COZEN O'CONNOR

David P. Zambito
Direct Phone 717-703-5892
Direct Fax 215-989-4216
dzambito@cozen.com

July 22, 2022

VIA E-FILING

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Distribution System Improvement Charge – Implementation Order to address all issues pertaining to the distribution system improvement charge calculations required in the Pennsylvania Supreme Court's decision in *McCloskey v. Pa. PUC,* 255 A.3d 416 (Pa. 2021); Docket No. M-2012-2293611

Comments of the National Association of Water Companies – Pennsylvania Chapter

Dear Secretary Chiavetta:

Enclosed for filing with the Pennsylvania Public Utility Commission ("Commission") are the Comments of the National Association of Water Companies – Pennsylvania Chapter in the above-referenced matter. A WORD-compatible version has been provided to Commission staff as shown below.

If you have any questions regarding this filing, please contact me. Thank you for your attention to this matter.

Sincerely,

COZEN O'CONNOR

By: David P. Zambito
Counsel for *National Association of Water Companies – Pennsylvania Chapter*

DPZ:kmg
Enclosures
cc: RA-PCDSICTAXES@pa.gov
J.T. Hand, President, National Association of Water Companies – Pa. Chapter
Marc Lucca, Incoming President - National Association of Water Companies – Pa. Chapter

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Distribution System Improvement Charge – Implementation Order to address all issues pertaining to the distribution system improvement charge calculations required in the Pennsylvania Supreme Court's decision in *McCloskey v. Pa. PUC,* 255 A.3d 416 (Pa. 2021)	: : : : : : :	Docket No. M-2012-2293611

COMMENTS OF THE NATIONAL ASSOCIATION OF WATER COMPANIES – PENNSYLVANIA CHAPTER

AND NOW COMES the National Association of Water Companies – Pennsylvania Chapter ("NAWC"), in response to the Secretarial Letters issued in this matter on April 22, 2022 and May 18, 2022, requesting that interested persons provide comments regarding all issues pertaining to the distribution system improvement charge ("DSIC") calculations required by the decision of the Supreme Court of Pennsylvania ("Supreme Court") in *McCloskey v. Pennsylvania Public Utility Commission*, 255 A.3d 416 (Pa. 2021) ("*McCloskey"*). NAWC respectfully requests that the Pennsylvania Public Utility Commission ("Commission") include NAWC in the working group mentioned in the Secretarial Letters and that the working group consider these comments in its deliberations.

I. INTRODUCTION

NAWC is a trade organization whose members are investor-owned water utilities in Pennsylvania that are regulated by the Commission.[1] Among other functions, NAWC provides members with a vehicle for expressing their position on legislative and regulatory developments before the General Assembly, the Commission and other regulatory agencies, and the courts. NAWC thanks the Commission for this opportunity to file comments.

NAWC commends the Commission for initiating a generic proceeding to implement the Supreme Court's order in *McCloskey*, rather than trying to implement that order in the DSIC proceedings of each individual utility that has a DSIC. NAWC also commends the Commission for seeking input from interested stakeholders. The manner in which utilities calculate the DSIC is a matter of great importance to NAWC's members. The DSIC is an important financing tool allowing utilities to recover reasonable and prudently-incurred costs related to the repair, improvement and replacement of utility infrastructure on a more timely basis, subject to reconciliation, audit and other consumer protections (including a limitation on the DSIC rate percentage and resetting the percentage to zero at certain times).

II. BACKGROUND

A. The DSIC

Pennsylvania's water utilities have been using a DSIC mechanism for more than twenty-five years. This ratemaking mechanism was expanded to wastewater and other utilities by Act 11 of 2012, enacted February 14, 2012 ("Act 11").

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[1] The members of NAWC are: Aqua Pennsylvania, Inc.; Columbia Water Company; Newtown Artesian Water Company; Pennsylvania-American Water Company; The York Water Company; and, Veolia Water Pennsylvania, Inc. (f/k/a SUEZ Water Pennsylvania Inc.). In addition to water operations, several of the members operate Commission-regulated wastewater systems.

