COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

JUL 01 2016

PUBLIC SERVICE COMMISSION

In the Matter of:

PETITION OF MOUNTAIN WATER DISTRICT FOR MODIFICATION OF ORDER OF CASE 2014-00324	)))	CASE NO. **2016-00062**

SECOND RESPONSE TO PSC ORDER DATED APRIL 8, 2016

Mountain Water District (MWD), by counsel, for its second response to the PSC Order dated April 8, 2016, regarding the results and analysis of the RFP solicitation for management of its water and sewer divisions submits the following information.

The Board of Commissioners of MWD held a Special Board Meeting on June 24, 2016, at 10:00 A.M., at MWD's office. On Tuesday morning prior to that meeting each Commissioner was provided the two (2) proposals for management and the respective pricing proposals from ESG Operations ("ESG") and Utility Management Group ("UMG"), as well as the Consultants' recommendation, all of which were previously provided to the Commission in the filing of June 8, 2016. In addition to the above, Commissioners were provided financial projections for independent operations developed by Mike Spears, MWD's CPA, a copy of which is attached as Exhibit "A". They were also provided a list of discussion points developed by MWD's consultant for them to consider in their analysis, a copy of which is attached as Exhibit "B". Lastly, attached as Exhibit "C", are excerpts from the minutes for that portion of the special meeting concerning this issue. MWD will supplement this report with a final approved copy of the minutes, following MWD's July 27, 2016, Board Meeting.

MWD's Board voted to pursue independent management, based on review of the price proposals and the analysis comparing contractual management with independent management. The primary factors in the decision were price, control and risk management. In comparing the price proposals of ESG, the contractor who prevailed in the RFP process over UMG, its three (3) year price was $23,767,440. MWD's independent cost analysis was $22,424,560, for an estimated savings over three (3) years of $1,342,654. It should be noted that Mike Spears, MWD's CPA, did not see any of the price proposals from UMG or ESG prior to developing MWD's cost for independent management. He did have access to the financial information concerning MWD that was made available to the contract bidders and he was asked to frame his proposal with the same assumptions that the contract bidders had to use. This provided a comparable analysis of the two (2) cost estimates.

MWD acknowledges that there will be additional expenses incurred that are not included in the cost analysis of contract operations and independent management. These additional expenses are outside the scope of contractual management, however, they would still be applicable whether the District's operations are outsourced or managed independently.

The next item noted was that ESG had requested thirty-four (34) contract amendments, the most significant of which involved a cap on the price of chemicals, water production and sewage treatment. MWD purchases a substantial portion of its water from the City of Williamson, WV and the City of Pikeville. A portion of its wastewater is treated by the City of Williamson. ESG's contract proposal requested a contract amendment to put caps on those three (3) items with a provision that there would be a rebate, if they operated below the cap, but a surcharge in the event the cost exceeded the budgetary number.

The concern expressed about this proposal was that it passes the risk of loss above the budget number to MWD. MWD would ultimately have that risk anyway with independent management, so there is no advantage to contract management if MWD is assuming that risk. Further, it creates a dis-incentive for ESG to operate as efficiently as possible, as MWD would subsidize the cost over the budgetary limit.

In terms of risk management, there was concern expressed about Pike County's economic future. There has clearly been a reduction in population over the last five (5) years with estimated reports as high as three thousand (3,000) people or four (4) to five (5) percent of the population. The closing of many coal mines has also eliminated a number of high volume customers. MWD does not know when this trend of declining sales will end. The Board felt it was important to maintain flexibility over its spending, as it would be in much better position to cut cost, should it be required to do so to address falling revenues. With a fixed price contract that escalates over a three (3) year period, it would lose that flexibility.

The next major issue was leadership and management. The Board expressed confidence in its current Administrator, Roy Sawyers and Financial Officer, Carrie Hatfield. It is believed that operations management under the leadership of David Taylor for water and Jamie Keathley for sewer, who were MWD employees prior to employment with UMG, will provide the necessary management skills to successfully operate MWD. They have been primarily responsible for MWD operations during UMG's contract term. Likewise, customer service should not be impacted as MWD is retaining the current UMG customer service team.

The Board also considered its ability to control asset management and stay current with modern technology. Its ability to do both was positively impacted by the potential cost savings of independent management.

