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October 22, 2024

VIA ELECTRONIC FILING

Hon. David Jones, Chairman
c/o Ectory Lawless, Docket Room Manager
Tennessee Public Utility Commission
502 Deaderick Street, 4th Floor
Nashville, TN 37243
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Electronically Filed in TPUC Docket Room
on October 22, 2024 at 2:22 p.m.

RE: ***Petition of Tennessee-American Water Company to Modify Tariff, Change and Increase Charges, Fees, and Rates, and for Approval of a General Rate Increase,*** **TPUC Docket No. 24-00032**

Dear Chairman Jones:

Attached for filing please find *Tennessee-American Water Company's Rebuttal Testimonies for (1) Heath Brooks; (2) Ann Bulkley; (3) Dominic J. DeGrazia; (4) Grant Evitts; (5) Nicholas Furia; (6) Larry Kennedy; (7) Bob Lane; (8) Robert V. Mustich; (9) Robert Prendergast; (10) Charles Rea; (11) Linda Schlessman; (12) Grady Stout; (13) Harold Walker, III; and (14) John Watkins* in the above-captioned matter.

As required, the original plus four (4) hard copies will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to contact me.

Very truly yours,

BUTLER SNOW LLP

Melvin J. Malone

clw
Attachments
cc: Bob Lane, TAWC
Shilina Brown, Consumer Advocate Division
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TENNESSEE-AMERICAN WATER COMPANY, INC.

DOCKET NO. 24-00032

REBUTTAL TESTIMONY

OF

LINDA SCHLESSMAN

ON

TOPICS:

TAX ACCOUNTING

SPONSORING PETITIONER'S EXHIBITS:
TAWC Schlessman Rebuttal Exhibit 1
TAWC Schlessman Rebuttal Exhibit 2
TAWC Schlessman Rebuttal Exhibit 3

REBUTTAL TESTIMONY
LINDA SCHLESMAN
TENNESSEE AMERICAN WATER COMPANY
DOCKET NO. 24-00032

TABLE OF CONTENTS

I. INTRODUCTION 1
II. NORMALIZATION AND FLOW-THROUGH METHODS OF TAX ACCOUNTING 3
III. THE REPAIRS TAX DEDUCTION EFFECT ON THE REVENUE REQUIREMENT AND RESPONSE TO WITNESS DITTEMORE 7
IV. PROTECTED AND UNPROTECTED TAX TIMING DIFFERENCES.....13
V. RESPONSE TO WITNESS GARRETT 15

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Linda Schlessman. My business address is 1 Water Street, Camden, NJ 08106.

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

A. I am employed by American Water Works Service Company, Inc. as the Director - Tax Regulatory. I am responsible for the oversight of calculating tax expense and accumulated deferred income taxes in rate cases and rate filings for American Water Works, Inc.'s subsidiaries, including Tennessee American Water Company ("TAWC" or the "Company").

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I received a Bachelor of Business Administration Degree in Accounting from Miami University in 2006 and am a Certified Public Accountant in the State of Ohio. I have eighteen years of tax experience and six years of utility tax experience. Prior to joining American Water in September of 2024, I was a Tax Accounting and Regulatory Support Manager at American Electric Power, Inc. Prior to that, I held positions in both public accounting and the private sector. My previous employers include GBQ Partners, LLC, HBD Industries, Inc. and L Brands, Inc., now Bath and Body Works, Inc.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN ANY REGULATORY PROCEEDINGS?

A. Yes. While employed at American Electric Power, I filed testimony in rate proceedings before the Oklahoma Corporation Commission in Case No. PUD 2022-000093, before the

Arkansas Public Service Commission in Case No. 23-012-FR, before the Public Service Commission of Kentucky in Case No. 2023-00159, and before the Public Utility Commission of Texas in Docket No. 56165.

Q. DID YOU PREVIOUSLY SUBMIT DIRECT TESTIMONY IN THIS PROCEEDING ON BEHALF OF TENNESSEE-AMERICAN WATER COMPANY, INC. ("TAWC" OR THE "COMPANY") IN THIS PROCEEDING?

A. No. I did not file direct testimony in this matter.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to address the following:

1. Consumer Advocate Division ("CAD") witness Dittemore's recommendation to adopt the flow-through methodology for the treatment of the Repair Deductions when computing state and federal income tax expense[1] and the recommendation to reduce the accumulated deferred income tax liability balance for the adoption of the flow-through tax methodology for the repairs timing difference[2].

2. City of Chattanooga witness Garrett's recommendation to use the flow-through of repair allowance as necessary to avoid a rate increase in this case.

Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR TESTIMONY?

A. Yes, I am sponsoring the following exhibits, which have been filed with my testimony.

1. TAWC Schlessman Rebuttal Exhibit 1
2. TAWC Schlessman Rebuttal Exhibit 2
3. TAWC Schlessman Rebuttal Exhibit 3

[1] Dittemore Testimony, p.9.

[2] Dittemore Testimony, p. 20.

II. NORMALIZATION AND FLOW-THROUGH METHODS OF TAX ACCOUNTING

Q. PLEASE DESCRIBE NORMALIZED TAX ACCOUNTING.

A. Generally speaking, in the context of a regulated utility, normalized tax accounting spreads out, over time, the recovery from ratepayers of the income tax expenses, much like taxes and insurance in a residential mortgage are collected from the homeowner over the course of each year instead of paying those expenses in larger lump sums in the months they are due. More specifically, Accounting Standards Codification (ASC) 740 covers how companies should both account for and report taxes based on income. The two basic objectives of ASC 740 are (i) to recognize the amount of taxes that are either payable or refundable for the current tax year, and (ii) to recognize the deferred tax assets and liabilities for the future tax consequences that have been recognized in a company's financial statements. The accounting for income taxes called for by ASC 740 is known as normalized income tax accounting. I explain these concepts more fully below.

