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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF SPIRIT LAKE EAST WATER COMPANY FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER SERVICE IN THE STATE OF IDAHO	**CASE NO. SPL-W-06-1** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Weldon B. Stutzman, Deputy Attorney General, and in response to the Notice of Modified Procedure and Order No. 30193 issued on November 30, 2006, submits the following comments.

BACKGROUND

On August 14, 2006, Spirit Lake East Water Company (Spirit Lake, Company) filed a general rate case Application requesting authority to increase its rates and charges for water service. The Company requested approval to increase its rates from $12 to $24 for the first 9,000 gallons of water usage, and from $.10 to $.20 for every 100 gallons of water used by a customer over 9,000 gallons per month. In addition, the Company asked for approval of an increase in the connection fee for new service from $1,200 to $2,500. The Company proposed an effective date of September

14, 2006 for the new rates. The Commission suspended the proposed effective date in Order No. 30119 issued August 29, 2006.

The Commission granted a Certificate of Public Convenience and Necessity (No. 293) to Spirit Lake in February 1983, although the water system began operating in 1977. Spirit Lake currently provides service to 287 customers in Kootenai and Bonner Counties, Idaho. The Application states that the Company's rates for consumption have not changed since initially approved by the Commission in November 1983. In June 2004, the Commission approved an increase in the Company's connection fee from $650 to $1,200. The Company states that the $2,500 connection fee it now proposes is the actual cost it incurs in connecting a new customer to the water system. The Company is requesting the new service connection fee to cover the amount actually paid to outside contractors who perform the connection work.

In 1982 the water distribution system owned by Hanson Properties, Inc. (HPI) was turned over to Spirit Lake, a wholly owned subsidiary of HPI. In November 1994, HPI became Hanson Industries, Inc. (HI), a Sub S Corporation, and Spirit Lake became a C Corporation. HI remained the majority owner of Spirit Lake, with the remaining ownership held by Raymond and Lois Hanson.

HI is involved in the mining industry, real estate development and property management. According to HI personnel, HI financed the construction of the water system, as well as its operation since inception. HI handles all accounts payable and receipts for Spirit Lake. Spirit Lake does not have a bank account separate from that of HI. Transactions are periodically moved through journal entries from HI to the water company general ledger. Spirit Lake's fiscal year is November 1 through October 31.

Spirit Lake's office is located in Spokane, Washington along with that of HI. Spirit Lake has no direct employees. Instead, HI personnel provide accounting, billing, customer service, water operator and maintenance services for Spirit Lake.

System Description and Service Problems

Spirit Lake's water system consists of one well with a 500 gpm, 100 horsepower pump which lifts water approximately 600 feet to a concrete reservoir. The reservoir is a reinforced concrete, above-ground cylinder with a total available capacity of 192,400 gallons. Three booster pumps deliver water from the reservoir to the mains and branches of the system at a set pressure of 45 psig. The booster pumps are housed in a below-ground concrete caisson. System control valves,

chlorinator and bladder type pressure tanks are housed in a building next to the reservoir. A small shed abutting the frame building is used to house a 75 kW diesel generator set for back-up power supply.

The Company's service territory covers an area of approximately six square miles. The system's mains and branches contain 126,585 feet of pipe, most of it PVC pipe, in sizes varying from 1 inch to 10 inches in diameter. Approximately 527 feet of pipe is galvanized steel. Because customer stub outs and valves were not installed on the mains and branches when the system was built, every new customer added to the system requires a tap into a main that is under pressure.

As of December 2006, the system serves 287 active customers in the Spirit Lake East and Treeport subdivisions. There are also 18 dormant customers (meters locked) connected to the system. The subdivisions are largely built out, with thirteen customer hook-ups in fiscal year 2005 and three new hook-ups in 2006. The service area terrain is mostly flat with the high point being in the northwest and the lowest point (45 to 50 feet lower than most of the service area) being the Treeport subdivision at the northeast corner of the service area.