The purpose of the DSIC is to promote the repair and replacement of infrastructure by reducing the regulatory lag that utilities experience in recovering the cost of infrastructure improvements. By reducing regulatory lag, the DSIC encourages utilities to accelerate their investment in utility infrastructure for the benefit of their customers.

The DSIC has proven to be a great success over the years; the Commission and the General Assembly have commended water and other utilities for their efforts in replacing Pennsylvania's aging infrastructure through the DSIC mechanism. These investments have proven to be a substantial public benefit, improving service to and increasing reliability for customers.

B. The *McCloskey* Litigation

The issue before the Supreme Court in *McCloskey* was whether Section 1301.1 of the Pennsylvania Public Utility Code ("Code"), 66 Pa. C.S. § 1301.1, applies to the DSIC. In pertinent part, that Section currently states:

> § 1301.1. Computation of income tax expense for ratemaking purposes.
>
> (a) Computation.--If an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce rates. If an expense or investment is not allowed to be included in a public utility's rates, the related income tax deductions and credits, including tax losses of the public utility's parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity. The income tax expense shall be computed using the applicable statutory income tax rates.

The Supreme Court held that Section 1301.1 applies to the DSIC. The Supreme Court remanded the case to the Commission "for the purpose of requiring [the Utilities] to revise their tariffs and Distribution System Improvement Charge calculations in accordance with Section 1301.1(a) of the Public Utility Code, 66 Pa. C.S. § 1301.1." *McCloskey*, 255 A.3d at 437.

The DSIC is not broken. The DSIC has worked well in the water industry for nearly 25 years and has served as a model for other states. NAWC does not believe that the Commission or utilities need to make extensive changes in order to comply with the Supreme Court's very limited holding in *McCloskey*. NAWC urges the Commission to make only the necessary changes on a prospective basis and refrain from making any additional changes; the Commission should not undermine the benefits of the DSIC by making a number of unnecessary changes or otherwise changing the Commission's administrative procedures related to the DSIC.[2]

III. COMMENTS

A. DSIC FORMULA, MODEL TARIFF AND RECONCILIATION PROCESS

The Commission requested comments on four topics. NAWC believes the following three topics are closely related, and so will provide comments on these topics together.

> Changes to be made to the current model DSIC tariff, including the necessary computation, reconciliation and other language to implement the directive of the Court to recognize incremental Accumulate Deferred Income Taxes (ADIT) and state tax depreciation deductions for accelerated depreciation in quarterly calculations of DSIC charges.
>
> Elements of the formula required for calculating quarterly DSIC updates needed to determine: (1) the state income tax effects of book-tax timing differences created by placing in service eligible property included in the DSIC calculation; and (2) ADIT that reflects the book-tax timing differences created by placing in service eligible property included in the DSIC, and to do so that such revisions to the formula for calculating the DSIC do not require unduly complicated computations but permit reasonable review and audit of DSIC charges and their supporting calculations.
>
> Standards to establish a reconciliation process for timing differences and issues for determining the proper level of ADIT and state income taxes for book-tax timing issues created by placing in service eligible property included in the DSIC.

[2] The Supreme Court's Order does not require that the Commission modify its procedures relating to the DSIC. The processes are currently effective and efficient.

As stated previously, NAWC does not believe extensive revisions are necessary to comply with the Supreme Court's Order in *McCloskey*. In its 2012 comments in this proceeding, the Office of Consumer Advocate ("OCA") proposed a very modest change in the Commission's proposed Model DSIC Tariff to recognize accumulated deferred income taxes ("ADIT") on DSIC property. **Appendix A** (Appendix A to the OCA's May 31, 2012 Comments in *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611).

Similarly, NAWC believes that only modest changes are necessary in the DSIC formula to comply with the Supreme Court's Order in *McCloskey*. NAWC's proposed modifications are shown on **Appendix B.** Specifically, NAWC proposes: (1) a modification in the definition of DSI to ensure that ADIT is included in the calculation of this variable; and (2) a change in the definition of PTRR to ensure that flow through state taxes are included in the calculation of this variable. At this time, NAWC does not believe further changes are necessary in the DSIC Model Tariff or the formula for calculating the DSIC.[3]

B. REFUND/RECOUPMENT OF OVERCHARGES

The Commission requested comments on the following topic:

> Determination of the revisions to the DSIC calculations and the potential refund/recoupment of overcharges dated back to August 2016, the date that Act 40 added Section 1301.1 to the Code:
>
> - Should a refund/recoupment be required;
> - Timing of any required refund/recoupment (When should the recoupment begin?)
> - Amortization period of any refund/recoupment;
> - Impact of the refund/recoupment on the utilities DSIC cap for each utility;
> - Should interest be applied, and if so, at what rate and the weighting for when interest is to be applied.

