



System Improvement Charges Distribution and Collection

Defining System Improvement Charges

Based on experience in the water industry, the Pennsylvania Public Utility Commission (PUC) urges the use of system improvement charges to allow natural gas and electric companies (distribution system improvement charge – DSIC) and wastewater companies (collection system improvement charge – CSIC) to use a surcharge on customers' bills to accelerate the replacement of existing aging facilities that otherwise will occur if the utility must wait until the completion of a rate case to begin receiving a return on its investment. System improvement charges reduce the frequency and the associated costs of base rate cases while maintaining a high level of customer protections.

System improvement charges are designed to provide ratepayers with improved service quality; greater rate stability; fewer main breaks; fewer service interruptions; increased safety; and lower levels of unaccounted for energy or wastewater. In light of today's difficult financial markets, system improvement charges are the type of innovative regulatory policies expected as rating agencies tighten ratings benchmarks and are a key element in maintaining access to capital markets on reasonable terms.

Section 1307 of the Public Utility Code authorizes the PUC to prescribe a mandatory system for automatic adjustment of a utility's rates by means of a sliding scale of rates. In 1997, the Public Utility Code was amended to add Section 1307(g), which specifically provided for an adjustment clause for the recovery of costs related to distribution system improvement projects designed to enhance water quality, fire protection reliability and long-term system viability.

The Commission cannot authorize a system improvement charge for natural gas, electric or wastewater improvements without authority from the General Assembly.

How It Works

A system improvement charge would appear as a surcharge on customers' bills. The surcharge amount is expressed as a percentage and applied to the total amount billed to customers under the company's otherwise applicable rates and charges, excluding amounts billed for public fire protection service and the State Tax Adjustment Surcharge.

The system improvement charge would be an automatic adjustment charge revised quarterly that enables natural gas, electric or wastewater companies to:

- Accelerate its investment in new utility plant to replace aging distribution infrastructure;
- Recover fixed costs (depreciation and pre-tax return) of certain non-revenue producing, non-expense reducing infrastructure improvement costs placed into service between base rate cases;
- Reduce the number of base rate cases and the associated expenses, resulting in a more gradual increases in rates for consumers;
- Better absorb increases in other categories of costs for a longer period of time, particularly during times of relatively low interest rates;
- Facilitate compliance with evolving regulatory requirements; and
- Implement solutions to regional supply problems.

Eligible additions are limited to revenue neutral projects, consisting principally of replacement investments. The costs of extending facilities to serve new customers would not be recoverable through the system improvement charge.

Checks and Balance

A number of consumer protections are built into system improvement charges, including the existing water-industry structure such as:

- A cap on the rate;
- An annual reconciliation of recoverable costs and revenues associated the charge by the PUC;
- An annual reconciliation hearing in accordance with Section 1307(e) of the Public Utility Code;
- Customer-notice requirements of changes in the system improvement charge;
- A reset to zero if the company’s quarterly or annual earnings reports – subject to review by the PUC – show that the company earnings are exceeding the allowable rate of return used to calculate fixed costs under the system improvement charge;
- PUC audits to make certain the money is spent on DSIC-eligible projects; and
- A reset to zero as of the effective date of new base rates that provide prospective recovery of annual costs that had been recovered under the system improvement charge.

Why a System Improve Charge?

The state’s aging infrastructure is an important issue. The main features of a system improvement charge are that it is:

- Pro-environmental as it significantly decreases line loss;
- Promotes a major objective of this Administration and this Legislature which is to fix Pennsylvania’s aging infrastructure;
- Provides cost benefits to consumers including reduction in the loss of the commodity and of costs associated with base rate cases; and
- Promotes economic development as it creates and maintains hundreds of jobs.

The existing water-industry DSIC has;

- Been in use since 1997, with the average monthly costs to ratepayers ranging from a few cents to about \$2.75 a month.
- Had a substantial impact on accelerating infrastructure remediation; and
- Increased a main replacement schedule from 30 miles of main a year to 80 miles, which more closely matches the actual service life of the mains; and
- Never had a complaint filed against a DSIC charge or during a DSIC proceeding.

DSIC as a “Best Practice”

DSIC is one of the most important regulatory tools of the past decade and is a “best-practices” regulatory tool created in Pennsylvania. Seven other states have adopted similar mechanisms. Due to DSIC and other innovative regulatory mechanisms, the PUC was recognized for effectively encouraging water company investment by Standard & Poor’s.

DSIC also has been recognized nationally in a resolution by the National Association of Regulatory Utility Commissioners endorsing it for its significance as a regulatory tool. The Council of State governments included DSIC as model legislation.

For further information, contact the Public Utility Commission:

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