Following a seven-day outage in October of 2004, the Idaho Department of Environmental Quality directed the Company to install a second well to serve the system because of well pump failure. During the course of discussions with the Company, DEQ noted numerous additional deficiencies in the water system. These included some items identified in an October 2004 engineering report commissioned by the Spirit Lake East Homeowners Association and the North Kootenai Water District.

Staff believes there are three maintenance items that require attention and thus affect the Company's rate request. The most important is unidentified leakage from the system; second is the failure of the recently installed back-up power supply that is exacerbated by the system leakage; third is repair of the flat roof over the water storage reservoir.

System Leakage

Leakage in the Spirit Lake system is more than 1-1/2 gallons for every gallon used, which is well beyond the recognized maximum acceptable levels of 10-15%. System well production, customer use and leakage parameters are presented in the table below. By any standard the leakage problem is severe, and appears to be increasing faster than customer usage, indicating that the volume of water leaking from the system as a percent of total production is increasing.

ITEM MEASURED	2005	2006	% Increase 2006/2005
Well Production	80,381	105,105	30.76
Metered to Customers	32,604	40,148	23.1
Gallons Leaked	47,778	64,958	36.0
Ratio Well Production to Gallons Metered	2.47	2.62	6.2
Ratio Gallons Leaked per Gallon Used	1.47	1.62	10.4

Staff initially was concerned that the recorded high volume of water produced may be an error in measurement of well production. Staff therefore corroborated the meter data by reviewing the electrical consumption and comparing it to the well meter data. The well pump meter data and electricity usage confirm Staff's calculation of the well production and leakage numbers.

Given the seriousness of the leakage problem, Staff recommends the Company be directed to prepare a plan to locate and repair system leaks. Once the significant leaks and repair costs have been identified, the Company could submit an application for a surcharge or other rate mechanism if necessary to provide the funding to make the needed repairs. For this case, Staff recommends that the cost of excess electricity consumed due to excessive leakage be disallowed in the Company's revenue requirement. Excess electricity cost is that which is required to pump water in excess of the metered usage plus 10%. Staff made allowance for the power cost associated with pumping. Staff calculates the pro-rata share of electricity to be disallowed to be 55% of the test year total electric bill assuming a reasonable exchange rate of about 12%.

Stand-by Power Generator

During the fall of 2005 the Company installed a 55 horsepower (approx. 75 kW) diesel standby generator serving the water system. Since then there have been two power outages where the generator was needed. In both instances, but for different reasons, the generator set failed. Additionally, the generator does not provide enough electricity to run the pump to keep the reservoir supplied during an outage.

Staff calculated the amount of time, under different conditions, that water service will be available from the reservoir during a power outage without refilling from the well pump. The reservoir provides system run time of only 3.8 hours under worst-case conditions (summer peak). If

the system leakage were only 10%, rather than 150%, the system run time in a power outage is extended to 6.1 hours. The two most recent outages lasted 11 hours and 37 hours. Under these circumstances the existing generator has very limited usefulness. The results of Staff's calculations are shown in Attachment A.

Elimination of system leakage is the priority, and will improve available operating time during a power outage. However, given the location of the water system and the duration of recent power outages, Staff recommends that the Company investigate the possibility of acquiring a larger back-up generator capable of operating the entire system.

Reservoir Roof Repair

A flat roof covers the water storage reservoir. Although the roof currently does not leak, water ponding on the roof presents a potential water quality issue. Water sitting on the flat surface will freeze and thaw, leading to leaks in the roof. The sitting water could then contaminate the reservoir below. Staff recommends the Company be directed to repair the roof to prevent ponding of surface water to assure a safe, reliable water supply.

STAFF REVENUE REQUIREMENT ANALYSIS

Audit

Staff examined the books and records of the Company for the fiscal year ending October 31, 2005 and selected transactions for the fiscal year ending October 31, 2006. Staff also reviewed the 2002 Staff audit and selected transactions/data from 2002 through 2006. A field audit was conducted in November 2006 at the Company's offices in Spokane. The purpose of the audit was to verify the accuracy of the revenues, expenses and rate base amounts included in the Company's Application and to determine if the Company's rate increase request is reasonable. The audit included (but was not limited to) examination of general ledger accounts and supporting invoices, employee timecards, payroll records, billing records, verification of physical plant and property, comments submitted by customers, Idaho Department of Environmental Quality (DEQ) records and discussions with the HI's employees. Spirit Lake does not employ an independent auditor to audit its financial statements; however, it does employ an accounting firm to prepare its federal and state tax returns.