[3] The Commission should recognize that not all utilities are the same and allow a reasonable degree of flexibility in the implementation of *McCloskey* and adoption of a DSIC methodology by a utility.

NAWC does not believe that the Commission should require utilities to refund amounts that they previously collected pursuant to their Commission-approved DSICs. The Supreme Court did not order that such refunds be paid. Therefore, there is no need to order refunds to be paid in order to comply with *McCloskey.*

NAWC respectfully submits that ordering refunds of amounts collected pursuant to a Commission-approved DSIC would constitute retroactive ratemaking, which is generally prohibited.[4] Moreover, in calculating its DSIC, each utility relied upon its Commission-approved tariff which has the "force and effect of law."[5] The financially punitive nature of a retroactive modification of a utility's Commission-approved DSIC tariff provisions would violate constitutional prohibitions against *ex post facto* laws.[6]

Even if the Commission had authority to order refunds, it should not do so in this case. As a practical matter, NAWC doubts that its members have the ability to calculate the past ADIT amounts with the needed accuracy to assure compliance with IRS normalization rules that allow companies to account for these timing differences on a deferred basis. This is especially true when considering that many utilities have also completed base rate cases, zeroed out their DSIC, and received rate base treatment for its ADIT outstanding. To differentiate what portion of the ADIT is DSIC for this time period and what is in base rate tariff revenue is anything but straightforward.

Finally, utilities might have made different business decisions if they had known that ADIT was required to be included in calculating the DSIC. For example, they might have delayed or accelerated different projects based on the DSIC calculations, or they might have selected different projects based on the DSIC calculations. Utilities should not be punished after-the-fact for making

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[4] *See, e.g., Pike County Light and Power. Co. v. Pa. Pub. Util. Comm'n*, 487 A.2d 118 (Pa. Cmwlth. Ct. 1985).
[5] *See, e.g., Pennsylvania Electric Co. v. Pa. Pub. Util. Comm.*, 663 A.2d 281, 284 (Pa. Cmwlth.1995).
[6] *See* Pa. Const. Art. 1, § 17; *see also* U.S. Const. Art. I, § 9, c. 3.

the best decisions they could based on the law in force at the time (including their Commission-approved tariffs and the Commission's interpretation of Section 1301.1).

IV. PROCESS GOING FORWARD

According to the Secretarial Letter, the Commission will convene a working group to discuss the comments submitted in response to the Secretarial Letter. NAWC strongly supports the use of a working group to inform the Commission's decision in this matter. NAWC believes that the free exchange of ideas in a collaborative proceeding will help to identify issues and, hopefully, resolve many of them. NAWC asks to be included in the working group. NAWC also asks that these comments (and all other comments submitted in this proceeding) be provided to the working group.

NAWC recommends that the working group's input be considered by the Commission when it issues a Tentative Second Supplemental DSIC Order. Interested stakeholders should then have the opportunity to submit comments and replies to comments before the Commission issues a Final Second Supplemental DSIC Order. This approach would provide the Commission with the benefit of as much public input as possible, which enhances decision-making and ensures that all interested parties are afforded due process.

V. CONCLUSION

NAWC thanks the Commission for the opportunity to submit these comments. NAWC looks forward to participating in the working group with the Commission and other stakeholders.

[Signature appears on next page.]