Q. HOW DOES THE NORMALIZED INCOME TAX ACCOUNTING CALCULATION WORK?

A. Normalized income tax accounting calculates income tax expense on the pre-tax income and expenses recorded for financial statement purposes, which are included in the cost of service for ratemaking purposes. Tax expense is then separated between the amount currently payable to the IRS ("current") and the amount that must be paid in the future ("deferred"). This division between current and deferred tax expense is calculated based on temporary differences between book and taxable income. The deferred tax expense is

recorded on the balance sheet as an ADIT (accumulated deferred income tax) liability or asset, whichever the case may be.

Q. IN YOUR DESCRIPTION OF NORMALIZED TAX ACCOUNTING, YOU DISCUSS TEMPORARY DIFFERENCES. CAN YOU PLEASE EXPLAIN THIS CONCEPT?

A. Yes. A temporary difference is a difference in the timing of a company's recognition of book income and its recognition of taxable income that occurs in one year and reverses in another. A temporary difference does not change the overall income tax expense required to be owed over the life of the timing difference; it simply affects the timing of the payment of a liability. To be clear, regardless of the accounting method (normalized or flow-through), the overall tax expense for the period remains the same. An example of a temporary difference, and one that is generally the largest in magnitude for a public utility company, results from the use of accelerated depreciation for tax purposes. While depreciation of an asset can only equal the cost of the asset and can only be recognized over the life of the asset, a temporary difference can occur when there are differing depreciation rates. For tax purposes, accelerated tax depreciation may be taken, whereas for book purposes the depreciation expense recognized for that same asset is calculated using the straight-line method. Over the life of the asset, the same total amount of depreciation will be recognized. But under the accelerated depreciation method, the deductions are higher in the earlier years of the asset's life as compared to the straight-line method. This results in taxable income that is lower in the earlier years. Importantly, though, as the straight-line depreciation begins to exceed the accelerated depreciation in the later years, it results in a taxable income that is higher than book income. Over the life

of the asset, the amount of depreciation deducted from income for both book and tax will be the same and the only impact will be the period in which the deductions are recognized.

Q. WHAT ARE PERMANENT DIFFERENCES AND HOW DO THEY DIFFER FROM TEMPORARY DIFFERENCES?

A. As described above, a temporary difference results only in a change in the period in which an item of income or expense is recognized for book and for tax. A permanent difference is an item of income or expense that will never be recognized for either book income or for taxable income. These differences arise due to the different rules that pertain to book accounting and the tax law. Because such an item will never be recognized for one or the other, it results in a difference that will not reverse over time, as in the case of a temporary difference. An example of a permanent difference is entertainment expenses. For book purposes, these expenses are generally recognized and reduce the overall net income of the company. However, for tax purposes, entertainment expenses are not allowed as a deduction from income. The difference between the book deduction and the tax deduction for these expenses is one that will never reverse. Therefore, tax expense must be increased by the tax on the non-deductible amount of these expenses.

Q. YOU MENTIONED THAT TEMPORARY BOOK/TAX DIFFERENCES ARE RECORDED ON THE BALANCE SHEET AS AN ADIT LIABILITY OR ASSET. WILL YOU PLEASE PROVIDE AN EXAMPLE OF HOW ADIT BALANCE ACCRUES?

A. Yes. Imagine a utility had a taxable income of $1,000 and a federal income tax rate of 21% in a given year. Absent any other factors, the utility would collect $210 from its customers in that year as federal income tax expense, and it would pay the Internal Revenue Service

$210 in federal income taxes. Now suppose the same set of facts, except that the utility has used accelerated depreciation to offset all of its $1,000 income. Because of normalization rules, the utility still collects $210 from its customers in that year, but because of the temporary timing difference, the utility will not have to pay that $210 to the IRS until some later date when the utility has taxable income. In effect, the utility is given a $210 interest-free loan from the federal government, but the utility must record that interest-free loan as an ADIT liability.

Q. HOW DOES THE ADIT BALANCE AFFECT A UTILITY'S RATES?

A. Until the deferred taxes (the ADIT balance) are paid back to the Internal Revenue Service, it is used as a dollar-for-dollar reduction of rate base. In my example above, in that given year, rate base would be reduced by $210. So, while the utility collects the $210 income tax expense from customers in that year, it also reduces rate base by that same amount. As the ADIT increases, rate base is reduced and the revenue requirement is lower.

Q. PLEASE EXPLAIN WHAT NORMALIZATION TAX ACCOUNTING MEANS IN THE CONTEXT OF A PUBLIC UTILITY COMPANY.

A. For a public utility company, normalization is a method of accounting in which the tax benefits of accelerated depreciation on public utility assets are shared with customers proportionately over the regulatory useful life of the assets in the form of reduced rates.

Q. CAN YOU EXPLAIN FLOW-THROUGH TAX ACCOUNTING AND HOW THAT DIFFERS FROM NORMALIZED TAX ACCOUNTING?

A. The flow-through method of tax accounting looks only at the amount of taxes that are payable for the current tax year and does not recognize the future benefit or detriment of

temporary differences in income recorded for book purposes and income determined for tax purposes. This method treats a temporary difference as an increase or decrease in the income tax expense for the period, depending on the direction of the temporary difference. This method results in benefits and detriments being allocated among customers in different periods depending on when a temporary difference originates and reverses. For example, a timing difference that results in a deduction in Year 1 would be enjoyed by the set of customers of the company in Year 1 as a reduction to the current year taxes payable. However, if this timing difference were to reverse in Year 2, the detriment of the increase to the current year taxes payable would be borne by the set of customers of the company in Year 2, which, of course, is not necessarily the same set of customers as in Year 1. Because the flow-through method only recognizes the current tax payable or receivable and ignores the impact of future tax impacts from timing differences, there is no deferred tax expense and as a result no ADIT that would be provided as a reduction to rate base.