Revenues, Expenses and Rate Base

The Company proposes using the actual test year data from its 2005 fiscal year. The Application's revenues and expenses are based upon the actual recorded performance of the Company for 2005 and are comparable to the 2005 annual report filed with the Commission with certain adjustments discussed below.

Revenues

The primary source of revenue for Spirit Lake is the sale of water to residential customers and in fiscal year 2005 this revenue totaled almost $48,000. In addition, the Company billed $18,000 of revenue for hook-up fees. The Company included within its Application adjustments to remove hook-up costs and revenues from its operating revenues and expenses. Staff proposes that annual test year revenues be further adjusted as discussed in "Adjustment E for Annual Revenue" and "Adjustment F to Impute Revenue."

Expenses

The Company reported total expenses of $96,833 in its 2005 report to the Commission. The Company removed hook-up costs of $30,075 from its operating expenses as explained in the rate base discussion below. The Company also adjusted its depreciation expense to reflect the changes to rate base that it proposes. Finally, the Company annualized water-testing expenses so that the test year includes the average yearly cost of water testing expenses. Staff proposes that annual test year expenses be further adjusted by Adjustments A through D, Adjustments F through I, and Adjustment K as discussed later in these comments.

Rate Base

The Company's proposed $160,529 rate base is comprised of the following components: utility plant in service ($961,201) less contributions in aid of construction ($70,050) and accumulated depreciation ($740,750); a working capital component ($7,073) using the $1/8^{th}$ operating and maintenance expense method; and an inventory of spare parts ($3,055) required by DEQ.

Spirit Lake's rate base is comprised of improvements and repairs made to the system. The original cost of the developer installed system including the well and distribution system were considered contributed property under Commission Rule 103, Policies and Presumptions for Small Water Companies. The rate base in the Company's Application includes plant in service recorded by the Company as restated to reflect Staff's audit of the Company's records in 2002, capital additions since 2002, and post test-year (pro forma) additions (Company Exhibit 1, Schedule A).

The plant, accumulated depreciation and contributions in aid of construction reported in the Company's FY '01 annual report netted to zero. Staff's 2002 audit review encompassed multiple fiscal years and determined some items expensed in several years actually replaced capital items originally put in service by the Company and therefore should have been considered part of rate base. The Company's Application includes those items identified by Staff's 2002 audit.

The Company has also adjusted rate base (more specifically, plant in service) to capitalize the hook-up costs during 2001 - 2005 that exceeded the corresponding hook-up fees. The Company has not been recording the hook-up fee as contributions in aid of construction nor has it been capitalizing the cost associated with the hook-up. Order No. 18466 issued November 22, 1983 in Case No. U-1139-1, implies that ratemaking treatment for hook-ups would be considered original plant investment to serve the lots developed. Instead, the Company has been reporting the hook-up fees as other water sales revenue and the cost associated with the hook-up has been reported and recorded as an operating expense.

Staff further adjusted the rate base proposed by the Company by Adjustments H and J as discussed later in these comments.

Adjustments and Accounting Issues

Based upon its review, Staff made the following adjustments to the Company's proposed revenues, expenses and rate base, as shown on Attachment C. These adjustments have been incorporated into Staff's calculation of its proposed revenue requirement and resulting increase in revenues as shown on Attachment B.

Adjustment A to Power and Chemical Costs

The Company's Application includes $16,570 power and $694 chemical costs (Exhibit No. 2, Schedule B, Column H, Lines 7 and 8). These costs are to pump and treat water from the Company's well. Staff identified substantial water loss in the system by comparing the customers' metered water usage, as reflected in the Company's billing data, to the metered water pumped by the well reflected in the Company's well logs. Because of the significant water loss in the system, the Company uses substantially more power and chemicals than would otherwise be needed. Based upon the level of water loss, Staff recommends that power costs be reduced by 55% or $9,114 and that chemical costs be reduced by $470. These adjustments reduce operating expenses by $9,583.