Respectfully submitted,

David P. Zambito (PA ID No. 80017)
Jonathan P. Nase (PA ID No. 44003)
Cozen O'Connor
17 North Second Street, Suite 1410
Harrisburg, PA 17101
Telephone: (717) 703-5892
Facsimile: (215) 989-4216
E-mail: dzambito@cozen.com
E-mail: jnase@cozen.com
Counsel for *National Association of Water Companies – Pennsylvania Chapter*

Date: July 22, 2022

APPENDIX A

(Appendix A to the OCA's May 31, 2012 Comments in *Implementation of Act 11 of 2012,* Docket No. M-2012-2293611)

Appendix A
OCA Proposed Change to Model DSIC Tariff

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

the DSIC, then the equity return rate used in the calculation will be the equity return rate calculated by the Commission in the most recent Quarterly Report on the Earnings of Jurisdictional Utilities released by the Commission.

C. Application of DSIC: The DSIC will be expressed as a percentage carried to two decimal places and will be applied to the total amount billed to each customer for distribution service **[WATER and WASTEWATER UTILITIES ONLY:** for service] under the Utility's otherwise applicable rates and charges, excluding amounts billed for **[WATER UTILITIES ONLY:** public fire protection service] and the State Tax Adjustment Surcharge (STAS). To calculate the DSIC, one-fourth of the annual fixed costs associated with all property eligible for cost recovery under the DSIC will be divided by the Utility's projected revenue for distribution service (including all applicable clauses and riders) for the quarterly period during which the charge will be collected, exclusive of **[WATER UTILITIES ONLY:** revenues from public fire protection service and] the STAS.

D. Formula: The formula for calculation of the DSIC is as follows:

$$DSIC = \frac{(DSI * PTRR)+Dep+e}{PQR}$$

Where:

DSI = Original cost of DSIC-eligible ~~distribution system improvement projects~~property net of accrued depreciation and accumulated deferred income taxes related to eligible property..

Comment [EG1]: Accumulated deferred income taxes related to DSIC-eligible property must be deducted from the original cost of the property. Please see the OCA's Comments for further discussion.

PTRR = Pre-tax return rate applicable to DSIC-eligible property.

Dep = Depreciation expense related to DSIC-eligible property.

e = Amount calculated under the annual reconciliation feature or Commission audit, as described below.

PQR = Projected quarterly revenues for distribution service (including all applicable clauses and riders) from existing customers plus revenue from any customers which will be acquired by the beginning of the applicable service period. **[NOTE: UTILITY TO MAKE ELECTION AND STATE WHETHER SUCH QUARTERLY REVENUES WILL BE DETERMINED ON THE BASIS OF EITHER THE SUMMATION OF PROJECTED REVENUES FOR THE APPLICABLE THREE-MONTH PERIOD OR ONE-FOURTH OF PROJECTED ANNUAL REVENUES.]**

APPENDIX B
NAWC's Proposed Modifications
Docket No. M-2012-2293611)

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
(DSIC)

In addition to the net charges provided for in this Tariff, a charge of **___%** will apply consistent with the Commission Order dated ______________ at Docket No. _______________, approving the DSIC.

[NOTE: THIS MODEL TARIFF IS EXPRESSED IN TERMS OF "DISTRIBUTION SYSTEMS." FOR WASTEWATER UTILITIES, THIS REFERS TO THEIR COLLECTION SYSTEMS.]

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
(DSIC)

1. General Description

A. Purpose: To recover the reasonable and prudent costs incurred to repair, improve, or replace eligible property which is completed and placed in service and recorded in the individual accounts, as noted below, between base rate cases and to provide the Utility with the resources to accelerate the replacement of aging infrastructure, to comply with evolving regulatory requirements and to develop and implement solutions to regional supply problems.

The costs of extending facilities to serve new customers are not recoverable through the DSIC.

[**NOTE FOR WATER/WASTEWATER:** Utility projects receiving PENNVEST funding or using PENNVEST surcharges are not DSIC-eligible property to the extent of the PENNVEST funding or surcharge.]

B. Eligible Property: The DSIC-eligible property[1] will consist of the following: [**CHOOSE UTILITY TYPE]**

[ELECTRIC DISTRIBUTION COMPANIES]

- Poles and towers (account 364);
- Overhead conductors (account 365) and underground conduit and conductors (accounts 366 and 367);
- Line transformers (account 368) and substation equipment (account 362);
- Any fixture or device related to eligible property listed above including insulators, circuit breakers, fuses, reclosers, grounding wires, crossarms and brackets, relays, capacitors, converters and condensers;
- Unreimbursed costs related to highway relocation projects where an electric distribution company must relocate its facilities; and
- Other related capitalized costs.