III. THE REPAIRS TAX DEDUCTION EFFECT ON THE REVENUE REQUIREMENT AND RESPONSE TO WITNESS DITTEMORE

Q. PLEASE EXPLAIN THE REPAIRS DEDUCTION AND HOW IT CREATES A TIMING DIFFERENCE BETWEEN TAXES PAID AND TAX EXPENSE FOR ACCOUNTING PURPOSES.

A. The Internal Revenue Service allows an immediate deduction for certain expenditures such as repairs which, for regulatory accounting purposes, are capitalized rather than expensed. This creates a timing difference between when the expenses of the repairs are deducted on the tax return and when the depreciation on the capitalized asset is expensed for book/accounting purposes. Because the Company can deduct the repairs on the tax return

prior to recognizing the expense on the books, the Company records a deferred tax liability (the ADIT account) for future taxes to be paid. The Company normalizes, or evens out, this timing difference over the life of the capitalized asset, providing the cost-free source of financing from the government to customers by reducing rate base by the ADIT balance. This is consistent with the Company's past practice.

Q. WHEN DID THE COMPANY ADOPT THE TAX METHOD TO CALCULATE REPAIRS?

A. The Company has used the normalized accounting method for repairs deductions since 2008. All customers since that time have shared equally in the benefits of the accelerated depreciation and deferred tax liability reduction to rate base. No set of customers has been treated preferentially under this method.

Q. HOW DOES WITNESS DITTEMORE PROPOSE THAT INCOME TAX EXPENSE BE DETERMINED IN THIS CASE?

A. Mr. Dittemore accepts the Company's calculation and inclusion of income tax expense to be used for the revenue requirement in this case, except for the Repair Deduction, which Mr. Dittemore recommends be treated under the flow-through method. Mr. Dittemore states that adoption of the flow-through approach better aligns income tax expense recovered in rates with taxes owed by the Company.

Q. DO YOU AGREE WITH MR. DITTEMORE'S RECOMMENDATION? PLEASE EXPLAIN.

A. No, the Company should continue to normalize tax repairs deductions. While the flow-through method does align income tax expense recovered in rates with the taxes *paid* by

the Company at a specific point in time, flow-through does not treat all customers over a period of years equally. Under flow-through, earlier years' customers would benefit from paying less tax expense, but later years' customers would bear the burden of both paying more tax *and* suffering the compounding increase in rate base. As Mr. Dittemore states, temporary book/tax timing differences such as the repairs timing difference will eventually result in the same amount of recognized revenue and expenses for both book and taxable income.[3] Therefore, over a given time period the Company will owe the same amount of tax under both the flow-through and normalized methods. For the customer, however, normalization provides stability in customer rates by not having large fluctuations in bills when the utility's taxes come due. For the utility, normalization allows the utility to recover costs more evenly over time. Essentially, both today's and tomorrow's customer will benefit from maintaining the normalization method because the timing difference is reflected as a zero-cost source of capital over the life of the repaired asset, which results in an overall lower net operating income for the Company. In contrast, flow-through gives 100% of the benefit of the tax deduction to today's customers, leaving none of the benefit for tomorrow's customers. Applying normalization, the utility matches the tax benefits and collections of taxes owed with the useful life of the assets. Applying flow-through, current customers receive the immediate benefit of the timing difference through lower rates at the front end; but when the utility must pay the taxes that are owed, future customers will then pay higher rates to cover the taxes owed to the government. In either case, though, the utility has the obligation to pay the tax because it is only a temporary timing difference,

[3] Dittemore Testimony, p.10.

not a permanent difference as defined earlier in my testimony. Regulatory tax accounting does not impact the relationship between the utility and the government.

Q. WHICH METHOD RESULTS IN A HIGHER REVENUE REQUIREMENT OVER THE LIFE OF THE REPAIRED PLANT IN SERVICE?

A. The flow-through method results in a higher revenue requirement over the life of a timing difference. Mr. Dittemore states that the flow-through methodology would result in a reduction to income tax expense by 100% of the tax benefit of the repair deduction thereby reducing the revenue requirement by the full amount.[4] However, this considers only the first year of the timing difference in isolation. Over the life cycle of the timing difference, the revenue requirement is higher in the flow-through method. Please see TAWC Schlessman Rebuttal Exhibit 2 for an illustration of the revenue requirement over time in both methodologies. The example illustrates the revenue requirement differences between the methodologies on assets at a cost of $1,000,000 and a useful life of five years that qualifies for the repairs deduction. In this example, the total revenue requirement for a timing difference under the flow-through method is higher because rate base is higher throughout the life cycle of the asset (because there is no ADIT to reduce rate base). In summary, while the initial year of in-service on the asset results in a lower revenue requirement, the following years result in higher revenue requirements which outweigh the initial year benefit.

Flow-Through (FT) Compared to Normalized (Norm):	Year 1	Year 2	Year 3	Year 4	Year 5	**Total**
FT Revenue Requirement Higher/(Lower) than Norm	(995,646)	265,924	261,671	257,418	253,165	**42,532**
FT Taxes Higher/(Lower) than Norm	(209,086)	55,844	54,951	54,058	53,165	**8,932**
FT Net Income Higher/(Lower) Norm	(786,560)	210,080	206,720	203,360	200,000	**33,600**

[4] Dittemore Testimony, p.14.