Adjustment B to Professional Services Costs – Engineering and Legal Expenses

The Company's records indicate that its Application includes $6,863 engineering and $8,444 legal expenses for a total of $15,307 for the 2005 test year. No professional services costs (other than for water testing) were reported for the Company in its 2002 and 2003 Annual Reports to the Commission. In the Company's 2004 Annual Report, $2,500 for professional services costs (other than for water testing) was reported, which was an engineering expense.

Staff recommends that a portion of the engineering and legal costs not be included for annual recovery in customer rates for three reasons. First, certain costs relate to the potential sale or transfer of the system from the Company's owners to another party. Staff believes these costs should be borne entirely by the Company's owners, not its customers. Second, other costs relate to repairs mandated by DEQ with which the Company did not comply, resulting in duplicated costs for a second approved repair. Third, the remaining costs relate to activities (a system study and improvements) that span more than one period. These costs should therefore be amortized and not recovered from ratepayers annually.

The Company identified engineering costs in 2004, 2005 and 2006 for (1) preparation of an engineering study report for analysis during the Company's discussions regarding transfer of the system from Spirit Lake's owners, (2) communications with the Company and other parties regarding the study, (3) field visits, and (4) communications with DEQ regarding engineering issues including a Plan of Correction and other DEQ mandates.

Invoices supporting both the engineering and legal costs were reviewed by Staff. Staff's review of these invoices, the engineering studies referenced, and DEQ documents identified that $2,946 of the engineering and $5,413 of the legal costs contained within the Company's Application relate to sale or transfer of the system or to duplicate repairs of the reservoir.

In addition, the remaining $6,948 ($15,307 - $8,359) engineering and legal costs reasonably attributed to the regulated operations should be amortized, at a minimum, over three years. In addition to being costs where benefits are received in more than one fiscal year, these costs are greater than the costs incurred by the Company during the previous three years combined and should not be included within the customers' rates for recovery on an annual basis. Staff proposes an amortization period of three years. Staff recommends that $2,316 engineering and legal costs be included for recovery on an annual basis. As a result, Staff reduced the Company's test year expenses by $12,991 ($15,307-$2,316).

Adjustment C to DEQ Fees

The Company's Application contains $1,842 for annual fees paid to DEQ (Exhibit No. 2, Schedule C, Column C, Line 9A). This amount is overstated by $750 due to the Company posting both an annual payment for the 2006 DEQ assessment and three quarterly payments of the 2005 fee (the first quarterly payment was processed in fiscal year 2004) during the 2005 test year. Staff removed $750 (the amount of the 2005 quarterly payments) from total expenses so that the fees reflect only the 2006 annual assessment.

Adjustment D to Water Testing Expenses

The Company's Application includes almost $900 for the average cost of water testing required by DEQ (see Company Water Testing Schedule and Cost Worksheet that follows Exhibit No. 6). Because not all water tests are performed every year, and several of the tests that are performed less frequently are quite costly, it is more equitable to use the average yearly water testing expenses when setting rates. This method, annualization of water testing expenses, is Commission practice and was most recently approved for another small water company in Case No. CAP-W-06-1 (Order No. 30198 dated December 12, 2006). However, as noted by HI personnel, from 2005 through 2007 DEQ waived certain tests that Spirit Lake included in its Application. Staff removed the costs associated with those tests. This adjustment reduces test year operating expenses by $577.

Adjustment E for Annual Revenue

The Company's Application includes annual revenue (excluding hook-up fees) of $47,903. However, that revenue includes only eleven months of minimum monthly customer charges. During October 2004, the Company experienced a significant outage due to pump failure. As a result, the Company credited customers' bills for one month. According to its 2004 Annual Report, the Company had 273 active customers as of October 31, 2004. This is representative of the customers affected by the outage in 2004. Staff increased revenues by $3,276 (273 x $12) so that the test year reflects an annual (twelve months) billing at the tariff rate in effect during the test year.

