PENNSYLVANIA
PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17105-3265

Public Meeting held October 27, 2022

Commissioners Present:
Gladys Brown Dutrieuille, Chairman
Stephen M. DeFrank, Vice Chairman
Ralph V. Yanora
Kathryn L. Zerfuss
John F. Coleman, Jr.

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 Nos.: M-2012-2293611

SUPPLEMENTAL IMPLEMENTATION ORDER

BY THE COMMISSION:

On April 22, 2022, the Pennsylvania Public Utility Commission (Commission) issued a Secretarial Letter (April Secretarial Letter) to provide interested parties notice and an opportunity to be heard and to initiate a generic proceeding for the purpose of revising the Model Tariff adopted by the Commission on August 2, 2012, to comply with Section 1301.1(a) of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 1301.1(a), as interpreted by the Pennsylvania Supreme Court in McCloskey v. Pa. Pub. Util. Comm'n, 255 A.3d 416 (Pa. 2021) (*McCloskey*).

The April Secretarial Letter initiated the generic proceeding and sought comments within thirty (30) days from interested parties addressing four key topics, which will facilitate resolution of the issues stemming from the *McCloskey* decision described in the

Letter. Subsequently, the Commission extended the timeframe for filing comments to July 22, 2022.[1]

By this order, the Commission has determined that there is general agreement on the changes that must be made to the DSIC calculation and the DSIC model tariff to implement changes required by the *McCloskey* decision. As such, the Commission directs each utility to file a proforma tariff supplement reflecting the updated formula for calculation of the DSIC, as set forth in Appendix A, the New Model DSIC Tariff attached to this Implementation Order, by December 1, 2022. Upon Commission approval of the pro forma supplement, each utility shall file its quarterly DSIC calculations and corresponding tariff updates by December 21, 2022, to be effective on January 1, 2023. [2] The updated DSIC calculations will therefore be made with each utility's fourth quarter 2022 quarterly DSIC filing. In this way, the DSIC surcharge mechanism will be in place for 2023 and avoid any further delay in implementing the changes required by the *McCloskey* decision.

Based on the comments received, issues related to refunds that may be required due to the *McCloskey* decision are beyond the scope of this implementation proceeding and cannot be made on the record before the Commission in this proceeding.

Background

As noted above, on April 22, 2022, the Commission issued a Secretarial Letter to provide interested parties notice and an opportunity to be heard and to initiate a generic proceeding for the purpose of revising the Model Tariff adopted in its Implementation

---

[1] The Energy Association of Pennsylvania filed a Petition for Expedited Consideration of its request to extend the due date for all interested parties to submit comments to the April 22 Secretarial Letter which was subsequently granted by the PUC on May 18, 2022.

[2] As will be explained in the body of the order, the Philadelphia Gas Works and Pittsburgh Water and Sewer Authority will not be required to file updated tariffs. Additionally, the Newtown Artesian Water Company, Inc. and the Columbia Water Company may file an updated DSIC calculation with their quarterly DSIC filings on January 21, 2023 with an effective date of February 1, 2023.

Order entered at Docket No. M-2012-2293611on August 2, 2012, to comply with Section 1301.1(a) of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 1301.1(a), as interpreted by the Pennsylvania Supreme Court in *McCloskey*.

In *McCloskey*, the Supreme Court affirmed the holding of the Commonwealth Court that new statutory language added by Act 40 applied to the DSIC and altered its calculation. Specifically, the Court affirmed the Commonwealth Court's decision, finding that Section 1301.1(a) of the Public Utility Code requires state income tax deductions and accumulated deferred federal income taxes (ADIT) associated with DSIC-eligible plant additions to be included in the DSIC calculation. *McCloskey*, 255 A.3d at 427. The Supreme Court remanded the matter, which involved Metropolitan Edison Company, Pennsylvania Electric Company, Pennsylvania Power Company and West Penn Power Company (collectively, the "FE Companies"), to the Commission for the purpose of requiring revisions to the FE Companies' tariffs and DSIC calculations in accordance with its interpretation of Section 1301.1(a) of the Public Utility Code, 66 Pa. C.S. § 1301.1(a).[3] *McCloskey*, 255 A.3d at 437.