Q. BASED ON THE CURRENT CASE ESTIMATES, WILL THE BENEFITS OF NORMALIZATION OF THE REPAIRS DEDUCTION TO CUSTOMERS EXCEED THE IMMEDIATE BENEFITS OF FLOW-THROUGH METHOD AS PROPOSED BY WITNESS DITTEMORE?

A. Yes. Please see TAWC Schlessman Rebuttal Exhibit 3. This exhibit compares the flow-through and normalized methods for repairs over time. The assumptions use a first-year depreciation allocation based on actual Company numbers from the Powerplan system.[5] The following years use the average book depreciation rate as provided in TAWC's depreciation study.[6] The annual increase in repairs is based on the average increase in utility plant in service from 2023 – 2025 as provided in the Company's submissions.[7] The increase to rate base due to lack of ADIT eventually outweighs the benefit of flowing-through current tax savings of annual repairs deductions, therefore increasing customer rates under the flow-through method over time. Witness Dittemore states that *theoretically* the book/tax timing difference will reverse[8]; however, my Rebuttal Exhibit 3 shows that based on reasonable assumptions, it *will* reverse. And, more importantly, as compared to normalization, the flow-through method will be more costly to customers in the long run.

Q. IF THE COMMISSION CHANGED COURSE AND REQUIRED THE COMPANY TO CONVERT TO THE FLOW-THROUGH METHOD FOR THE REPAIRS

[5] See TAWC Schlessman Rebuttal Exhibit 2

[6] See TAWC EXHIBIT Kennedy Report Depreciation Study – LK

[7] Petitioner's Exhibit RB-2-UPIS-DD

[8] Dittemore Testimony Page 14

TIMING DIFFERENCE, DO YOU AGREE WITH THE IMPACT AS PROPOSED BY MR. DITTEMORE?

A. No. In CAD Dittemore Exhibit DND-2, Mr. Dittemore states that the repairs deduction for the Attrition Year amounts to $13,933,763. Mr. Dittemore overstates the repairs timing difference for the Attrition Year 147,185[9] because he does not appear to have considered that the Company cannot deduct both the repair and the depreciation on the repaired assets. In other words, while Mr. Dittemore accurately calculates the Attrition Year reduction in revenue requirement for the repairs deduction, he does not net this figure with the book depreciation. TAWC Schlessman Rebuttal Exhibit 1 shows the corrected calculation of $13,786,578 resulting in a reduction of $3,603,122 in tax expense and, importantly, the corresponding increase in rate base. Once the flow-through method's short-term benefit is offset by the inability to reduce rate base through depreciation, we are able to see how the flow-method will affect future customers, which is higher tax expense in later years to offset the deduction in the first year. Additionally, Schlessman Rebuttal Exhibit 1 shows the expected increase in revenue requirement based on the removal of repairs ADIT from rate base. In total, the reduction in revenue requirement is $3,317,034 as opposed to $3,641,589 as proposed in Dittemore Exhibit DND-2. As previously stated, the flow-through method's tax benefit in today's rates will lead to increased tax consequences—and higher rates—for tomorrow's customers.

[9] Amount of book depreciation based on the Powerplan system

Q. ARE THERE OTHER EFFECTS THE COMMISSION SHOULD KNOW ABOUT BEFORE REQUIRING TAWC TO CONVERT TO THE FLOW-THROUGH METHOD IN THE CURRENT CASE?

A. Yes. Please see the rebuttal testimony of Company Witness Nicholas Furia for a discussion on how adopting the flow-through methodology will impact the Company's financing needs.

IV. PROTECTED AND UNPROTECTED TAX TIMING DIFFERENCES

Q. WHAT DO THE TERMS "PROTECTED" AND "UNPROTECTED" MEAN?

A. The term "Protected" refers to timing differences that the Internal Revenue Code and accompanying Treasury regulations require to be normalized – flow-through treatment is not available. IRS normalization requirements specify that the timing differences must be accounted for in ratemaking under the normalization method. An example of a timing difference that is protected is accelerated depreciation and the associated deferred tax liability that results from its use. The term "Unprotected" refers to all other timing differences.

Q. DOES THE CLASSIFICATION OF THE REPAIRS DEDUCTION AS "UNPROTECTED" FOR EXCESS ACCUMULATED DEFERRED TAXES PURPOSES REQUIRE THAT REPAIRS DEDUCTION BE TREATED UNDER THE FLOW-THROUGH METHOD?

A. No. Classifying the timing difference as unprotected for excess accumulated deferred income tax (EADIT) purposes does not mean that the timing difference must be treated under the flow-through method, nor does it imply an adoption of the flow-through methodology as Mr. Dittemore suggests. When the Commission determined that the

EADIT on the repairs deduction be treated as "unprotected" in TPUC Docket No. 18-00039, this was only for purposes of refunding excess taxes as the result of the Tax Cuts and Jobs Act to customers and did not equate to the Commission adopting the flow-through method on the timing difference going forward.

Q. MR. DITTEMORE CITES TO THE COMMISSION'S AUGUST 3, 2020 FINAL ORDER IN DOCKET 18-00039 AS SUPPORT FOR USING THE FLOW-THROUGH METHOD FOR THE REPAIRS DEDUCTION.[10] SHOULD THIS DECISION BE USED AS PRECEDENT FOR USING THE FLOW-THROUGH METHOD WITH REPAIRS DEDUCTIONS?

