Exhibit 2
Direct Testimony
Lee Watkins

Before the South Dakota Public Utilities Commission
of the State of South Dakota

In the Matter of the Application of Black Hills Power, Inc d/b/a Black Hills Energy for Approval of its Tax Cut and Jobs Act Proposal

Docket No. EL18-___

June 29, 2018

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I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Lee Watkins. My business address is 7001 Mount Rushmore Rd., Rapid City, South Dakota 57702.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Black Hills Service Company, LLC ("BHSC") as the Vice President, Tax. My responsibilities involve overseeing all tax related matters pertaining to the consolidated group of companies that comprises Black Hills Corporation ("BHC") including those that affect Black Hills Power. Additional responsibilities include providing support to the regulatory team with respect to tax related matters for all entities that comprise the regulated business segment of Black Hills Corporation.

Q. FOR WHOM ARE YOU TESTIFYING ON BEHALF OF TODAY?

A. I am testifying on behalf of Black Hills Power, Inc. d/b/a Black Hills Energy ("Black Hills" or the "Company").

Q. PLEASE DESCRIBE YOUR EDUCATION AND BUSINESS BACKGROUND.

A. I have a Bachelor of Science degree in Accounting from the University of Alabama - Birmingham. I am a Certified Public Accountant in the states of Alabama and Georgia and a member of the American Institute of Certified Public Accountants.

Prior to joining BHC, I was an Executive Director with Ernst & Young, LLP in their National Tax - Power & Utilities practice from 2014 until joining BHC in the fall of 2016. Previously, from 2012-2014, I was the Vice President - Strategic Tax Practice for PowerPlan, Inc., which is a software company providing asset, tax and forecasting software for the power & utilities industry. Before joining PowerPlan, Inc. I was a Tax

Director at the Southern Company for ten years managing tax accounting, depreciation, regulatory and SEC tax reporting.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to explain how the passage of the Tax Cuts and Jobs Act ("TCJA") impacts the Company.

III. EFFECT OF THE TAX CUT AND JOBS ACT

Q. WHAT IS THE TCJA AND WHAT DOES IT CHANGE THAT AFFECTS THE COMPANY'S COST OF SERVICE?

A. The TCJA was signed into law on December 22, 2017. The TCJA amends the Internal Revenue Code of 1986 ("Tax Code") in several ways with key provisions that will affect customer rates. The following changes impacting regulated utilities resulted from the TCJA:

1. The Federal Corporate Income Tax rate ("FIT Rate") changed from 35% to 21% effective January 1, 2018;

2. Bonus depreciation is no longer available for public utility property placed in service after September 27, 2017;

3. As a result of the corporate rate change, Accounting Standard Codification ("ASC") 740 requires the revaluation of the Accumulated Deferred Income Tax ("ADIT") accounts as of December 31, 2017; and

4. For regulated entities, the FIT Rate change results in the creation of a regulatory liability account associated with the revaluation of these ADIT items to be included in rate base ("Regulatory Liability" or "Excess Deferred Federal Income Tax" or

"EDFIT"), that will be amortized and flowed back to customers as prescribed in the TCJA.

Q. PLEASE EXPLAIN THE REVALUATION OF ADIT NECESSITATED BY THE TAX RATE CHANGE UNDER THE TCJA.

A. Accumulated Deferred Income Taxes (ADIT) result from the differences in timing of recognizing income and expenses for book versus tax purposes. Those differences are tracked and recorded in a deferred tax asset or deferred tax liability and calculated in accordance with Generally Accepted Accounting Principles ("GAAP") based upon the tax rate in effect at the time it is recorded. As a result of the TCJA, the ADIT must be revalued to reflect the future value of those timing differences based on the lower tax rate. For non-regulated entities, the revaluation of deferred income taxes results in deferred tax expense or benefit in the period of enactment that is allocated to income from continuing operations. However, regulated entities are required by their regulators to return through future rates the portion of deferred taxes recovered from customers based on the higher pre-TCJA tax rates. These deferred taxes to be returned to customers are defined as Excess Deferred Federal Income Taxes ("EDFIT") and recorded as a regulatory liability in the period of enactment.

As an example of the revaluation, consider an expense recognized on the books of $100 that is not able to be recognized for income tax purposes until the following year, which would have an ADIT balance of $35 prior to the law change, calculated as the timing difference times the federal tax rate ($100 * 35%). The new 21% corporate tax rate would require the reduction of the ADIT to $21, again calculated as the timing difference times the federal tax rate ($100 * 21%). The $14 ($35 - $21) change is removed from the ADIT account and placed in the new Regulatory Liability, or EDFIT account, if the original $35 is included in the rate base ADIT calculation. The revalued ADIT balance reflects the amount the Company is expected to pay for future income tax expense and the EDFIT balance reflects the amount originally booked as future income tax expense, but that will now be returned to customers due to the change in the corporate tax rate. The ADIT balances represent both deferred tax assets and deferred tax liabilities.