Greg Heitzman, the Board's consultant, did an excellent job in reviewing with the Board the critical issues which needed to be considered for this decision. In summary, the MWD Board has full confidence in current management and the personnel to be transferred from UMG to successfully operate MWD. The estimated cost savings of $1.3 million over a three (3) year period is substantial and could be used to help make needed infrastructure repairs. The overall risk of having a fixed price contract, while facing a decline in customers, is not a fiscally sound arrangement. Accordingly, MWD elected to manage its operations independently.

In conclusion, MWD believes that this report addresses the request of the Commission.

SUBMITTED BY:

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CERTIFICATE:

I certify that a copy of this document was served on the Attorney General, 1024 Capital Center Drive, Frankfort, Kentucky 40601, and filed with the Public Service Commission on the __1st ___ day of ___July_________, 2016.

John N. Hughes

EXHIBIT "A"

MOUNTAIN WATER DISTRICT

Financial Projections

for

Independent Operations

ATTACHMENT D

Proposer Name: __Michael Spears____________________________

Date: __June 16, 2016__________________

Authorized Signature: ____________________

Mountain Water District Estimate for Comparison of Internal vs. Contract Service of Operations this is not to be considered a District Budget					
Category	**Source**	**Year 1**	**Year 2**	**Year 3**	**Total**
Raw Salary	Worksheet	$ 1,857,479	$ 1,876,054	$ 1,894,814	$ 5,628,347
Direct Labor Overhead	Worksheet	$ 924,450	$ 933,695	$ 943,031	$ 2,801,176
Utilities	Data Room	$ 1,104,264	$ 1,115,307	$ 1,126,460	$ 3,346,030
Chemicals	Data Room	$ 254,751	$ 260,000	$ 275,000	$ 789,751
Equipment	Worksheet	$ 99,306	$ 100,000	$ 100,000	$ 299,306
Materials/Supplies	Worksheet	$ 45,750	$ 50,000	$ 50,000	$ 145,750
Outside Services	Worksheet	$ 2,400	$ 2,400	$ 2,400	$ 7,200
Repair and Maintenance	Requirement	$ 960,000	$ 1,020,000	$ 1,080,000	$ 3,060,000
Insurance and Bonds	Worksheet + $50k	$ 250,000	$ 250,000	$ 250,000	$ 750,000
Other (specify)					$ -
Water Purchased	Data Room	$ 1,153,843	$ 1,165,381	$ 1,177,035	$ 3,496,260
Sewage Fees	Worksheet	$ 163,514	$ 165,149	$ 166,801	$ 495,464
Vehicle	Data Room	$ 130,580	$ 140,000	$ 150,000	$ 420,580
Postage	Worksheet	$ 111,210	$ 112,000	$ 112,000	$ 335,210
Professional Fees		$ -	$ -	$ -	$ -
Other Office Costs	Worksheet	$ 88,318	$ 89,000	$ 89,000	$ 266,318
Solid Waste	Worksheet	$ 6,805	$ 6,800	$ 6,800	$ 20,405
Laboratory Testing	Worksheet	$ 37,141	$ 38,000	$ 38,000	$ 113,141
Hand Tools	Worksheet	$ 14,000	$ 14,000	$ 14,000	$ 42,000
Subtotal- Cost of Service		$ 7,203,811	$ 7,337,786	$ 7,475,341	$ 22,016,938
Contingency of 3% of Non Labor	n/a	132,656	135,841	139,125	$ 407,622.44
					$ -
TOTAL PRICE		$ 7,336,467	$ 7,473,627	$ 7,614,466	$ 22,424,560

Footnotes and Assumptions:

1) This estimate is only for the cost of caily operations of the disctrict and is not to be construed as a complete budget. No costs outside the contract were considered as those are borne by the district in either scenario. (ie. Commisioner salary, legal and accounting, interest expense, etc.) Otherwise those cost would need to be added to the bids to make them comparative to our analysis. This is just for comparison purposes to run the daily operations.
2) I have included one a/p clerk at $35,000
3) Professional fees are not included as we should have no addititonal to operate the district independantly vs contractor
4) Contingency is added to non labor items as a buffer for unknown expenses that may be included in the Contractors overhead, etc.
5) This analysis does not include a Capital Asset Plan either as that is outside the scope of the contract and would not be included in bids from prospective contractors.