A. No. The Commission should not be looking to this docket for precedential value on the appropriate method of applying the repairs deduction. To his credit, Mr. Dittemore concedes that the issue addressed by the Commission's Phase Two decision in Docket No. 18-00039 is different from the issue that he has raised in this rate case.[11] The Commission's Final Order Resolving Phase Two Issues addressed the ramifications on reserves held by a utility when those reserves, and the underlying rates, were set under the assumption of a higher federal corporate tax rate. Congress approved a dramatic change in US corporate tax rates in 2017 in the Tax Cuts and Jobs Act ("TCJA"), which resulted in an excess amount of taxes in the ADIT account. The Commission ultimately determined that the mechanism for returning this excess to the customers was to employ flow-through accounting treatment. Therefore, emanating from the TCJA, the Commission's Final Order Resolving Phase Two Issues should be viewed as effectively making a one-time adjustment

[10] Dittemore Testimony at 19:2-14.

[11] Dittemore Testimony at 18:8-12.

to quickly provide to the ratepayers the benefits of the changes in the corporate tax laws under the TCJA. In other words, the 2020 order in Docket No. 18-00039 was a targeted solution to a large unforeseen change in rate base. In this case, on the other hand, routine repairs deductions should not be required to have flow-through treatment applied. The Commission can both support its decision in Docket No. 18-00039 while at the same time declining to accept Mr. Dittemore's proposition in this case. In sum, the Commission's Final Order Resolving Phase Two Issues is simply not precedent for Mr. Dittemore's approach for the treatment of repairs deductions. Rather, the Commission's order is precedent for a one-time adjustment in the event of a federal corporate tax rate cut.

V. RESPONSE TO WITNESS GARRETT

Q. WHAT DOES CITY OF CHATTANOOGA WITNESS GARRETT SAY ABOUT FLOW-THROUGH ACCOUNTING OF THE REPAIRS DEDUCTION?

A. Witness Garrett acknowledges that if the tax benefits are flowed through to ratepayers currently, they would not be available for the future as the related assets are depreciated.[12]

Q. DO YOU AGREE WITH CITY OF CHATTANOOGA WITNESS GARRETT THAT THERE ARE DRAWBACKS TO FLOWING THE REPAIR ALLOWANCE THROUGH TO RATEPAYERS?

A. Yes. As Witness Garrett points out, if the tax benefits are flowed through to ratepayers currently, they would not be available in the future. The analysis completed in TAWC Schlessman Rebuttal Exhibit 2 and Exhibit 3 provide the proof that this is the case.

[12] Garrett Testimony at 43:16-19.

Q. DO YOU AGREE WITH WITNESS GARRETT'S RECOMMENDATION TO UTILIZE THE FLOW THROUGH METHOD OF THE REPAIRS DEDUCTION "AS NECESSARY"?

A. No. Even with a portion of repairs treated as flow-through, the long-term effects are higher revenue requirements for customers as illustrated in TAWC Schlessman Rebuttal Exhibit 2 and Exhibit 3. As witness Garrett acknowledges, his recommendation would be only to avoid a rate increase in the current docket, but would have long-term implications. Furthermore, it would be overly burdensome to track repairs treated as flow-through and repairs treated as normalized in this manner.

Q. DO YOU AGREE WITH WITNESS GARRETT'S CALCULATION THAT THE DEDUCTION FOR REPAIRS UNDER THE FLOW-THROUGH METHOD WOULD BE $3,831,785?

A. No. As with the calculation completed by Mr. Dittemore, the method would need to include the reversal of book depreciation on the assets capitalized for book purposes. The correct calculation can be found at TAWC Schlessman Rebuttal Exhibit 1.

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE TREATMENT OF THE REPAIRS TIMING DIFFERENCE?

A. I recommend that the Commission continue to provide for normalized method of accounting for the repairs deduction timing difference pursuant to practices utilized in TAWC's prior rate cases. As demonstrated in my exhibits, flow-through is more costly to customers in the long run and is not a prudent treatment for tomorrow's customers. Flowing through the repairs deductions treats current customers preferentially to the detriment of future years' customers, which I do not believe to be a prudent practice.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

TAWC Schlessman Rebuttal Exhibit 1
Re-calculation of Repair Deduction under Flow-Through

Tennessee American Water Company
Docket No. 24-00032

Calculation of Income Tax Expense and ADIT Implications of Flow-Through of Repair Deduction

Line No.	Item		Amount	Source
1	2025 Repair Deduction	$	(13,933,763)	TAWC Deferred Tax File;Book-Tax Dff Tab; "Repairs"
2	Book Depreciation on 2025 Repair Qualifying Book Capitalized Assets	$	147,185	Book Tax Diff - 2025 Vintage Cell Z6
3	Total Timing Difference on Repairs	$	(13,786,578)	Line 1 + Line 2
4	State Income Tax Effect		6.50%	
5	Reduction in State Tax Expense/Reduction in ADIT - State	$	(896,128)	Line 3 * Line 4
6	Reduction in Net Income Subject to Federal Tax	$	(12,890,451)	Line 3 - Line 5
7	Federal Tax Rate		21%	
8	Reduction in Federal Tax/Reduction in ADIT - Federal	$	(2,706,995)	Line 6 * Line 7
9	Reduction in Income Tax Expense/Reduction in ADIT	$	(3,603,122)	Line 5 + Line 8
10	Weighted Average Cost of Capital		7.94%	Schedule CS-1.1
11	Removal of Repairs ADIT from Rate Base	$	286,088	Line 9 * Line 10
12	Reduction in Revenue Requirement for Flow-Through of Repair Deduction	$	(3,317,034)	Line 9 + Line 11