Q. PLEASE DESCRIBE THE EXCESS DEFERRED FEDERAL INCOME TAX COMPONENTS AND RESTRICTIONS ON AMORTIZATION.

A. There are two components to the EDFIT balances. Black Hills would classify the first component as the balance subject to the income tax normalization requirements of the TCJA ("Protected EDFIT"), while the second component consists of the balance not subject to the normalization requirements ("Non-Protected EDFIT"). The TCJA specifically requires that EDFIT generally associated with property and specifically connected to the accelerated depreciation of property must be normalized into customer rates in a highly-prescriptive manner referred to as the average rate assumption method ("ARAM")[1] These EDFIT's are referred to as "Protected EDFIT". ARAM specifies that the utility cannot return to customers any of the EDFIT that is protected under the

[1] "ARAM" or "Average Rate Assumption Method" is defined as follows: The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, during the time period in which the timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying- (i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by (ii) the amount of the timing differences which reverse during such period.).

TCJA until the year in which the book depreciation expense is more than the tax depreciation on the underlying assets. Once this occurs, the utility begins to record the associated amount under ARAM at a rate no faster than the remaining book life of that asset. The Non-Protected EDFIT may be treated by the Commission like any other regulatory asset or liability in the rate setting process.

IV. BLACK HILLS' CLASSIFICATION OF PROTECTED AND NON-PROTECTED EDFIT

Q PLEASE DESCRIBE BLACK HILLS' COMPONENTS OF THE EDFIT AND RECOMMENDED IMPACT TO CUSTOMERS.

A. Black Hills' EDFIT balance consists of Protected EDFIT and Non-Protected EDFIT differences. The Protected EDFIT is subject to the normalization rules and is required to be returned to customers under the ARAM method. Black Hills' Non-Protected EDFIT is a regulatory asset to be recovered from South Dakota retail customers. BHP proposes to amortize the entire debit balance of Non-Protected EDFIT in 2018. The current estimated Non-Protected EDFIT for 2018 is a $1.4 million grossed-up regulatory asset on a total company basis. The current estimated Protected EDFIT to be returned to customers is anticipated to be a $1.4 million grossed-up regulatory liability on a total company basis. By amortizing all of the Non-Protected EDFIT in 2018, it matches well with the 2018 Protected EDFIT amount. The Black Hills' Protected and Non-Protected EDFIT balances are estimated at this time and are expected to be finalized in November 2018. Mr. White discusses the Company's proposal to address these balances in his direct testimony.

Q. WHY DO YOU RECOMMEND THIS TREATMENT OF THE NON-PROTECTED ITEMS?

A. Black Hills' Non-Protected EDFIT and associated regulatory liability is a negative number. Therefore, it is a debit balance on Black Hills' books. This means that it has not been recovered from Black Hills' customers.

Q. PLEASE EXPLAIN WHY THE NON-PROTECTED DEBIT BALANCE HAS NOT BEEN RECOVERED FROM CUSTOMERS.

A. The Protected EDFIT credit balance represents an over recovery of tax expense from customers due to the corporate rate reduction from 35% to 21% for expense items where the timing of the deduction for tax versus the book expense timing is accelerated. The Non-Protected EDFIT debit balance represents the opposite in that for certain book expense items the tax deduction has not yet occurred creating a deferred tax asset and thus a Non-Protected EDFIT debit balance or deficiency for the 35% to 21% FIT Rate reduction. For example, one item in BHP's Non-Protected EDFIT debit balance is related to accrued vacation that has been expensed on BHP's books but has not yet been deducted for tax purposes. Just as customers are entitled to the Protected EDFIT credit balance, BHP is entitled to the recovery of the Non-Protected EDFIT debit balance or deficiency in collection of tax expense.

Q HOW WILL THE PROTECTED EDFIT BE RETURNED TO CUSTOMERS?

A. Black Hills is proposing to return the Protected EDFIT in accordance with the ARAM methodology as prescribed by the TCJA. Black Hills proposes to utilize the final 2018 ARAM calculation based upon the December 31, 2017 Protected EDFIT balances, finalized in November 2018 for the 2019 base rate change. This is necessary in order to prevent a normalization violation.

Q. WHAT IS THE IMPACT IF BHP DOES NOT CONFORM TO THE NORMALIZATION REQUIREMENTS?

A. Failure to comply with the normalization requirements results in a utility's tax liability for a given year to increase by the amount which it reduced its excess tax reserve in excess of the amount permitted under the normalization rules. In addition, the utility becomes ineligible to deduct accelerated depreciation for federal income tax purposes and instead may only deduct the amount of depreciation expensed for regulatory reporting purposes. In addition, the TCJA implemented a tax penalty for failure to comply with the normalization rules.

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes.

STATE OF SOUTH DAKOTA)
) SS
COUNTY OF PENNINGTON)

I, Lee Watkins, being duly sworn on oath, depose and state that I am the witness identified in the foregoing prepared testimony and I am familiar with its contents, and that the facts set forth are true to the best of my knowledge, information and belief.

Lee Watkins

Subscribed and sworn to before me this 27th day of June, 2018.

BECKY PURINGTON NOTARY PUBLIC STATE OF SOUTH DAKOTA

(SEAL)

Notary Public

My Commission Expires June 22, 2023

My Commission Expires:________________