[NATURAL GAS DISTRIBUTION COMPANIES AND CITY NATURAL GAS DISTRIBUTION OPERATIONS]

- Piping (account 376);
- Couplings (account 376);

[1 Whether a project is DSIC eligible is not controlled by the account number. The listing of projects and inclusion of account numbers in the model tariff is illustrative to emphasize that DSIC tariffs must reflect account numbers. The lists of property and account numbers in the model tariff are neither finite nor exclusive.

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

- Gas services lines (account 380) and insulated and non-insulated fittings (account 378);
- Valves (account 376);
- Excess flow valves (account 376);
- Risers (account 376);
- Meter bars (account 382);
- Meters (account 381);
- Unreimbursed costs related to highway relocation projects where a natural gas distribution company or city natural gas distribution operation must relocate its facilities; and
- Other related capitalized costs.

[WATER UTILITIES]

- Services (account 333000), meters (account 334100) and hydrants (account 335000) installed as in-kind replacements for customers;
- Mains and valves (account 331800) installed as replacements for existing facilities that have worn out, are in deteriorated condition, or are required to be upgraded to meet under 52 Pa Code § 65 (relating to water service);
- Main extensions (account 331800) installed to eliminate dead ends and to implement solutions to regional water supply problems that present a significant health and safety concern for customers currently receiving service from the water utility;
- Main cleaning and relining (account 331800) projects; and
- Unreimbursed costs related to highway relocation projects where a water utility must relocate its facilities; and
- Other related capitalized costs.

[WASTEWATER UTILITIES]

- Collection sewers (account 360), collecting mains (account 360), and service laterals (account 361), including sewer taps, curbstops, and lateral cleanouts installed as in-kind replacements for customers;
- Collection mains (account 361) and valves (account 367) for gravity and pressure systems and related facilities such as manholes, grinder pumps, air and vacuum release chambers, cleanouts, main line flow meters, valve vaults, and lift stations installed as replacements or upgrades for existing facilities that have worn out, are in deteriorated condition, or are required to be upgraded by law, regulation, or order;

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

- Collection main extensions (account 381) installed to implement solutions to wastewater problems that present a significant health and safety concern for customers currently receiving service from the wastewater utility;
- Collection main rehabilitation (account 360) including inflow and infiltration projects;
- Unreimbursed costs related to highway relocation projects where a wastewater utility must relocate its facilities; and
- Other related capitalized costs.

C. Effective Date: The DSIC will become effective (**EFFECTIVE DATE**).

2. Computation of the DSIC

A. Calculation: The initial DSIC, effective (**EFFECTIVE DATE**), shall be calculated to recover the fixed costs of eligible plant additions that have not previously been reflected in the Utility's rates or rate base and will have been placed in service between **(THREE-MONTH PERIOD ENDING ONE MONTH PRIOR TO EFFECTIVE DATE)**. Thereafter, the DSIC will be updated on a quarterly basis to reflect eligible plant additions placed in service during the three-month periods ending one month prior to the effective date of each DSIC update. Thus, changes in the DSIC rate will occur as follows:

Effective Date of Change	Date to which DSIC-Eligible Plant Additions Reflected
	(CHART TO BE FILLED IN BY UTILITY)

[THE FOLLOWING PARAGRAPHS PERTAIN TO WATER, WASTEWATER, ELECTRIC DISTRIBUTION, AND NATURAL GAS DISTRIBUTION UTILITIES ONLY. FOR CITY NATURAL GAS DISTRIBUTION OPERATIONS, SEE BELOW.]

B. Determination of Fixed Costs: The fixed costs of eligible distribution system improvements projects will consist of depreciation and pre-tax return, calculated as follows:

1. Depreciation: The depreciation expense shall be calculated by applying the annual accrual rates employed in the Utility's most recent base rate case for the plant accounts in

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

which each retirement unit of DSIC-eligible property is recorded to the original cost of DSIC-eligible property.

