



# OLR RESEARCH REPORT

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## **FUEL SWITCHING INCENTIVES AND WATER RATES**

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You asked (1) why natural gas companies have different policies regarding incentives to encourage fuel switching and (2) what accounts for the difference in rates charged by Connecticut Water Company in northeastern Connecticut and the Metropolitan District Commission (MDC) in nearby areas.

### **FUEL SWITCHING INCENTIVES**

The Department of Public Utility Control (DPUC) generally bars gas and electric companies from using ratepayer funds to provide incentives for fuel switching, for example to encourage customers to switch from oil to gas heat. The rationale for this policy is that the subsidies could give the companies an advantage over their competitors at the expense of their ratepayers who do not benefit from the incentives. However, DPUC does not regulate how the companies use shareholder funds. Connecticut Natural Gas and Southern Connecticut Gas have each allocated \$500,000 of shareholder funds to provide incentives to customers who switch to gas heat. The companies will match incentives provided by gas furnace and boiler distributors for this purpose. The companies are subsidiaries of UIL Holdings, which is also the parent company of United Illuminating.

Yankee Gas Services, which is a subsidiary of Northeast Utilities (NU), does not provide a comparable incentive. According to Tom Dorsey, NU’s manager of government relations, NU’s management is considering offering such incentives.

**WATER RATES**

In Connecticut, water rates vary substantially by utility. Connecticut Water Company’s rates also vary by the divisions that serve different parts of the state and the type of customer. MDC charges \$2.35 per 100 cubic feet of water for all types of customers; those who are served by MDC’s sewer system pay an additional charge. Table 1 shows the rate per 100 cubic feet of water for the two Connecticut Water Company divisions that serve northeastern Connecticut. The Connecticut Water Division covers East Windsor, Ellington, Enfield, Somers, South Windsor, Stafford, Tolland, Vernon, and other towns. The Mansfield Division covers Ashford, Columbia, Coventry, Manchester, Mansfield, Marlborough, Willington, Woodstock, and other towns. Both divisions have a few small water systems with higher residential rates.

**Table 1: Connecticut Water Company Rates**

	<i>Connecticut Water Division</i>	<i>Mansfield Division</i>
Residential	\$5.49	\$4.28
Commercial	\$4.81	\$3.70
Industrial	\$4.09	n.a.

Part of the difference in rates between the MDC and the Connecticut Water Company is due to economies of scale. MDC has more than four times as many customers as the Connecticut Water Company. A number of the major costs of providing water, including the costs of distribution systems, treatment plants and water testing, are more expensive on a per customer basis for small utilities than for large utilities.

Jim Vacolina, head of DPUC’s water unit, notes that in many cases DPUC has ordered larger water companies to acquire small companies that were at risk of failing. For example, DPUC ordered Connecticut Water Company to acquire the former Eastern Water Company. Often the small companies had high rates as a result of diseconomies of scale. When DPUC ordered the acquisition of the smaller companies, it sought to avoid having the existing customers of the acquiring companies pay for the costs of the acquisition. As a result, the rates for customers of the acquired companies have remained relatively high.

Other factors that affect water rates include: the service area's population density (rural areas are more expensive to serve because they have fewer customers per mile of water main), where the utility gets its water (groundwater usually requires less treatment than surface water), the degree to which a utility's service area is contiguous and its systems connected with each other (contiguous territories require fewer staff to serve), and the service territory's topography (hillier areas are more difficult to serve since the utility must pump water uphill).

Finally, DPUC does not regulate the rates of municipal and regional water utilities, including the MDC. Part of the reason public water utilities typically charge lower rates than comparable-size water companies is that they enjoy tax exemptions and as a result have a lower cost of capital.

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