TAWC Schlessman Rebuttal Exhibit 1
Powertax Tax Timing Difference Report - Vintage 2025

consolidation_id	parent_id	consol_desc	sort_order	version_id	version_description	tax_year	normalization_schema	jurisdictior	jurisdictior	def_incom	normalization_id	amortizati	amortization_type_description	rollup_description	rollup_view_description	from_rep	to_repor	def_inco	def_income_t	def_income_t	norm_di	norm_diff_bala	from_depr_	from_gl_	to_depr_cal	to_gl_ca	orig_diff_calc	curr_timing_dif	tax_depr	tax_gl_p	from_ac	to_accur	from_tra	to_transfer_activity
-1	1026	1026-Tennessee American Water Co	0	242	TN Rate Case - 2023-2025	2025	1026 Fed - M/L	1	Fed	73	109	1	Depreciation Difference	Total Tax Classes	Total Tax Classes	-	-	-	48,463	48,463	-	230,777	489,099	-	258,322	-	-	230,777	-	-	-	-	-	-
-1	1026	1026-Tennessee American Water Co	0	242	TN Rate Case - 2023-2025	2025	1026 Fed - Tax Repairs	1	Fed	73	11201050	0	Book Overhead	Total Tax Classes	Total Tax Classes	-	-	-	2,926,090	2,895,181	-	13,786,578	-	-	147,185	-	(13,933,763)	13,786,578	-	-	-	-	-	-
-1	1026	1026-Tennessee American Water Co	0	242	TN Rate Case - 2023-2025	2025	1026 Fed - AFUDC Equity FT	1	Fed	74	11201502	0	Book Overhead	Total Tax Classes	Total Tax Classes	-	-	-	-	-	-	572,195	-	-	6,109	-	(578,304)	572,195	-	-	-	-	-	-
-1	1026	1026-Tennessee American Water Co	0	242	TN Rate Case - 2023-2025	2025	1026 Fed - Taxable CIAC	1	Fed	73	11201004	-1	Tax Overhead	Total Tax Classes	Total Tax Classes	-	-	-	(30,965)	(30,346)	-	(144,503)	2,949	-	-	-	147,452	(144,503)	-	-	-	-	-	-

TAWC Schlessman Rebuttal Exhibit 2

Illustration of Flow-Through and Normalization effects on Revenue Requirement

1	1,000,000	Property Cost
2	200,000	Annual Depreciation - Book
3	1,000,000	Repair Deduction
4	5.00	Life of Asset
5	8%	WACC
6	21%	Tax Rate
7	1.27	Gross-Up Factor

Line	Description	Year 1	Year 2	Year 3	Year 4	Year 5		
8	Book Cost - Line 1	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000		
9	Book Depreciation - Line 2	(200,000)	(400,000)	(600,000)	(800,000)	(1,000,000)		
10	Net Book Value (NBV) - Line 8 + Line 9	800,000	600,000	400,000	200,000	-		
11	Tax Cost - Line 1	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000		
12	Repair Deduction - Line 3	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)		
13	Net Tax Value (NTV) - Line 1 plus Line 3	-	-	-	-	-		
14	NTV less NBV - Line 13 less line 10	(800,000)	(600,000)	(400,000)	(200,000)	-		
15	Deferred Tax Liability (DTL) - 21% Line 14	(168,000)	(126,000)	(84,000)	(42,000)	-		
	Normalization of Repairs Deduction:						Total	
16	Rate Base (NBV less DTL) - Line 10 plus Line 15	632,000	474,000	316,000	158,000	-		
17	Book Income (Rate Base times WACC) - Line 16 times Line 5	50,560	37,920	25,280	12,640	-	126,400	
18	Revenue Requirement - Line 17 times Line 7	64,000	48,000	32,000	16,000	-	160,000	Note 1
19	Taxes - Line 18 times Line 6	13,440	10,080	6,720	3,360	-	33,600	
20	Net Income - Line 18 less Line 19	50,560	37,920	25,280	12,640	-	126,400	
	Flow-Through of Repairs Deduction:							
21	Rate Base - Line 10	800,000	600,000	400,000	200,000	-		
22	Book Income (Rate Base times WACC) - Line 21 times Line 5	64,000	48,000	32,000	16,000	-	160,000	
23	Repairs Timing Difference - Line 14 less prior year Line 14	(800,000)	200,000	200,000	200,000	200,000	-	
24	Revenue Requirement on Book Income - Line 22 times Line 7	81,013	60,759	40,506	20,253	-	202,532	Note 1
25	Revenue Requirement on Repairs - Line 23 times Line 7	(1,012,658)	253,165	253,165	253,165	253,165	-	Note 2
26	Total Revenue Requirement - Line 24 plus Line 25	(931,646)	313,924	293,671	273,418	253,165	202,532	
27	Taxes - Line 26 times Line 6	(195,646)	65,924	61,671	57,418	53,165	42,532	
28	Net Income - Line 26 less Line 27	(736,000)	248,000	232,000	216,000	200,000	160,000	

Flow-Through (FT) Compared to Normalized (Norm):	Year 1	Year 2	Year 3	Year 4	Year 5	**Total**
FT Revenue Requirement Higher/(Lower) than Norm	(995,646)	265,924	261,671	257,418	253,165	**42,532**
FT Taxes Higher/(Lower) than Norm	(209,086)	55,844	54,951	54,058	53,165	**8,932**
FT Net Income Higher/(Lower) Norm	(786,560)	210,080	206,720	203,360	200,000	**33,600**

Note 1: Revenue Requirement on book income is higher in the FT method because rate base is higher. Rate base is higher in the FT method because it does not include a reduction for deferred income taxes

Note 2: Revenue Requirement on the repairs timing difference is zero in totality which matches the normalized method.