2. Pre-tax return: The pre-tax return shall be calculated using the statutory state and federal income tax rates, the Utility's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day for the three-month period ending one month prior to the effective date of the DSIC and subsequent updates. The cost of equity will be the equity return rate approved in the Utility's last fully litigated base rate proceeding for which a final order was entered not more than two years prior to the effective date of the DSIC. If more than two years shall have elapsed between the entry of such a final order and the effective date of the DSIC, then the equity return rate used in the calculation will be the equity return rate calculated by the Commission in the most recent Quarterly Report on the Earnings of Jurisdictional Utilities released by the Commission.

C. Application of DSIC: The DSIC will be expressed as a percentage carried to two decimal places and will be applied to the total amount billed to each customer for distribution service [**WATER and WASTEWATER UTILITIES ONLY:** for service] under the Utility's otherwise applicable rates and charges, excluding amounts billed for [**WATER UTILITIES ONLY:** public fire protection service] and the State Tax Adjustment Surcharge (STAS). To calculate the DSIC, one-fourth of the annual fixed costs associated with all property eligible for cost recovery under the DSIC will be divided by the Utility's projected revenue for distribution service (including all applicable clauses and riders) for the quarterly period during which the charge will be collected, exclusive of [**WATER UTILITIES ONLY:** revenues from public fire protection service and] the STAS.

D. Formula: The formula for calculation of the DSIC is as follows:

$$\text{DSIC} = \frac{(\text{DSI} * \text{PTRR}) + \text{Dep}}{\text{PQR}} + \frac{e}{\text{PQR}}$$

Where:

DSI = Original cost of eligible distribution system improvement projects net of accrued depreciation <u>and accumulated deferred income taxes related to eligible property</u>.

PTRR = Pre-tax return rate applicable to DSIC-eligible property <u>utilizing flow through state taxes</u>.

Dep = Depreciation expense related to DSIC-eligible property.

e = Amount calculated (+/-) under the annual reconciliation feature or Commission audit, as described below.

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
(DSIC)

PQR = Projected quarterly revenues for distribution service (including all applicable clauses and riders) from existing customers plus netted revenue from any customers which will be gained or lost by the beginning of the applicable service period.
[**NOTE: UTILITY TO MAKE ELECTION AND STATE WHETHER SUCH QUARTERLY REVENUES WILL BE DETERMINED ON THE BASIS OF EITHER THE SUMMATION OF PROJECTED REVENUES FOR THE APPLICABLE THREE-MONTH PERIOD OR ONE-FOURTH OF PROJECTED ANNUAL REVENUES.]**

[NOTE: The DSIC calculation does not factor in the plant of acquired troubled companies or the revenue of customers acquired from troubled companies until such plant and customer rates have been part of a base rate case by the acquiring utility.]

[FOR CITY NATURAL GAS DISTRIBUTION OPERATIONS ONLY]

B. Recoverable Costs: The recoverable costs shall be amounts reasonably expended or incurred to purchase and install eligible property and associated financing costs, if any, including debt service, debt service coverage, and issuance costs.

C. Application of DSIC: The DSIC will be expressed as a percentage carried to two decimal places and will be applied to the total amount billed to each customer for distribution service under the Utility's otherwise applicable rates and charges. To calculate the DSIC, one-fourth of the annual recoverable costs associated with all property eligible for cost recovery under the DSIC will be divided by the Utility's projected revenue for distribution services (including all applicable clauses and riders) for the quarterly period during which the charge will be collected.

D. Formula: The formula for calculation of the DSIC is as follows:

$$DSIC = \frac{DSI}{PQR} + \frac{e}{PQR}$$

Where:

DSI = Recoverable costs (defined in Section B. directly above)

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

e	=	the amount calculated under the annual reconciliation feature or Commission audit, as described below.
PQR	=	Projected quarterly revenues for distribution service (including all applicable clauses and riders) including any revenue from existing customers plus netted revenue from any customers which will be gained or lost by the beginning of the applicable service period. [**NOTE: UTILITY TO MAKE ELECTION AND STATE WHETHER SUCH QUARTERLY REVENUES WILL BE DETERMINED ON THE BASIS OF EITHER THE SUMMATION OF PROJECTED REVENUES FOR THE APPLICABLE THREE-MONTH PERIOD OR ONE-FOURTH OF PROJECTED ANNUAL REVENUES.]**

3. Quarterly Updates: Supporting data for each quarterly update will be filed with the Commission and served upon the Commission's Bureau of Investigation and Enforcement, the Office of Consumer Advocate, and the Office of Small Business Advocate at least ten (10) days prior to the effective date of the update.

