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**DISTRIBUTION SYSTEM IMPROVEMENT CHARGE (DSIC)****I. 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 and to be recorded in the individual accounts, as noted 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. The costs of extending facilities to serve new customers are not recoverable through DSIC. Also, Company projects receiving PENNVEST funding are not DSIC-eligible property.

**Eligible Property:** The DSIC-eligible property will consist of the following:

- services (account 323), meters (account 324) and hydrants (account 325) installed as in-kind replacements for customers;
- mains and valves (account 322) installed as replacements for existing facilities that have worn out, are in deteriorated condition, or upgraded to meet Chapter 65 regulations of Title 52.
- main extensions (account 322) installed to eliminate dead ends and to implement solutions to regional water supply problems that have been documented as presenting a significant health and safety concern for customers currently receiving service from the Company or the acquired Company.
- main cleaning and relining (account 322) projects; and
- unreimbursed funds related to capital projects to relocate Company facilities due to highway relocations.

**Effective Date:** The DSIC will become effective for bills rendered on and after March 8, 1998.

**II. 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 between September 1, 1997, and November 30, 1997. 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:

<u>Effective date of Change</u>	<u>Date to Which DSIC-Eligible Plant Addition Reflected</u>
April 1	February 28/29
July 1	May 31
October 1	August 31
January 1	November 30

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:** The pre-tax return will be calculated using the state and federal income tax rates, the capital structure and actual cost rates for long-term debt and preferred stock of the corporation that is the source of the Company's external financing as of the last day of the three-month period ending one month prior to the effective date of the DSIC and subsequent updates; provided, however, that if the Commission uses a certain capital structure in determining rate of return in the Company's most recent fully-litigated base-rate case, the Company will use such a Commission-determined capital structure to determine pre-tax return. The cost of equity will be the equity return rate approved in the Company's previous base-rate proceeding (either by adjudication of a disputed issue or by approval of a cost of equity to be used in calculating a DSIC agreed to in conjunction with a full or partial settlement), in a rate case for which a final order was entered not more than two years prior to the effective date of the DSIC calculation. If more than two years shall have elapsed between the entry of such a final order and the effective date of the DSIC calculation, then the equity return rate used in the calculation will be the equity return rate calculated by the Commission Staff in the latest Quarterly Report on the Earnings of Jurisdictional Utilities released by the Commission.

**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, excluding amounts billed for 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 Company's projected revenue for sales of water for the quarterly period during which the charge will be collected, exclusive of revenues from public fire protection service and the STAS.

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**Formula:** The formula for calculation of DSIC Surcharge is as follows:

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

**Where:**

DSIC= the original cost of eligible distribution system improvement projects net of accrued depreciation

PTRR= The pre-tax return rate applicable to eligible distribution system improvement projects.

Dep = Depreciation expense related to eligible distribution system improvement projects.

e = The amount calculated under the annual reconciliation feature as described below.

PQR = Projected quarterly revenue including any revenue from acquired companies that are now being charged the rates of the acquiring company.

**Quarterly updates:** Supporting data for each quarterly update will be filed with the Commission and served upon the Office of Trial Staff, the Office of Consumer Advocate and the Office of Small Business Advocate at least ten (10) days prior to the effective dates of the update.

### III. Safeguards

**Cap:** The DSIC will be capped at 5% of the amount billed to customers under otherwise applicable rates and charges.

**Audit/Reconciliation:** The DSIC will be subject to audit at intervals determined by the Commission. It will also be subject to annual reconciliation based on a reconciliation period consisting of the 12 months ending December 31 of each year. 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. If DSIC revenues exceed DSIC-eligible costs, such overcollections will be refunded with interest. Interest on the overcollections 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. sec.101, et seq.) and will be refunded in the same manner as an overcollection.

**New Base Rates:** The charge will be reset at zero as of the effective date of new base rates that provide for prospective recovery of the annual costs that had theretofore been recovered under the DSIC. Thereafter, only the fixed costs of new eligible plant additions that have not previously been reflected in the Company's rate base, would be reflected in the quarterly updates of the DSIC.

**Earning Reports:** The charge will also be reset at zero if, in any quarter, data filed with the Commission in the Company's then most recent Annual or Quarterly Earnings reports show that the Company will 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.

**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.

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DISTRIBUTION SYSTEM IMPROVEMENT CHARGE

EXCEPT PUBLIC FIRE PROTECTION

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 October 1, 2010. (I)

The above charge will be recomputed quarterly, using the elements prescribed by the Commission in its Order dated August 26, 1996 at Docket No. P-00961031.

(I) Indicates an increase