On January 31, 2022, the FE Companies filed a Petition for Interlocutory Review and Answer to Material Question asking the Commission to initiate a generic proceeding in light of due process concerns for the purpose of revising the model DSIC tariff[4] to comply with the Supreme Court interpretation of Section 1301.1 (a) of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 1301.1 (a). In its Order entered February 24, 2022, ,[5] the Commission affirmed the Petition for Interlocutory Review and Answer to Material Question filed by the FE Companies, stating:

---

[3] *See Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, *et al*., at Docket Nos. P-2015-2508942, P-2015-2508948, P-2015-2508936 and P-2015-2508931.

[4] The current model DSIC tariff was approved by the Commission in 2016. *See, Supplemental Implementation Order Re: Implementation of Act 11 of 2012,* Docket No. M-2012-2293611 (September 15, 2016).

[5] *See Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, *et al*., Opinion and Order at Docket Nos. P-2015-2508942, P-2015-2508948, P-2015-2508936 and P-2015-2508931. (*February Order*).

> In order to provide all interested parties notice and an opportunity to be heard, as due process requires, should the Commission initiate a generic proceeding within 60 days from a determination on this material question at Docket No. M-2012-2293611 for the purpose of revising the Model Tariff adopted in its Implementation Order entered at that docket number on August 2, 2012, to comply with Section 1301.1(a) of the Pennsylvania Public Utility Code as interpreted by the Pennsylvania Supreme Court in McCloskey v. Pa. PUC, 255 A.3d 416 (Pa. 2021)?

February Order, Ordering Paragraph 1.

Additionally, the Commission ordered:

> That the Commission's Secretary's Bureau in consultation with the Bureau of Technical Utility Services within sixty (60) days of entry of this Opinion and Order issue a secretarial letter with appropriate notices to all jurisdictional water and wastewater utilities, electric distribution companies, natural gas distribution companies and city natural gas distribution operations and all appropriate stakeholders establishing a generic proceeding at Docket No. M-2012-2293611 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).

February Order, Ordering Paragraph 2.

In order to provide a forum for discussion and feedback from stakeholders as ordered by the Commission, the April Secretarial Letter invited interested persons to provide comments and to address the following key topics:

- 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;

- 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; and

- 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.

Discussion

Comments were received from the Office of Consumer Advocate (OCA), the Energy Association of Pennsylvania (EAP),[6] the National Association of Water Companies (NAWC),[7] the Industrial Energy Consumers of Pennsylvania (IECPA),[8] the

[6] The EAP is a trade association whose members include the major natural gas and electric public utilities operating in the Commonwealth of Pennsylvania. Its electric distribution company (EDC) members include : Citizens' Electric Company; Duquesne Light Company; Metropolitan Edison Company; PECO Energy Company; Pennsylvania Electric Company; Pennsylvania Power Company; Pike County Light & Power Company; PPL Electric Utilities Corporation; UGI Utilities, Inc. (Electric Division); Wellsboro Electric Company; and, West Penn Power Company, and its natural gas distribution company (NGDC) members include: Columbia Gas of Pennsylvania, Inc.; Pike County Light & Power Company; National Fuel Distribution Corp.; PECO Energy Company; Peoples Natural Gas Company LLC; Philadelphia Gas Works.; UGI Utilities Inc.; and Valley Energy Inc.

[7] The NAWC is a trade organization whose members are investor-owned water and wastewater utilities in Pennsylvania. The members of NAWC include 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.).

[8] The IECPA is an association of energy-intensive industrial consumers of electricity and natural gas taking service from regulated utilities in Pennsylvania. IECPA states that for the purpose of this matter, IECPA's membership consists of: Air Products & Chemicals, Inc.; Benton Foundry, Inc.; Carpenter Technology Corporation; Cleveland-Cliffs Inc.; East Penn Manufacturing Company; Keystone Cement Company; Knouse Foods Cooperative, Inc.; Linde, Inc.; Marathon Petroleum Corporation; Proctor & Gamble Paper Products Company; and United States Gypsum Company.

Columbia Water Company (CWC), the FE Companies, PPL Electric Utilities Corporation (PPL Electric), Philadelphia Gas Works (PGW) and Duquesne Light Company. Other companies such as UGI Utilities, Inc. and PPL Electric provided additional contacts for the informal exchange of information related to the DSIC ADIT proceeding.

A. **<u>Elements of the formula required for calculating quarterly DSIC updates.</u>**

Prior to determining any changes to the current DSIC Model Tariff we will discuss the Elements of the formula required for calculating quarterly DSIC updates needed to determine the following: (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 such that 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.

The Commission notes that the Philadelphia Gas Works (PGW) and the Pittsburgh Water and Sewer Authority (PWSA) do not need to modify their DSIC respective tariffs because these entities are permitted a different methodology in determining their DSIC surcharge and each of these entities are not subject to state or federal taxes.