4. Customer Safeguards

A. Cap: The DSIC is capped at 5.0% of the amount billed to customers for distribution service (including all applicable clauses and riders) as determined on an annualized basis.

[Note: Several water utilities have Commission-approved DSICs that are capped at 7.5% of the amount billed for service.]

B. Audit/Reconciliation: The DSIC is subject to audit at intervals determined by the Commission. Any cost determined by the Commission not to comply with any provision of 66 Pa C.S. §§ 1350, *et seq.*, shall be credited to customer accounts. The DSIC is subject to annual reconciliation based on a reconciliation period consisting of the twelve months ending December 31 of each year or the utility may elect to subject the DSIC to quarterly reconciliation but only upon request and approval by the Commission. The revenue received under the DSIC for the reconciliation period will be compared to the Company's eligible costs for that period. The difference between revenue and costs will be recouped or refunded, as appropriate, in accordance with Section 1307(e), over a one-year period commencing on April 1 of each year, or in the next quarter if permitted by the Commission. If DSIC revenues exceed DSIC-eligible costs, such over-collections will be refunded with interest. Interest on over-collections and credits will be calculated at the residential mortgage lending specified by the Secretary of Banking in accordance with the Loan Interest and Protection Law (41 P.S. §§ 101, *et seq.*) and

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

will be refunded in the same manner as an over-collection. The utility is not permitted to accrue interest on under collections.

C. New Base Rates: The DSIC will be reset at zero upon application of new base rates to customer billings that provide for prospective recovery of the annual costs that had previously been recovered under the DSIC. Thereafter, only the fixed costs of new eligible plant additions that have not previously been reflected in the Utility's rates or rate base will be reflected in the quarterly updates of the DSIC.

D. Customer Notice: Customers shall be notified of changes in the DSIC by including appropriate information on the first bill they receive following any change. An explanatory bill insert shall also be included with the first billing.

E. All customer classes: The DSIC shall be applied equally to all customer classes.

F. Earning Reports: The DSIC will also be reset at zero if, in any quarter, data filed with the Commission in the Utility's then most recent Annual or Quarterly Earnings reports show that the Utility would earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the DSIC as described in the pre-tax return section. <u>The utility shall file a tariff supplement implementing the reset to zero due to overearning on one-day's notice and such supplement shall be filed simultaneously with the filing of the most recent Annual or Quarterly Earnings reports indicating that the Utility has earned a rate of return that would exceed the allowable rate of return used to calculate its fixed costs.</u> **[NOTE: THIS PARAGRAPH IS NOT APPLICABLE TO CITY NATURAL GAS DISTRIBUTION OPERATIONS UTILITIES.]**

~~**G. Public Fire Protection**: The DSIC of a water utility will not apply to public fire protection customers.~~

G. Residual E-Factor Recovery Upon Reset To Zero: The utility shall file with the Commission interim rate revisions to resolve the residual over/under collection or E-factor amount after the DSIC rate has been reset to zero. The utility can collect or credit the residual over/under collection balance when the DSIC rate is reset to zero. The utility shall refund any overcollection to customers and is entitled to recover any undercollections as set forth in Section 4.B. Once the utility determines the specific amount of the residual over or under collection amount after the DSIC rate is reset to zero, the utility shall file a tariff supplement with supporting data to address that residual amount. The tariff supplement shall be served upon the Commission's Bureau of Investigation and Enforcement, the Bureau of Audits, the Office of

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Consumer Advocate, and the Office of Small Business Advocate at least ten (10) days prior to the effective date of the supplement.

H. **Public Fire Protection**: The DSIC of a water utility will not apply to public fire protection customers.