Mountain Water District

Projected Cost Comparison of Assuming Operations of the District
June 30,2014 revised for known factors

	UMG Direct Expenses		MWD Additional	MWD Projected Cost		
Payroll and Administrative Expenses						
Salary and Wages						
Regular Pay	$ 1,609,414		(95,000) (1)	$ 1,514,414		
Overtime	85,925			85,925		
Paid leave	222,271			222,271		
HR, Safety, AP Clerk	-		34,869 (1)	34,869		
Total Salaries and Wages		$ 1,917,610	(60,131)			$ 1,857,479
Direct Labor Overhead						
Payroll Taxes						
Fica	141,479		(4,600) (2)	136,879		
Futa	6,993		96 (2)	7,089		
Suta	17,837		(559) (2)	17,278		
Total Payroll Taxes		166,309			161,246	
Health Insurance Expense		375,656	9,600 (3)		385,256	
Life Insurance Expense		7,462	136 (4)		7,598	
Long Term Disability		6,715	122 (5)		6,837	
State Retirement System		54,522	292,455 (6)		346,977	
Training Expense		5,505			5,505	
Travel						
Lodging	4,931			4,931		
Meals	5,245			5,245		
Mileage	855			855		
Total Travel		11,031			11,031	$ 924,450
Equipment						
Note payments for existing vehicles curently paid by UMG.			69,306 (8)		69,306	
Note payments for 5 additional vehicles			30,000 (7)		30,000	
			99,306			$ 99,306
Materials and Supplies						
Uniforms		26,497			26,497	
Safety Supplies		16,274			16,274	
Laboratory Supplies		2,979			2,979	$ 45,750
Outside Services						
Other Outside Services		2,400				$ 2,400
Repair and Maintenance						
Repair and Maintenance		758,439	201,561 (9)			$ 960,000
Insurance						
General Liability	149,073				149,073	
Auto	15,417				15,417	
Contingency			49,804 (10)		49,804	
Workers Compensation	35,706				35,706	
Total Insurance Expense		200,196				$ 250,000
Sewage Fees						
Sewage Fees		163,514				$ 163,514
Postage						
Postage		111,210				$ 111,210

Other Office Costs					
Office Storage Rental	1,090		1,090		
Office Equipment Lease	7,253		7,253		
Office Supplies	31,930		31,930		
Janatorial Expense	20,092		20,092		
Telephone					
Office	11,736		11,736		
Mobile	13,848		13,848		
Other	1,910		1,910		
Security Service	459		459	$	88,318
Solid Waste					
Solid Waste	6,805			$	6,805
Laboratory Testing					
Laboratory Testing	37,171			$	37,171
Hand Tools					
Hand Tools	13,316	684		$	14,000

Mountain Water District

Projected Cost Comparison of Assuming Operations of the District
Assumptions
June 30,2014 revised for known factors

Number

1 The district will require 1 additional employee included inUMG's Corporate Overhead Number
Propose the addition of an A/P Clerk at $34,869, Also the elimination of Grondall position

2 The additional Fica is calculated at 7.65% of the Salary, FUTA at .006 of $8,00 per Employee and SUTA at prorata to UMG's cost related to total payroll

3 Cost estimated at $800 per new employee multiplied by 12 months.

4 Pro rata UMG's number to their total payroll, adjusted for the 1 new employees

5 Pro rata UMG's number to their total payroll, adjusted for the 1 new employees

6 Total payroll of $1,952,479 multiplied by the current KERS Retirement percentage of 18.68% less the UMG costs of $54,522.

7 UMG currently uses 7 trucks of theirs on our project, we will only replace 5 of those. Estimated at $500 per month by the five new trucks.

8 UMG pays for notes that are in MWD's name for vehicles used on our project. We would not have this expense without the contract with UMG. We would however have to make the payments on those notes.

9 Repair and Maintenance Adjusted to what we asked the prospective operators to use.

10 Used amount to adjust to $250,000 in case their has been any increases since 2014.

EXHIBIT "B"

MOUNTAIN WATER DISTRICT

Questions for Discussion

Mountain Water District
Strategic Issues and Questions for MWD Board
June 15, 2016
Prepared by Ed Wetzel and Greg Heitzman

The following is a list of strategic issues and questions that should be considered by the MWD Board in making a decision to retain contract management services or in-source the management and operations of the Mountain Water and Wastewater System.

