



Ernie Fletcher
Governor

LaJuana S. Wilcher, Secretary
Environmental and Public
Protection Cabinet

Christopher L. Lilly
Commissioner
Department of Public Protection

Joe Hammond
Martin County Water District
HC 69, Box 875
Inez, KY 41224

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

Mark David Goss
Chairman

Teresa J. Hill
Vice Chairman

Gregory Coker
Commissioner

June 27, 2006

RE: Case No. 2006-00303

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

A handwritten signature in black ink, appearing to read "Beth O'Donnell".

Beth O'Donnell
Executive Director

BOD/jc
Enclosure

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE MANAGEMENT)
AND OPERATION OF MARTIN COUNTY) CASE NO. 2006-00303
WATER DISTRICT)

ORDER

Martin County Water District ("Martin District"), a water district organized pursuant to KRS Chapter 74, owns and operates facilities that treat and distribute water to approximately 3,376 persons in Martin County, Kentucky.¹ It is a utility subject to Commission jurisdiction. KRS 278.010(3(d)); KRS 278.015; KRS 278.040.

In recent years, the Commission has become concerned about Martin District's operation and management. Commission Staff has inspected the water district on numerous occasions since 1997 and found that it was experiencing significantly high water loss, not performing routine maintenance and testing, and failing to follow acceptable management practices.

In April 2002, Martin District experienced a system-wide water shortage after the only operable high service pump at its water treatment plant failed. Commission Staff inspected Martin District's facilities on April 4, 2002 and noted some serious concerns:

Martin District's equipment is in serious disrepair. Redundancies required by any water system are lacking. Necessary equipment is either inoperable or is damaged. Insufficient personnel are available to ensure continued operation of the system. In short, there is a very real, and entirely unacceptable, possibility that the hundreds of homes

¹ Annual Report of Martin County Water District to the Kentucky Public Service Commission for the Calendar Year Ended December 31, 2003 at 27.

and businesses served by Martin District could lose water service.²

Responding to this report, the Commission initiated an investigation to examine the serious operating deficiencies that immediately threatened Martin District's ability to provide water service. It subsequently expanded this investigation to consider 20 service and management issues. It found that an examination of these issues "was necessary to assess the current condition of Martin District's operations and management, to determine the rules, methods, and practices that are required to ensure the water district provides adequate and reasonable service, and to restore public confidence in the water district's operations."³

Significant changes occurred in Martin District's operations and management while this investigation was proceeding, including the appointment of several new members to Martin District's Board of Commissioners and Martin District's execution of a contract with American Water Services for the management of the water district's operations. As part of its effort to resolve its outstanding operations issues, Martin District entered into negotiations with Commission Staff regarding the actions necessary to bring the water district into proper operating condition.

On October 20, 2003, Commission Staff and Martin District entered into an Agreement that addressed a wide array of Martin District's operation and management aspects and mandated significant remedial actions on Martin District's part. The Commission approved this agreement on November 17, 2003.

² Case No. 2002-00116, Investigation of the Operating Capacity of Martin County Water District Pursuant to KRS 278.280 (PSC Ky. April 5, 2002) at 1.

³ Case No. 2002-00116, Investigation of the Operating Capacity of Martin County Water District Pursuant to KRS 278.280 (PSC Ky. July 1, 2002) at 2.

While Martin District has made some progress in the 32 months that have elapsed since the Commission's approval of this agreement, this progress has been slow and unsteady. Martin District has not yet satisfied all of the provisions in the Agreement. Additionally, it has yet to file its required financial and statistical reports for Calendar Years 2004 and 2005. Moreover, Martin District has terminated its management contract with American Water Services and again assumed full responsibility for the operation and management of the water district's facilities and operations.

In view of these developments, the Commission finds that, pursuant to KRS 278.250, an investigation into the condition of Martin District should be initiated. The purpose of this investigation is to not only identify the existing deficiencies in Martin District's management and operation but to identify possible solutions to those deficiencies and possible courses of actions to improve the quality of service. To this end, the Commission further finds that, pursuant to KRS 278.255, a management and operations audit should be conducted to investigate Martin District's management, engineering and technical operations and that a competent, qualified and independent firm should be retained to perform this audit.

KRS 278.255(3) requires that the audited utility bear the cost of any management audit. The Commission recognizes that the imposition of such cost on a utility with limited financial resources, such as Martin District, might impose significant hardships on the utility and ultimately its customers. The Commission has therefore sought and

obtained in principle an alternative source of funding upon which Martin District could rely to meet its obligations under KRS 278.255(3).⁴

IT IS THEREFORE ORDERED that:

1. This proceeding is initiated to investigate and examine the condition of Martin District.

2. Pursuant to KRS 278.255, a competent, qualified and independent firm shall be retained to perform a full and comprehensive audit of the management effectiveness and operational efficiency of Martin District.

3. Pursuant to KRS 278.255(3), Martin District shall bear the cost of this audit.

4. Commission Staff shall take all actions necessary for the selection and retention of a competent, qualified and independent firm to conduct the audit of Martin District and for the performance of such audit.

5. Upon completion of the audit, Commission Staff shall file with the Commission a written report of the auditing firm's findings and conclusions and all documents that were assembled or produced as a result of the audit.

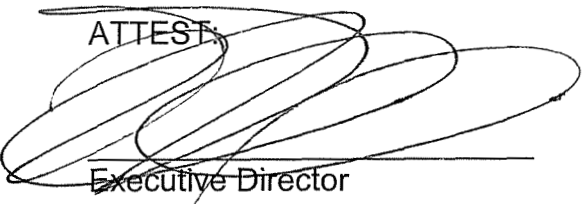
6. Until the completion and filing of the final report of the auditing firm's findings and conclusions, Commission Staff's Management Audit Branch shall file with the Commission on the fifteenth day of each month a report on the audit's status.

⁴ Letter from David W. Morgan, Director, Division of Water, Kentucky Environmental and Public Protection Cabinet, to Robert A. Amato, Deputy Executive Director, Kentucky Public Service Commission (June 23, 2006). The Division of Water has agreed to allocate an amount not to exceed \$95,000 from the Drinking Water State Revolving Fund Set-Aside Program towards the cost of the audit on the condition that Martin District provide 5 percent of the total cost of the audit not to exceed \$5,000 and that Martin District agree to implement any Audit recommendations that the Commission deems necessary.

Done at Frankfort, Kentucky, this 27th day of June, 2006.

By the Commission

ATTEST



Executive Director

Case No. 2006-00303