(1) State Income Tax Deductions

Commentors agree that per *McCloskey* the DSIC calculation will need to be adjusted for actual state taxes. The EAP defined State Tax Flow Through (STFT) as the “pre-tax flow through calculated on book-tax timing differences between accelerated tax depreciation and book depreciation, net of federal tax.” EAP Comments at 5. The Commission accepts the use of this term to define a utility’s state income tax deductions for the purposes of its DSIC tariff.

Both the EAP and the OCA suggest that the STFT can be used to adjust the DSIC calculation for the STFT by either calculating the STFT by a separate calculation (Method 1), or alternatively, by using an effective tax rate method and include the STFT in the pre-tax rate of return (PTRR) component (Method 2). Method 1 as proposed by the OCA would determine the amount of state income tax expense that's reflected in the DSIC revenue requirement. This amount would not be converted to a percentage and the unadjusted statutory state income tax rate would be used as a separate component in the DSIC surcharge calculation. Alternately, Method 2 would derive an effective tax rate and this effective tax rate would be used in the tax gross-up for the PTRR calculation. EAP Comments at 5-6, OCA Comments at 2. OCA states that Method 2 is its preferred method and the NAWC suggests using the PTRR calculation as the means for adjusting the DSIC for state taxes. OCA Comments at 4, NWAC Comments at 5. The EAP suggests that the model DSIC tariff provide utilities with the option to include the alternative approach (Method 2) in their specific DSIC tariff. EAP Comments at 5-6.

CWC suggests that the Commission should allow utilities flexibility and optionality in how to apply Section 1301.1 to their respective DSICs and that at this time the "Effective Tax Rate" method proposed by the OCA in the *McCloskey* proceeding appears to be an efficient and straightforward method of implementation for CWC. CWC further notes that it prefers using the effective tax rate paid by a utility instead of the statutory tax rate to modify the revenue conversion factor/tax multiplier used to calculate the PTTR in the DSIC formula. CWC Comments at 1,4.

The Commission has determined that utilities with a DSIC mechanism should revise their tariffs to incorporate its STFT into the DSIC formula and will permit either Method 1 or Method 2 as described above. Ultimately, either method will calculate an identical DSIC surcharge. However, as suggested by the OCA, the Commission prefers that Method 2 be used when a utility calculates its DSIC surcharge.

(2) Federal Income Tax Deductions

Commentors agree that federal income taxes should be reflected in the tax credits associated with DSIC-eligible infrastructure investment in DSIC rates by reducing the net DSIC plant investment amount by the directly related Accumulated Deferred Income Taxes (ADIT). More specifically, the EAP suggests that ADIT be recognized and included in the Distribution System Improvement ("DSI") component of the formula and expands the definition of DSI to include the phrase "and associated accumulated deferred income taxes pertaining to property-related book/tax depreciation timing differences resulting from the use of accelerated depreciation per Internal Revenue Code, 26 U.S. Code § 168" at the end of the sentence to comply with the Supreme Court interpretation of Section 1301.1(a). 66 Pa. C.S. § 1301.1(a). EAP Comments at 5. The OCA and NAWC also agree that the DSI component of the tariff should be modified to include ADIT and the model tariff should be modified accordingly. OCA Comments at 7.

Similar to adjusting for state taxes, CWC suggest that it prefers using the effective tax rate paid by a utility instead of the statutory tax rate to modify the revenue conversion factor (or tax multiplier) used to calculate the PTTR in the DSIC formula. CWC Comments at 4.

Accordingly, the Commission directs all jurisdictional utilities that have a DSIC mechanism to modify their tariffs as suggested by the EAP to include ADIT in the DSI component of the formula and expand the definition of DSI to include the phrase "and associated accumulated deferred income taxes pertaining to property-related book/tax depreciation timing differences resulting from the use of accelerated depreciation per Internal Revenue Code, 26 U.S. Code § 168."

Additionally, to provide for flexibility and optionality in how to apply Section 1301.1 to their respective DSICs as requested by CWC and echoed by the NAWC, the Commission will permit those companies with the inability to determine its ADIT on a quarterly basis and/or pay no federal income taxes, to adjust its federal income using the effective tax rate paid by a utility, instead of the statutory tax rate, to modify the revenue conversion factor (or tax multiplier) used to calculate the PTTR in the DSIC formula. However, the Commission's preference is that the DSI component be adjusted for ADIT and that the PTRR adjustment for federal taxes be permitted only in particular circumstances as described above.