Adjustment F to Impute Revenue

The revenues for Spirit Lake are generated through billing under the existing tariffs on file with the Commission. The Company includes in its Application the revenue billed customers for water consumption and minimum monthly charges during the 2005 test year. During test year 2005, there were 13 new customers connected to the system. Because these new customers were not connected to the system for the entire test year only a partial year's water consumption and

corresponding revenue for these customers is included in the Company's Application. Staff identified the additional fiscal year 2006 water consumption and revenue associated with these hook-ups and recommends that the Company's test year revenues be increased by $1,610 so the test year revenue more closely reflects those customers' annual revenue level.

Adjusting revenues to reflect increased water consumption also requires adjustment to the Company's power expenses for pumping that water. Staff calculated the average power cost per gallon in the test year, adjusted the average to reflect the water loss discussed in Adjustment A, and multiplied that by the increased water consumption. As a result, Staff increased power costs by $158. The increased chemical costs for treating the additional water consumption is de minimis and should be reflected in existing supply levels and expense.

Adjustment G for Rate Case Expenses

While the Company has amortized over a three-year period an estimated rate case expense of $5,000 (Exhibit No. 6), it did not include the $2,207 annual amortization of rate case costs in its requested revenue requirement. Staff, in this adjustment, included within its recommended revenue requirement a three-year average of the actual rate case costs provided by the Company. Most recently in Case No. CAP-W-06-1 (Order No. 30198 dated December 12, 2006), the Commission approved a three-year amortization of rate case expenses as appropriate for recovery through Capitol Water Company's rates. To reflect this treatment, Staff has increased Spirit Lake's test year expenses by $1,977 ($5,931/3 years).

Adjustment H for Plant no Longer in Service

The Company included costs for a pump that was replaced in 2004. While the costs for the pump currently in service should remain in the case, the costs associated with the pump it replaced should be removed from plant in service, accumulated depreciation and depreciation expense.

The National Association of Regulatory Utility Commissioners Uniform System of Accounts for Class C Water Utilities requires that when plant is retired, accumulated depreciation be charged and plant in service be credited with the entire recorded original cost of plant retired regardless of the amount of depreciation that has been accumulated for the item. Accumulated depreciation is also credited with the salvage value recovered from plant retired.

The Company's Application includes $21,392 in utility plant and $1,070 in depreciation expense for this pump. The Company valued at $1,806 two items salvaged when this pump was retired (replaced). Staff in this adjustment decreased utility plant by $21,392, accumulated depreciation by $19,586 ($21,392-$1,806), and depreciation expense by $1,070.

Adjustment I for Out of Period Expense (Restocking Charge)

The Company in its Application has expensed in its 2005 test year a restocking charge incurred before the beginning of the test year, which is November 1, 2004. In addition to relating to a prior fiscal year's activity, this charge is not considered appropriate as it does not represent goods or services used in providing water service to its customers. For both these reasons, Staff has reduced Materials and Supplies – Operation and Maintenance Expense by $462.

Adjustment J to Working Capital

Staff accepts the Company's method of calculating working capital as one-eighth of annual Operating and Maintenance (O&M) expenses. Due to Staff's adjustments to operating expenses, the same methodology results in an adjustment to the resulting working capital to reflect the adjusted O&M levels. Adjustment J, as shown on Staff Attachment C, decreases working capital in Staff's proposed rate base by $2,685. This is the same type of adjustment most recently approved in Case No. CAP-W-06-1 by Order No. 30198 dated December 12, 2006.

Adjustment K to State and Federal Income Tax

This adjustment reflects the income tax effect of all the preceding Staff adjustments to the Company's net income. While individual adjustments may not affect income taxes, cumulatively the adjustments result in taxable income and require that State and Federal Income Tax be increased by $700 and $1,545, respectively.

Costs Omitted from the Company's Application

The Company incurred costs in 2005 and 2006 that were inadvertently left out of its Application. One of the largest items is associated with a used generator that HI bought and installed at Spirit Lake's facilities. In 2005 Spirit Lake recorded a market cost of $12,360 for the generator provided by HI. Transactions between affiliated companies should be recorded at cost. Staff requested the cost basis of this generator and was informed that it was part of a larger, non-itemized purchase by HI and therefore, no cost basis could be provided for the generator. Because of the lack of cost data, the Company's plant in service should not be increased now or in the future to reflect the cost of this generator. The Company did include in its Application costs to install the generator. Staff did not adjust these costs in the Company's rate base calculation.

