio as the asset.

## APPENDIX 1

### BHSC DEPARTMENTS

*Accounting Systems (4700)* – Maintains the corporate wide accounting systems of Black Hills Corporation, most notably the general ledger and financial statement preparation systems. (Blended Ratio)

*Accounts Payable (4701)* – Processes payments to vendors and prepares 1099s and applicable documentation for the majority of Black Hills Corporation subsidiaries. (Blended Ratio)

*Corporate Development (4702)* – Facilitates the development of the corporate strategy, prepares strategic plans, and evaluates potential business opportunities. (HoldCo Blended Ratio)

*Corporate Governance and Shareholder Services (4703)* – 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. Provides various recordkeeping and administrative services related to shareholder services. Assists in the administration of equity-based compensation plans. (HoldCo Blended Ratio)

*Tax (4704)* – 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. (Blended Ratio)

*Credit and Risk (4705)* – Provides risk management, risk evaluation, and risk analysis services. Provides support to the Executive Risk Committee. Evaluates contract risks. (Blended Ratio)

*Legal - Corporate (4706)* – 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. (Blended Ratio)

*Environmental Services (4709)* – 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. (Asset Ratio)

*Executive Management (4710)* – Provides overall oversight of Black Hills Corporation subsidiaries. Provides the Board of Directors information for decision making purposes. (HoldCo Blended Ratio)

*Safety (4711)* – Develops and implements safety planning activities and provides employee safety education. Administers the corporate safety program. Assists with compliance with DOT, OSHA, and MSHA regulations. (Employee Ratio)

*Finance and Treasury (4712)* – 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. (HoldCo Blended Ratio)

*Financial Reporting (4713)* – 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. (HoldCo Blended Ratio)

*Budget and Forecasting (4714)* - Oversees the accumulation of subsidiary financial budgets and forecasts. Provides the consolidation of the corporate wide budget and forecast. Guides the preparation of strategic plans. (Blended Ratio)

*General Accounting (4715)* – Provides maintenance of accounting and financial reporting, researches emerging accounting issues, and assists in the compliance of all accounting rules and regulations. (Blended Ratio)

*Accounting- Central Services (4716)* – Maintains the accounting records for Black Hills Service Company and Black Hills Corporation. Provides oversight of Accounts Payable, Payroll, and Property Accounting departments. (Blended Ratio)

*Accounting-Generation Services (4717)* – Provides general ledger accounting to non-regulated generation facilities and accounting support to all generation facilities. (Generation Capacity Ratio)

*Human Resources Corporate (4718)* – Establishes and administers policies related to employment, compensation and benefits. Provides general HR support services. (Employee Ratio)

*Human Resources Regulated (4720)* – Administers policies related to employment, compensation and benefits for the regulated subsidiaries. Provides general HR support services to the regulated subsidiaries. (Employee Ratio)

*Compensation and Benefits (4721)* – Administers policies related to compensation and benefits. Oversees the self-insured medical benefits plans and provides support to the third party administrators of the plans. (Employee Ratio)

*Organization Development and Training (4722)* – Provides technical and professional development training. Provides general HR support services. (Employee Ratio)

*Insurance (4724)* – Facilitates physical risk management strategies through the purchase and evaluation of various types of insurance coverage. Provides claims management services. (Blended Ratio)

*Internal Audit (4725)* – Reviews internal controls and procedures to ensure assets are safeguarded and transactions are properly authorized and recorded. Oversees the Sarbanes Oxley compliance efforts. (Blended Ratio)

*Company Communications (4726)* – Provides oversight to the corporate communications processes. Provides communications to investors and the financial community. Provides advertising and branding development for the companies within Black Hills Corporation. Responsible for media relations. Manages and tracks all contributions made on behalf of Black Hills and its subsidiaries, as well as Black Hills Corporation Foundation. Assists in the preparation of the annual report. (Blended Ratio)

*Payroll (4727)* – 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. (Employee Ratio)

*Power Delivery Management (4728)* – Performs resource planning, power delivery management, strategic planning, and construction management for the corporation's power generation assets. (Generation Capacity Ratio)