B. Required DSIC Model Tariff Changes

The DSIC Model Tariff changes will mirror the discussion of state income tax adjustments, STFT, and the federal tax adjustments mainly due to ADIT. Currently, the formula for calculation of the DSIC rate is as follows:

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

Where:

DSI = Original cost of eligible distribution system improvement projects net of accrued depreciation.

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.]**

The Commission proposes that the changes to the Model Tariff mirror the model tariff as presented by the EAP in its comments where:

The formula for calculation of the DSIC is as follows:

$$\text{DSIC} = \frac{(\text{DSI} * \text{PTRR} + \text{STFT} + \text{Dep} + e) \times 1/(1-T)}{\text{PQR}}$$

Where:

DSI = Original cost of eligible distribution system improvement projects net of accrued depreciation **and associated accumulated deferred income taxes pertaining to property-related book/tax depreciation timing differences resulting from the use of accelerated depreciation per Internal Revenue Code, 26 U.S. Code § 168.**

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

Dep = Depreciation expense related to DSIC-eligible property.

STFT (State Tax Flow Through) = Pre-tax flow through calculated on book-tax timing differences between accelerated tax depreciation and book depreciation net of federal tax [Note that a utility may elect to include STFT calculation in the PTRR component.]

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 applicable customers. [**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.]

T= If applicable, Pennsylvania Gross Receipts Tax rate in effect during the billing month, expressed in decimal form.

EAP Comments Attachment A.

Alternately, for those utilities that desire the flexibility to report their federal tax adjustment through the PTRR as described above, the model tariff may be changed to reflect the following definition of Pre-Tax return:

Pre-Tax Return: The pre-tax return will be calculated using the Company's effective tax rate [rather than its **statutory** state and federal income tax rates].

C. Standards to establish a reconciliation process

The Commission requested comments regarding the need for 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.

The OCA recommended that state income tax expense and ADIT should be trued-up at the same time the utility prepares its annual DSIC reconciliation for each calendar year and in the same manner in which estimates for projected quarterly DSIC revenue are reconciled to actual per 66 Pa. C.S. §§ 1357(d), 1358(d)(2), (e). OCA Comments at 15.

EAP, along with the FE Companies and PPL Electric suggest that a reconciliation process as already provided in the DSIC tariff is sufficient and that no additional reconciliation is necessary.[9] EAP Comments at 8, FE Companies Comments at 10, PPL Electric Comments at 8-9. These parties further explain that the quarterly DSIC calculation is based on eligible property placed in service and can be determined at the time of the DSIC rate filing, including the calculation of ADIT and STFT. Therefore, reconciliation of the book versus tax depreciation timing differences would not be necessary as such differences are already included in the DSIC calculation. EAP Comments at 8, FE Companies Comments at 10, PPL Electric Comments at 8.

[9] PPL Electric and EAP do suggest that a reconciliation may be necessary if legislation is passed that changes the way tax depreciation is calculated on a retrospective basis.

The Commission agrees that an additional reconciliation process for ADIT and STFT is not warranted at this time and that the reconciliation of DSIC revenues and DSIC costs as provided in the model tariff is sufficient.

In its request for comments, the Commission also requested that the DSIC calculation changes required by the *McCloskey* Decision be made in such a way 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. In general, Commentors have not provided much in the way of details as to the supporting calculations/information that will be required for the STFT and ADIT/federal tax adjustments.

PPL Electric in its detailed explanation as to why a reconciliation process is not required details its process for determining how the company can calculate the actual tax depreciation and utilize the actual book depreciation on its DSIC assets to calculate the deferred tax and state flow-through impacts. PPL Electric further explains that "By isolating the DSIC assets in a separate tax case, PPL Electric can calculate the actual tax depreciation and utilize the actual book depreciation on the DSIC assets to calculate the deferred tax and state flow-through impacts. Because the tax system calculates an annual tax depreciation amount on monthly book additions, PPL Electric will allocate the annual tax deprecation calculated each period (monthly or quarterly) across the remaining months of the year to be more in line with how book depreciation is reflected. By the end of each year, the DSIC will be completely supported by the cumulative net book and net tax amounts reflected in the tax system." PPL Electric states that it uses a similar approach in the Smart Meter Rider – Phase 2. PPL Comments at 8.