Maintenance and Transportation Expenses

The Company incurred significantly higher maintenance and transportation expenses for the test year 2005 (November 1, 2004 through October 31, 2005) when compared to previous fiscal years. Employee timecards and payroll records support the labor costs. The transportation costs are

derived from the number of trips to Spirit Lake's system and the Internal Revenue Service mileage rate. Although these costs are greater than in previous fiscal years, Staff recommends that the Company be allowed to include these expenses in rates. The system water operator is now required by DEQ to travel to the system facilities at least weekly. Both DEQ and customers have expressed concern regarding the past maintenance of the system. For these reasons Staff recommends that the Company continue a higher level of maintenance in the future than it did in the past.

Customers have indicated an interest in the Company having a sinking fund that would replace equipment on a periodic scheduled basis. Non-cash expenses, such as depreciation expense, could be used for such a purpose.

Capital Structure

The Company's capital structure is 100% common equity. Staff agrees with the Company's requested return on equity of 12%. This is the same return on equity recently approved for Capitol Water Corporation by Order No. 30198 in Case No. CAP-W-06-1.

Revenue Requirements

Staff's calculation of the proposed revenue requirement for Spirit Lake is shown on Attachment B. After the adjustments proposed above, Staff's recommended rate base for Spirit Lake is $156,038. Applying the 12% rate of return produces a return on rate base (or income required) of $18,725. Staff's adjustments to revenues and expenses result in net income after taxes of $8,052. Comparing this net income with the income requirement of $18,725, Spirit Lake's income deficiency is $10,673. After applying the net (income) to gross (revenue) multiplier for income taxes, the total revenue increase recommended by Staff is $13,751.

Staff proposes a revenue increase of $13,751 or 28.71% compared to the request by the Company for an increase of $47,866, nearly 100%. Staff's revenue requirement identifies the revenues to be recovered through customer rates excluding hook-up fees. The determination of the costs to be recovered through hook-up fees is discussed in the "Connection Fees" section of Staff's comments.

Staff Recommendations for Tariffs

Staff reviewed and analyzed the Company's metered water sales for the test year. The results of that analysis are presented in Attachment D. The water consumption pattern is normal for

a panhandle subdivision and the amounts used by the customers do not warrant any consumption issues such as conservation being part of the tariff structure.

Staff proposes an increase from $12.00 to $13.00 in the minimum monthly charge, which includes the first 9,000 gallons of use, and that the commodity charge be increased from $0.10 to $0.13 per hundred gallons over 9,000 gallons. The table below compares the present, Company proposed and Staff proposed tariffs and the average monthly bill for each of the three tariffs. The difference between the Company's proposed tariff increase of 100% and the resulting average monthly bill increase of 127% is due to differing assumptions about the amount of water in excess of 9,000 gallons per month the customers use. The Staff proposed tariff provides revenue of $61,902, slightly more than the requirement of $61,654.

Staff's proposed tariff structure moves the split of revenue between minimum charge revenue and commodity charge revenue from the present 75/25 split to a 70/30 split. This is consistent with revenue splits of other similar companies and requires larger water users to pay slightly more.

Calculations assume 280 customers per the Company's Application	Spirit Lake Tariff Comparison				
	Test Year	Company Proposed		Staff Proposed	
	Tariff	Tariff	% Increase	Tariff	% Increase
Minimum Charge	$12.00	$24.00	100.00%	$13.00	8.33%
Charge for Water over 9,000 Gal/Month	$0.10	$0.20	100.00%	$0.13	30.00%
Average Bill	$14.26	$32.34	127.00%	$18.42	29.00%

Connection Fees

The Company requested an increase in its fee to connect new customers from $1,200 to $2,500. In 2004, when the Company requested an increase in the connect fee, the Commission approved an increase from $650 to $1,200 for new connections.