*Property Accounting (4729)* – Maintains the accounting records for property, plant and equipment for the majority of subsidiaries of the corporation. Assists in the compliance with regulatory accounting requirements as it relates to property. Prepares various operating and financial reporting for management. (Asset Ratio)

*Records Management (4730)* – Administers and maintains the records retention policies and procedures of the corporation. Manages and maintains the content management software. (Blended Ratio)

*Supply Chain Management (4731)* – Develops strategies and provides general oversight to Facilities, Contract Management, Strategic Sourcing, Fleet Services, Materials Management and Supplier Diversity departments. (Blended Ratio)

*Contracts Management (4732)* – Manages contracts, including drafting, negotiating and reviewing and interpreting contracts. (Blended Ratio)

*Strategic Sourcing (4733)* – Executes the procurement process including, purchasing activities, managing vendor relationships, and issue resolution and tracking and expediting orders. (Blended Ratio)

*Fleet Services (4734)* – Manages fleet expense cards, fleet contracts, vehicle purchasing, replacement and disposal and licensing and registration. Manages vehicle maintenance schedules. (Blended Ratio)

*Supplier Diversity (4735)* – Develops new sources of supply for all types of products and services and promotes the inclusion of diverse suppliers into the supply chain bidding process. (Blended Ratio)

*Facilities Management (4736)* – Provides facility, construction, and real estate management services for corporate-wide facilities. Supports disaster recovery and business continuation planning. (Blended Ratio)

*Utility Communications (4737)* – Manage and create internal and external communications for the utility companies. Provides advertising and branding development for the utility companies within Black Hills Corporation. (Utility Blended Ratio)

*Creative Services (4738)* – Provides graphical support to internal and external communications, advertising and branding for the companies within Black Hills Corporation. Maintains logo standards. (Blended Ratio)

*Federal Governmental Affairs (4739)* – Monitors, reviews, and researches government legislation and acts as a liaison with legislators. Manages the company's lobbying strategy. (Blended Ratio)

*Regulatory Management (4740)* - Manages all aspects of regulatory requirements and relationships. (Blended Ratio)

*State Governmental Affairs (4741)* – Monitors, reviews, and researches government legislation and acts as a liaison with legislators. Maintains relationships with local and state governmental bodies. (Blended Ratio)

*Information Technology Administration (4742)* – Provides guidance, governance, and strategic planning to the overall information technology operations. Provides liaison services between information technology departments and their business partners. (Blended Ratio)

*Information Technology Business Applications Financial and HR Systems (4743)* – Manages, maintains, and enhances the financial and human resource related business applications of the company. (Blended Ratio)

*Information Technology Business Applications (4744)* – Manages, maintains, and enhances business applications within the utility companies. (Utility Blended Ratio)

*Information Technology Business Applications Web Service Support (4745)* – Manages, maintains, and enhances the web-based service business applications of the company. (Blended Ratio)

*Information Technology Business Applications Wholesale and Enterprise Systems (4746)* – Manages, maintains, and enhances the wholesale and enterprise-wide business applications of the company. (Blended Ratio)

*Information Technology Infrastructure Services (4747)* – Manages, maintains, and enhances data center operations, infrastructure servers, storage, system software, enterprise architecture, and corporate databases. (Blended Ratio)

*Information Technology Communications (4748)* – Manages and supports the data and voice communication needs for the company. Provides telecommunication expense management services. (Blended Ratio)

*Information Technology User Services (4749)* – Provides technology support services for the company, including field services, the help desk, and technology integration. (Blended Ratio)

*Corporate Security (4750)* – Manages and supports the systems that provide both information and physical security services for the company. (Blended Ratio)

*Information Technology Compliance (4751)* – Responsible for internal and external audit compliance, disaster recovery, change management and legal compliance related to technology. (Blended Ratio)

*Materials Management (4752)* – Manages inventory, obsolescence and scrap. Ensure availability of proper materials. Pull, restock and stage materials. (Blended Ratio)

*Process Improvement (4753)* - Helps identify solutions to improve work processes, maximize business performance and add value for customers and stakeholders. (Blended Ratio)

