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STATE OF WASHINGTON
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
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Ref.: 4-1253

May 6, 2005

Derek Dorland
Iliad Water Services Inc.
PO Box 20429
Seattle WA 98102

Subject: Alder Lake Water System
UW-041830 Assessment Charge

Dear Mr. Dorland:

In Iliad Water Services, Inc.'s (Iliad) April 28, 2004, response to Staff's draft analysis of the proposed surcharge, Iliad addressed three issues: Microscopic Particulate Analysis, DOH Inspection Fee, and the company-proposed Contingency Charge. Staff's response to each issue follows.

Microscopic Particulate Analysis Costs - In its response, Iliad stated that it understood that the Microscopic Particulate Analysis (MPA) was required by the Department of Health (DOH) to determine whether the engineering and construction would need a filtering or chlorination system. However, DOH does not agree with the company's understanding. Ingrid Salmon, DOH's Regional Compliance Manager of the Office of Drinking Water, clearly stated that the MPA requirement was not related to its order to chlorinate. MPA is used to determine if a source is classified as ground water. In addition, review of the applicable documents show chlorination was ordered in December 2000 but the MPA testing was not completed until almost a year later (October 2001). Further, the engineering plans for chlorination were completed in May 2001; four months before the MPA testing was done. DOH information and documentation on file with the Commission clearly show that MPA testing was not required to determine the scope of the chlorination project. Staff will continue to exclude MPA test costs from the costs associated with the chlorination project.

DOH Inspection Fees - In its response, Iliad clarified that DOH inspection fees are not a DOH cost, rather the design engineer's inspection fee to ensure that the new system is

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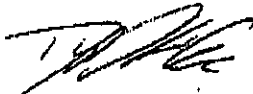
installed correctly, tested, and meets the engineering standards. It is useful to know that this fee is actually paid to Iliad's engineer. However, in the April 21, 2004, letter from Western Engineers, Inc., Mr. McDonnell estimated a fee of \$1,500. Staff's Data Request #3 requests reconciliation between the engineer's estimate of \$1,500 and the Company's requested \$2,500.

Contingency Charge - Staff's position regarding Iliad's request for a contingency charge apparently needs further explanation. The form of the bid supporting the requested cost of \$68,020 is a lump-sum bid. A lump-sum bid is an offer from a contractor to perform the work required by the contract for the fixed dollar amount proposed in the bid. The subcontractor is the one that normally imbeds a contingency component in its fixed bid as it is the subcontractor, absent some significant risk which the owner is explicitly willing to bear, who takes the risk of any unforeseen events. However, the subcontractor is constrained by the bidding process to minimize the total of any contingency amounts it may embed in its bid. Admittedly the time factor is relevant here and it may be prudent to have the bids updated.

If projects incur cost overruns, the Commission has included such costs in rate base if the incurred costs do not represent significant cost overruns over the budgeted amount or are not related to mismanagement. However, the burden to show the reasonableness of the overruns falls on the company. The distinction in this case is that the company is requesting recovery of additional cost overruns that have not yet occurred. There are no cases that Staff is aware of where the Commission allowed recovery of potential cost overruns before the costs overruns were actually incurred. Therefore, Staff holds firm to its position that no contingency costs can be embedded in the proposed surcharge.

If you have any questions, please call me at (360) 664-1253.

Sincerely,



Danny Kermod CPA
Regulatory Analyst

cc: Richard Finnigan, Attorney
Ingrid Salmon, Department of Health