Staff reviewed the contractor invoices provided by the Company for connecting new customers. In the test year there are eleven invoices for connecting new customers for a flat charge of $2,500. There are no details included in those invoices. Because the Company did not submit any cost justification including data about equipment, labor or material costs for the fixed rate, Staff cannot support the proposed $2,500 charge. Staff's review of the most recent invoices for new

connections from a different contractor who performed on a time and materials basis indicates that a more appropriate cost is $1,600.

Staff recommends an increase in the New Customer Connection Tariff to $1,600.

Consumer Issues

Spirit Lake filed a Customer Notice with its Application for Approval of Increase in Rates and Changes for Water Service. Included in the customer's August 15, 2006 billing statements was a copy of the Notice, in compliance with the Utility Customer Relations Rules (IDAPA 31.21.02102).

Timberlake High School Library was the host site for a Consumer Workshop on November 8, 2006. Thirty-seven customers attended the workshop. Customers voiced concerns regarding poor water quality, low system pressure, inadequate maintenance of the water system, lack of justification for the requested rate increase, and failure by the Company to provide fire hydrants or fire protection access. A majority of the attendees were well-informed members of the Spirit Lake East Homeowners Association and the homeowners from the Treeport Subdivision, which is not represented in the Spirit Lake East Homeowners Association. Both groups have been in contact with DEQ and Hanson Industries during the past several years to address service and water quality issues with Spirit Lake.

Customers also voiced dissatisfaction with the notice provided for the workshop, and indicated a notice posted on the Homeowners Association website would have generated a larger turnout. On October 19, 2006, the Commission issued a press release regarding the workshop to the Coeur D'Alene and Sandpoint newspapers. Staff also provided a copy of the press release to the Homeowners Association's president via email on October 20, 2006.

The Commission has received twenty-one written comments and a petition with 56 customer signatures regarding this rate case. Several comments received after the initial workshop requested that an additional workshop or a hearing be held. Ten comments were in support of an increase provided that a plan showing substantial investment to improve water quality and pressure would be implemented. Eleven comments reflected opposition to the proposed rate increase based on past failure of the Company to adequately maintain and improve the system over the years. A few comments supported an increase in rates to finance an additional well rather than relying on only the one that the Company currently has. Three customers requested that, contingent upon the granting of a rate increase, some of the funds be directed into a Capital Improvement Fund account.

Several comments requested backflow devices be required on all existing and future homes to help prevent contamination within the system. Four comments addressed the Company's request to increase the hookup fees. All felt that the fees should represent the true cost of providing the connection rather than become a means for the Company to increase profit. Five comments requested installation of fire hydrants. One customer stated that the Homeowners Association had sought permission to install fire hydrants at no cost to the Company but the request has gone unanswered. Additionally, almost every comment expressed frustration with the Company's lack of response to water and service quality issues. The petition addressed many of those same issues and requested a second workshop and/or hearing.

The Commission received nineteen complaints regarding the Company from January 1, 2004 to January 8, 2007. Six of the complaints concerned extended water outages in October 2004. Other complaints concerned poor water quality, a billing dispute and objections to this proposed rate increase. Five complaints were received during the December 2006 outage referencing the failure of the back-up generator to adequately handle the system needs, stating that the Company was not diligent in maintaining the back-up battery. Complainants also expressed concern that a boil order mailed to customers during the busy holiday season, in the middle of a major storm, resulted in the notice reaching residents two or more days after the system had been flushed with chlorine. These customers requested a more timely notification process for boil orders. A similar request was also made in one of the 2004 service outage complaints. It appears the Homeowners Association website would be a good avenue for notifying customers in addition to mailing notices to customers.

A review of Spirit Lake's forms, notices and billing statement show the Company is now in compliance with all of the Utility Customer Relations Rules (IDAPA 31.21.01000 et seq.) and Utility Customer Information Rules (IDAPA 31.21.02000 et seq.). Before December 2006, customers were required to call an out-of-state long distance number (509-922-5252) in order to reach Hanson Industries to discuss outages, emergencies and billing questions. At the request of the PUC Staff, the Company obtained a toll free number (866-869-8518). All customer notices now reflect the new contact number.