TAWC Schlessman Rebuttal Exhibit 3
Estimated Repairs Deduction Flow-through to Normalized Comparison

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)
	Year	Current Year Timing Difference	State Income Taxes	Federal Income Taxes	Subtotal: Current Tax Benefit	Flow-Through Revenue Requirement (Reduction)	Deferred Tax Expense if Normalized	Rate Base ADIT If Normalized	Required Operating Income if Normalized	Normalized Revenue Requirement (Reduction)	Flow-Through Higher/ (Lower) than Normalized
(1)	2025	(13,786,578)	(896,128)	(2,706,995)	(3,603,122)	**(4,877,983)**	3,603,122	(3,603,122)	(286,088)	**(387,312)**	**(4,490,671)**
(2)	2026	(13,975,183)	(908,387)	(2,744,027)	(3,652,414)	**(4,944,716)**	3,652,414	(7,255,536)	(576,090)	**(779,922)**	**(4,164,793)**
(3)	2027	(14,172,240)	(921,196)	(2,782,719)	(3,703,915)	**(5,014,438)**	3,703,915	(10,959,451)	(870,180)	**(1,178,069)**	**(3,836,370)**
(4)	2028	(14,378,126)	(934,578)	(2,823,145)	(3,757,723)	**(5,087,285)**	3,757,723	(14,717,174)	(1,168,544)	**(1,581,999)**	**(3,505,286)**
(5)	2029	(14,593,238)	(948,560)	(2,865,382)	(3,813,943)	**(5,163,397)**	3,813,943	(18,531,117)	(1,471,371)	**(1,991,973)**	**(3,171,424)**
(6)	2030	(14,817,989)	(963,169)	(2,909,512)	(3,872,682)	**(5,242,918)**	3,872,682	(22,403,799)	(1,778,862)	**(2,408,261)**	**(2,834,658)**
(7)	2031	(15,052,811)	(978,433)	(2,955,620)	(3,934,052)	**(5,326,003)**	3,934,052	(26,337,851)	(2,091,225)	**(2,831,145)**	**(2,494,858)**
(8)	2032	(15,298,156)	(994,380)	(3,003,793)	(3,998,173)	**(5,412,811)**	3,998,173	(30,336,024)	(2,408,680)	**(3,260,922)**	**(2,151,889)**
(9)	2033	(15,554,493)	(1,011,042)	(3,054,125)	(4,065,167)	**(5,503,509)**	4,065,167	(34,401,191)	(2,731,455)	**(3,697,901)**	**(1,805,608)**
(10)	2034	(15,822,317)	(1,028,451)	(3,106,712)	(4,135,163)	**(5,598,271)**	4,135,163	(38,536,354)	(3,059,786)	**(4,142,404)**	**(1,455,867)**
(11)	2035	(16,102,143)	(1,046,639)	(3,161,656)	(4,208,295)	**(5,697,279)**	4,208,295	(42,744,649)	(3,393,925)	**(4,594,768)**	**(1,102,511)**
(12)	2036	(16,394,506)	(1,065,643)	(3,219,061)	(4,284,704)	**(5,800,723)**	4,284,704	(47,029,353)	(3,734,131)	**(5,055,345)**	**(745,378)**
(13)	2037	(16,699,971)	(1,085,498)	(3,279,039)	(4,364,537)	**(5,908,803)**	4,364,537	(51,393,890)	(4,080,675)	**(5,524,504)**	**(384,299)**
(14)	2038	(17,019,123)	(1,106,243)	(3,341,705)	(4,447,948)	**(6,021,726)**	4,447,948	(55,841,838)	(4,433,842)	**(6,002,629)**	**(19,097)**
(15)	2039	(17,352,576)	(1,127,917)	(3,407,178)	(4,535,096)	**(6,139,708)**	4,535,096	(60,376,933)	(4,793,929)	**(6,490,122)**	**350,413**
(16)	2040	(17,700,970)	(1,150,563)	(3,475,586)	(4,626,149)	**(6,262,978)**	4,626,149	(65,003,082)	(5,161,245)	**(6,987,402)**	**724,424**
(17)	2041	(18,064,976)	(1,174,223)	(3,547,058)	(4,721,282)	**(6,391,771)**	4,721,282	(69,724,364)	(5,536,114)	**(7,494,909)**	**1,103,138**
(18)	2042	(18,445,293)	(1,198,944)	(3,621,733)	(4,820,677)	**(6,526,335)**	4,820,677	(74,545,041)	(5,918,876)	**(8,013,100)**	**1,486,765**
(19)	2043	(18,842,652)	(1,224,772)	(3,699,755)	(4,924,527)	**(6,666,929)**	4,924,527	(79,469,568)	(6,309,884)	**(8,542,454)**	**1,875,525**
(20)	2044	(19,257,815)	(1,251,758)	(3,781,272)	(5,033,030)	**(6,813,823)**	5,033,030	(84,502,598)	(6,709,506)	**(9,083,472)**	**2,269,649**
(21)	2045	(19,691,582)	(1,279,953)	(3,866,442)	(5,146,395)	**(6,967,298)**	5,146,395	(89,648,993)	(7,118,130)	**(9,636,675)**	**2,669,377**
(22)	2046	(20,144,786)	(1,309,411)	(3,955,429)	(5,264,840)	**(7,127,652)**	5,264,840	(94,913,833)	(7,536,158)	**(10,202,611)**	**3,074,959**
(23)	2047	(20,618,297)	(1,340,189)	(4,048,403)	(5,388,592)	**(7,295,190)**	5,388,592	(100,302,425)	(7,964,013)	**(10,781,849)**	**3,486,659**
(24)	2048	(21,113,026)	(1,372,347)	(4,145,543)	(5,517,889)	**(7,470,235)**	5,517,889	(105,820,314)	(8,402,133)	**(11,374,985)**	**3,904,750**
(25	2049	(21,629,924)	(1,405,945)	(4,247,035)	(5,652,981)	**(7,653,125)**	5,652,981	(111,473,295)	(8,850,980)	**(11,982,643)**	**4,329,519**
(26)	2050	(22,169,983)	(1,441,049)	(4,353,076)	(5,794,125)	**(7,844,209)**	5,794,125	(117,267,420)	(9,311,033)	**(12,605,474)**	**4,761,265**
(27)	2051	(22,734,241)	(1,477,726)	(4,463,868)	(5,941,594)	**(8,043,856)**	5,941,594	(123,209,014)	(9,782,796)	**(13,244,156)**	**5,200,300**
(28)	2052	(23,323,784)	(1,516,046)	(4,579,625)	(6,095,671)	**(8,252,448)**	6,095,671	(129,304,685)	(10,266,792)	**(13,899,400)**	**5,646,952**
(29)	2053	(23,939,744)	(1,556,083)	(4,700,569)	(6,256,652)	**(8,470,388)**	6,256,652	(135,561,337)	(10,763,570)	**(14,571,949)**	**6,101,561**
(30)	2054	(24,583,304)	(1,597,915)	(4,826,932)	(6,424,847)	**(8,698,093)**	6,424,847	(141,986,183)	(11,273,703)	**(15,262,578)**	**6,564,484**