The OCA states: "To inform the evaluation and consideration of these matters by the Commission and its staff, the OCA suggests that the utilities with DSIC provisions in their tariffs should be directed to inform the Commission whether they are subject to income tax return filing requirements and/or whether they pay federal and state income taxes. To the extent that some utilities with DSICs are not subject to income taxes (such as municipally-owned utilities), a different modification to the DSIC tariff and supporting calculations may be warranted." OCA Comments at 10.

The Commission agrees with the example provided by PPL Electric and directs jurisdictional utilities to track and file adequate documentation to adjust their DSIC for STFT and federal ADIT as described above.

Conclusion

The purpose of this Supplemental Implementation Order is to address the DSIC calculation and the DSIC model tariff to implement changes required by the *McCloskey* decision. The Commission has determined that to comply with the *McCloskey* decision jurisdictional utilities that have a DSIC mechanism file an updated DSIC tariff and DSIC calculations consistent with the Model Tariff as attached as Appendix A. The updated Model Tariff should be filed as the utility's fourth quarter 2022 quarterly DSIC filing with an issue date of December 1, 2022 to be effective January 1, 2023. Should a utility not file a tariff consistent with the Model Tariff, such as those variances described by the Columbia Water Company, it should provide an explanation for the variance. The Commission will review the tariff filings and claims made under this Supplemental DSIC Implementation Order and will, after notice and opportunity to be heard, adjudicate any disputes as they arise; **THEREFORE,**

IT IS ORDERED:

1. That the Secretary shall publish a copy of this Supplemental Implementation Order in the *Pennsylvania Bulletin.*

2. That all jurisdictional utilities with a Commission-approved DSIC mechanism file a pro forma tariff supplement reflecting the updated formula for calculation of the DSIC, as set forth in Appendix A, the New Model DSIC Tariff attached to this Implementation Order by December 1, 2022. Upon Commission approval of the pro forma supplement, the utility shall be permitted to implement the proposed tariff changes with its quarterly DSIC update effective January 1, 2023.

3. That a copy of this Supplemental Implementation Order be served on all jurisdictional water and wastewater companies, electric distribution companies, natural gas distribution companies and Philadelphia Gas Works, the Energy Association of Pennsylvania, the National Association of Water Companies, the Industrial Energy Consumers of Pennsylvania and the statutory advocates.

BY THE COMMISSION,

Rosemary Chiavetta
Secretary

(SEAL)

ORDER ADOPTED: October 27,2022
ORDER ENTERED: October 27, 2022

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17105-3265

APPENDIX A

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.

[**WATER/WASTEWATER UTILITIES ONLY:** 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[10] 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);
- Gas services lines (account 380) and insulated and non-insulated fittings (account 378);
- Valves (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)

- 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;
- 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

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

- 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 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

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

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/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:

$$\text{DSIC} = \frac{(\text{DSI} * \text{PTRR} + \text{STFT} + \text{Dep} + \text{e}) \times 1/(1-\text{T})}{\text{PQR}}$$

Where:

DSI	=	Original cost of eligible distribution system improvement projects net of accrued depreciation and associated accumulated deferred income taxes pertaining to property-related book/tax depreciation timing differences resulting from the use of accelerated depreciation per Internal Revenue Code, 26 U.S. Code § 168.
PTRR	=	Pre-tax return rate applicable to DSIC-eligible property.
STFT	=	(State Tax Flow Through) Pre-tax flow through calculated on book-tax timing differences between accelerated tax depreciation and book depreciation net of federal tax. **[NOTE: UTILITY MAY ELECT TO INCLUDE STFT CALCULATION IN THE PTRR COMPONENT.]**
Dep	=	Depreciation expense related to DSIC-eligible property.
e	=	Amount calculated (+/-) under the annual reconciliation feature or Commission audit, as described below.
T	=	If applicable, Pennsylvania Gross Receipts Tax rate in effect during the billing month, expressed in decimal form.
PQR	=	Projected quarterly revenues for distribution service (including all applicable clauses and riders) from applicable customers. **[NOTE: UTILITY TO MAKE ELECTION AND STATE WHETHER SUCH QUARTERLY REVENUES WILL BE DETERMINED ON THE BASIS OF EITHER THE SUMMATION OF**

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
(DSIC)

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:

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

Where:

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

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

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 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.

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (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. The utility shall file a tariff supplement implementing the reset to zero due to overearning on one-days' 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. **[NOTE: THIS PARAGRAPH IS NOT APPLICABLE TO CITY NATURAL GAS DISTRIBUTION OPERATIONS UTILITIES.]**

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 under collections 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 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.