Hanson Industries' receptionist handles all incoming customer calls. Billing questions are directed to the Company controller, while emergencies are forwarded to the certified operator. Hanson Industries does not track the number of busy signals customers encounter, customer service average handling time or first call resolution rate. The Company has reported six customer

complaints filed directly with it for year ending 2005. Two complaints were regarding quality of the water service while the remaining four were disputing high water consumption bills. The Company made no disconnections for nonpayment of bills in 2005 and one request for payment arrangements.

STAFF RECOMMENDATIONS

Revenue Requirement

Staff recommends that the Commission approve the adjustments made by Staff resulting in a revenue requirement of $61,654 for Spirit Lake. This requires increasing the Company's revenues by $13,751 or 28.71%.

Tariffs

- Staff recommends that the Commission approve a customer tariff consisting of a $13.00 minimum monthly charge to include the first 9,000 gallons of use and a commodity charge of $0.13 per hundred gallons over 9,000 gallons to meet the revenue requirement.
- Staff recommends that the Commission approve an increase in the New Customer Connection Tariff to $1,600.

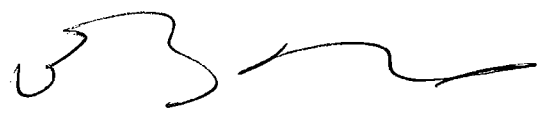
Repairs and Improvements

- Staff recommends the Company be directed to provide a plan and schedule to locate and repair system leaks.
- Staff recommends the Company investigate the possibility of acquiring a back-up power supply of sufficient size to supply and operate the entire water system during power outages.
- Staff recommends that the Company be directed to provide a plan and schedule to repair the reservoir roof to prevent ponding.

Customer Issues

- Staff recommends that the Commission schedule another workshop and/or a hearing at a suitable time, to provide more information to the Company's customers due to an overwhelming request by the customers in both subdivisions.
- Staff recommends the Company respond to the Homeowners Association regarding installation of fire hydrants and/or other emergency fire suppression access.
- Staff recommends that the Company work with the Homeowners Association and Water Association to provide a more timely boil order disbursement.

Respectfully submitted this 19th day of January 2007.



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ATTACHMENT A

System Operating Time Available From the Reservoir

The relationship between the back-up power supply and the system leakage is an important one. The size of the generator selected for the system does not allow for the well pump to run during a power outage. Only the booster pumps that draw from the reservoir to pressurize the system can be run from the standby generator. Because the system leakage is a much larger draw on the reservoir than customer demand, the ability of the reservoir to provide capacity to meet demand through an outage without running the well pump is diminished. During the 36-hour power outage mentioned above, the reservoir drained quickly by gravity and was too low for the Company to run the booster pumps when, approximately 18 hours into the outage, they were able to start the generator.

During the two most recent outages the stand-by generator failed to provide power. In the first instance, an 11-hour outage, improper control settings resulted in the generator set not working. During the second outage that lasted more than 36 hours, failure of both the main and back-up batteries resulted in the engine set not running.

SPIRIT LAKE EAST WATER - OPERATING TIME PROVIDED BY THE SYSTEM RESERVOIR, WITH EXISTING LEAKAGE	
Reservoir Drawdown Available	When Full 192,000 Gallons
	Low Level 96,000 Gallons
Winter Period Oct 1- Mar 31	**Operating Time Available**
Avg. Flow, Reservoir Full	20 hours
Peak Flow, Reservoir Low	7 hours
Summer Months Jul 1 – Sep30	
Avg. Flow, Reservoir Full	11 Hours
Peak Flow, Reservoir Low	3.8 Hours
OPERATING TIME PROVIDED LEAKAGE IS REDUCED TO 10 %	
Winter Period Oct 1- Mar 31	
Avg. Flow, Reservoir Full	72 hours
Peak Flow, Reservoir Low	24 hours
Summer Months Jul 1 – Sep30	
Avg. Flow, Reservoir Full	18 Hours
Peak Flow, Reservoir Low	6.1 Hours