(31)	**Assumptions:**	
(32)	WACC	7.94%
(33)	Marginal State Income Tax Rate	6.5%
(34)	Marginal Federal Income Tax Rate	21.0%
(35)	Federal Benefit of State Taxes	-1.4%
(36)	Marginal Income Tax Rate	26.1%
(37)	Revenue Conversion Factor (Income Taxes Only)	135.38%

TAWC Schlessman Rebuttal Exhibit 3
Estimated Repairs Deduction Flow-through to Normalized Comparison

			Repairs Deduction																														Current Year Timing Difference
		Year	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046	2047	2048	2049	2050	2051	2052	2053	2054	
			(13,933,763)	(14,558,123)	(15,210,461)	(15,892,029)	(16,604,138)	(17,348,156)	(18,125,512)	(18,937,701)	(19,786,284)	(20,672,891)	(21,599,226)	(22,567,070)	(23,578,282)	(24,634,805)	(25,738,670)	(26,891,999)	(28,097,007)	(29,356,011)	(30,671,429)	(32,045,791)	(33,481,736)	(34,982,025)	(36,549,541)	(38,187,296)	(39,898,437)	(41,686,253)	(43,554,179)	(45,505,806)	(47,544,884)	(49,675,331)		
(1)	Book Depreciation	2025	147,185																														(13,786,578)
(2)		2026	429,160	153,780																													(13,975,183)
(3)		2027	429,160	448,390	160,671																												(14,172,240)
(4)		2028	429,160	448,390	468,482	167,871																											(14,378,126)
(5)		2029	429,160	448,390	468,482	489,474	175,393																										(14,593,238)
(6)		2030	429,160	448,390	468,482	489,474	511,407	183,252																									(14,817,989)
(7)		2031	429,160	448,390	468,482	489,474	511,407	534,323	191,463																								(15,052,811)
(8)		2032	429,160	448,390	468,482	489,474	511,407	534,323	558,266	200,043																							(15,298,156)
(9)		2033	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	209,006																						(15,554,493)
(10)		2034	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	218,372																					(15,822,317)
(11)		2035	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	228,157																				(16,102,143)
(12)		2036	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	238,390																			(16,394,506)
(13)		2037	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	249,062																		(16,699,971)
(14)		2038	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	260,222																	(17,019,123)
(15)		2039	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	271,882																(17,352,576)
(16)		2040	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	284,065															(17,700,970)
(17)		2041	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	296,794														(18,064,976)
(18)		2042	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	310,093													(18,445,293)
(19)		2043	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	323,988												(18,842,652)
(20)		2044	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	338,506											(19,257,815)
(21)		2045	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	353,674										(19,691,582)
(22)		2046	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	369,522									(20,144,786)
(23)		2047	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	386,080								(20,618,297)
(24)		2048	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	403,380							(21,113,026)
(25		2049	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	1,176,169	421,455						(21,629,924)
(26)		2050	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	1,176,169	1,228,872	440,340					(22,169,983)
(27)		2051	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	1,176,169	1,228,872	1,283,937	460,071				(22,734,241)
(28)		2052	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	1,176,169	1,228,872	1,283,937	1,341,469	480,687			(23,323,784)
(29)		2053	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	1,176,169	1,228,872	1,283,937	1,341,469	1,401,579	502,226		(23,939,744)
(30)		2054	429,160	448,390	468,482	489,474	511,407	534,323	558,266	583,281	609,418	636,725	665,256	695,066	726,211	758,752	792,751	828,274	865,388	904,165	944,680	987,010	1,031,237	1,077,446	1,125,726	1,176,169	1,228,872	1,283,937	1,341,469	1,401,579	1,464,382	524,730	(24,583,304)

(31) Assumptions:

(32)	Repairs Deduction Annual Increase Assumption	4.48%
(33)	Average Book Depreciation Rate	3.08%

TAWC Schlessman Rebuttal Exhibit 3
Average Increase of Utility Plant In Service

	12/31/2023	12/31/2024	12/31/2025	
UPIS Balance	472,080,671	502,876,105	515,138,706	Petitioner's Exhibit RB-2-UPIS-DD
Increase Amount		30,795,434	12,262,601	
Increase %		6.52%	2.44%	
Average %			4.48%	

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail or electronic mail upon:

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This the 22nd day of October 2024.

Melvin J. Malone