*Generation Plant Operations (4754)* – Operates and manages the new generation for BHCOE and BHCIPP. (Nameplate Generation Ratio)

*Asset Blended (4793)* – Records depreciation for the Service Company assets. (Blended Ratio)

*Benefits Pooled (4794)* – Records those benefit costs, primarily related to health and welfare, for all companies to be pooled and allocated to subsidiaries. (Employee Ratio)

*Accounting Accruals (4795)* – Records accrual of certain charges not related to specific departments or not significant enough to allocate to each department. (Blended Ratio)

*Benefits Loading (4796)* - Records overhead benefit costs loaded to labor costs (Blended Ratio)

## **APPENDIX 2**

### **ALLOCATION FACTORS**

*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 FERC value, meaning that assets for the utility subsidiaries will not include any 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, but this elimination journal entry is not factored into the calculation of the Asset Cost Ratio.

The Environmental Services and Property Accounting departments utilize 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 departments utilize this ratio, but it is a component in both the Blended Ratio and the Holding Company Blended Ratio.

*Payroll Dollars Ratio* – Based on the total payroll dollars 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 dollars 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 departments 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 Dollars Ratio, and the Gross Margin Ratio. These factors are equally weighted. This factor is sometimes referred to as the general allocation factor.

Departments that utilize this ratio include Accounting Systems, Accounts Payable, Tax, Credit and Risk, General Accounting, Insurance, Internal Audit, Legal, Company Communications, Records Management, Supply Chain Management, Contract

Management, Strategic Sourcing, Fleet Services, Supplier Diversity, Facilities, Creative Services, Federal Governmental Affairs, Regulatory Management, State Governmental Affairs, Information Technology Administration, Information Technology Business Applications Wholesale and Enterprise, Information Technology Business Applications Web Service Support, Information Technology Business Applications Financial and HR Systems, Information Technology Infrastructure Services, Information Technology Communications, Information Technology User Services, Corporate Security, Information Technology Compliance, Materials Management, Process Improvement, Central Services, Budgeting & Forecasting, Assets Blended, Accounting Accruals, Benefits, Retiree and BHSC portion of the Rapid City Plant Street Facility and Bellevue Data Center Facility.

*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 Dollars Ratio, and the Gross Margin Ratio. These factors are equally weighted.

Departments that utilize this ratio include Corporate Development, Corporate Governance and Shareholder Services, Executive Management, Finance and Treasury and Financial Reporting.

In addition, a portion of directors and officer's insurance expense incurred through the Insurance cost center will be direct charged to the BHC Holding Company.

*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.

Departments that utilize this ratio include Payroll, Safety, Human Resources Corp., Human Resources Regulated, Compensation and Benefits, Organization Development, and Payroll. Health and welfare costs for BHC will be in a pool and allocated to subsidiaries based on the Employee Ratio.

*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 capacity in service and capacity under construction.

Departments that use this ratio include Power Delivery Management and Accounting-Generation Services.

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

subsidiaries will not include any 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, but this elimination journal entry is not factored into the calculation of the Utility Asset Cost Ratio.

No departments utilize this ratio, but it is a component in the Utility Blended Ratio

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

No departments utilize this ratio, but it is a component in the Utility Blended Ratio.

*Utility Payroll Dollars Ratio* – Based on the total utility payroll dollars for the prior year ending December 31, the numerator of which is for an applicable BHC utility subsidiary and the denominator of which is for all applicable BHC utility subsidiaries. Utility payroll dollars 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 departments utilize this ratio, but it is a component in the Utility Blended Ratio.

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

The Utility Communications and IT Business Applications departments utilize this ratio.

*Nameplate Generation Capacity Ratio* – Based on the total Colorado Airport Project 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. Nameplate generation includes capacity in service and capacity under construction at the Colorado Airport Project.

The Generation Plant Operations department utilizes this ratio.

*Square Footage Ratio* – The total square footage of a given facility, the numerator of which is for an applicable BHC subsidiary and the denominator of which is for all applicable BHC subsidiaries.

The Rapid City Plant Street Facility operating unit utilizes this ratio.