

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)

1. General Description

Purpose: To recover the fixed costs (depreciation and pre-tax return) of certain non-revenue producing, non-expense reducing distribution system improvement projects completed and placed in service as described below, between base rate cases and to provide the Company with the resources to accelerate the replacement of aging water distribution infrastructure, to comply with evolving regulatory requirements imposed by the Safe Drinking Water Act and to develop and implement solutions to regional water supply problems.

Eligible Distribution System Improvements: Means new, used and useful water utility plant projects that:

- (a) were not included in the public utility's rate base in its most recent general rate case; and which
- (b) replace or renew water mains, valves, services, meters and hydrants serving existing customers that have reached their useful service life, are worn out, are in deteriorated condition, or which negatively impact the quality and reliability of service to the customer if not replaced or renewed; or
- (c) extend mains to eliminate dead ends which negatively impact the quality and reliability of service to the customer; or
- (d) relocate existing facilities as a result of governmental actions that are not reimbursed, including but not limited to relocations of mains located in highway rights of way as required by the Department of Transportation; or
- (e) place in service, for the benefit of the customers of the water utility applying for the DSIC rate, water supply sources identified as "A list projects" in the Governor's Task Force Report dated December 2, 1999 to resolve the regional water supply concerns or subsequently added to the "A list projects" by the Delaware Water Supply Coordinating Council, all such added projects to have been so identified by the Delaware Water Supply Coordinating Council by December 31, 2002; or
- (f) place in service new or additional water treatment facilities, plant or equipment required to meet changes in state or federal water quality standards, rules or regulations.

Effective Date: The DSIC will become effective for bills rendered on and after January 1 and July 1 of every year.

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC) (Continued...)

2. Computation of the DSIC

Calculation: The initial charge shall be calculated to recover the fixed costs of eligible plant additions that have not previously been reflected in the Company's rate base and will have been placed in service before October 31, 2001. Thereafter, the DSIC will be updated on a semi annual basis to reflect eligible plant additions placed in service during the six month periods ending two months prior to the effective date of each DSIC update. Any request for a change in the DSIC rate will be filed, together with supporting data, at least 30 days before its effective date.

The fixed costs of eligible distribution system improvement projects will consist of depreciation and pre-tax return, calculated as follows:

Depreciation: The depreciation expense will be calculated by applying to the original cost of DSIC-eligible property the annual accrual rates employed in the Company's last base rate case for the plant accounts in which each retirement unit of DSIC-eligible property is recorded.

Pre-Tax Return: Revenues necessary to:

- (a) Produce net operating income equal to the public water utility's weighted cost of capital as established in the most recent general rate proceeding for the public water utility multiplied by the net original cost of eligible distribution system improvements. At any time the Commission, by its own motion, or by motion of the water utility, Commission staff or the Public Advocate, may determine to revisit and, after hearing without the necessity of a general rate filing, reset a water utility's cost of capital to reflect its current cost of capital. The DSIC rate shall be adjusted back to the date of the motion to reflect any change in the cost of capital determined by the Commission through this process;
- (b) Provide for the tax deductibility of the debt interest component of the weighted cost of capital;
- (c) Pay state and federal income taxes applicable to such income.

DSIC Surcharge Amount: The charge will be expressed as a percentage carried to two decimal places and will be applied to the total amount billed to each customer under the Company's otherwise applicable rates and charges. To calculate the DSIC, one-half of the annual fixed costs associated with all property eligible for cost recovery under the DSIC will be divided by the Company's projected revenue for sales of water for the semi-annual period during which the charge will be collected.

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC) (Continued...)

The DSIC Rate applied between base rate filings shall be capped at 7.5% of the amount billed to customers under otherwise applicable rates and charges, but the DSIC rate increase applied shall not exceed 5% within any twelve month period.

The DSIC Rate shall be subject to audit at intervals determined by the Commission. It will also be subject to annual reconciliation based on a period consisting of the 12 months ending December 31 of each year. The revenue received under the DSIC Rate for the reconciliation period shall be compared to the public water utility's eligible costs for that period with the difference between revenue received and eligible costs for the period recouped or refunded, as appropriate, over a one year period commencing July 1 of each year. If the DSIC Revenues exceeded the DSIC eligible costs, such over-collections shall be refunded with interest.

The DSIC Rate shall be reset to zero as of the effective date of new base rates that provide for the prospective recovery of the annual costs theretofore recovered under the DSIC Rate.

The DSIC Rate shall also be reset to zero if, in any quarter, data filed with the Commission by the public water utility show that the public water utility will earn a rate of return that exceeds the rate of return established in the last general rate filing or by Commission order pursuant to §314(a)(5)(i) of this Title, if such was determined subsequent to the final order in the water utility's last general rate filing. Further, the DSIC rate shall be reinstated when such data show that the established rate of return is not exceeded and will not be exceeded if the DSIC is reinstated and reset.

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.

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE

In addition to the net charges provided for in this Tariff, a charge of 0.91% will apply to all charges for bills rendered on or after July 1, 2010.

The above charge will be recomputed semi-annually, using the elements prescribed by Section 314 of Title 26 of the Delaware Code.