1. Cost Efficiency – the annual cost and efficiency for operations and maintenance of the District.

    a. Will in-house operations be more or less expensive than contract operations?

    b. Are there costs associated with in-house operations that are not being properly considered? (For example, does the current contractor provide any equipment, tools, or services at no cost to the District that will need to be provided by the District and are those costs included in the analysis?)

    c. Are there additional costs that the District may incur that are not included in the contract? (ESG has asked for a contract amendment to cap certain costs)

    d. Who bears risk of unknown costs?

2. Organization and Leadership- Organizational leadership and management is currently the responsibility of the current operator (UMG). In-house operations will require this responsibility to transfer to a new management team under the direction of the MWD Board.

    a. Does Board have confidence in the current management to lead the District?

    b. Is the leadership team adequately prepared to manage the various back office functions, including HR, IT, Finance/Accounting, IT, Public Relations/Customer Service?

    c. Do the additional resources (management and technical) proposed by the company contract operator strengthen the organization and provide stronger leadership than the MWD team?

3. Human Resource Management- Managing of human resources will become the direct responsibility of the MWD and the District Administrator. This includes: recruiting, hiring, retaining employees; employee disputes/complaints; compensation, payroll, benefits, worker's compensation and tax administration; training (skill and operator certification training), risk management/safety/security; and HR compliance reporting.

    a. Is the Board prepared to take on this responsibility?

    b. Is management in place to oversee this function?

    c. If not, what is the plan to meet this need?

    d. Are there any disadvantages to contract management as it relates to HR?

4. Asset Management – Under in-house operations the management team will be responsible for asset management for long term performance. This requires strategy development and Long term planning and development, which is a growing expectation from regulators (EPA, PSC and KY DOW) in the technical, managerial, and financial areas for water/wastewater utilities

EXHIBIT "C"

MOUNTAIN WATER DISTRICT

Partial Minutes of

SPECIAL MEETING

JUNE 24, 2016

PARTIAL TRANSCRIPTION OF MOUNTAIN WATER DISTRICT

SPECIAL MEETING 6/24/16

5. Review of RFP for Contract Management and Consultant's Recommendations

Mr. Stratton stated that to give the Board a very brief history and context of what we are looking at here, in the PSC Case 2016-0062, they directed us to bid out the Contract Management Services through an RFP. They directed us to hire an independent consultant to draft the RFP and to evaluate the bids. We retain the services of Ed Wetzel, a consulting engineer in Tennessee who developed the RFP and published it. We received three (3) responses. We had an on-site inspection and received two bids; one from UMG and one from a company called ESG. We subsequently filed our report to the PSC as required outlining the bid process and the bids that were received. As part of the evaluation process, Mr. Wetzel thought it would be good if there were more than one set of eyes to evaluate it, so we agreed to have Greg Heitzman and Gary Larrimore, with Kentucky Rural Water Association, form a committee. The three (3) of them did an evaluation and Greg will go through that when he gets to that point, and they have a recommendation for your consideration. The PSC has further directed us to evaluate these bids, and Greg is going to lead us through that, and then we will file a report with the PSC on the decision that the Board makes today. So, that is the history and the process. Mr. Stratton asked Chairman Blackburn to turn the floor over to Mr. Heitzman.

6. Analysis of Contract vs. Independent Management

Mr. Heitzman stated that the RFP went out to be advertised and we did receive the two (2) proposals; one from UMG and one from ESG. Our committee looked at a ranking system, very similar to the insurance ranking and evaluations system. The difference between this one and the insurance is that this did include cost. Cost was not a sole factor but was one of the factors in the insurance RFP. Mr. Stratton stated that the Board has been given all of the written materials including the proposals from ESG and UMG, the committee's recommendations and financial projections for self-management, that were ran independently. He apologized for the interruption but stated that he wanted that on the record that they were provided than earlier in the week. Mr. Heitzman stated that since you have that information in there, he doesn't think he needs to go through it line item by line item, but essentially there were two (2) very qualified firms that submitted proposals and when they went through the evaluation, he wanted to tackle the cost thing first, because all of that is a major driver for all practical purposes...the costs were essentially the same. They were within less than 1% between them. It was very, very close on the cost so the cost of the service provided by those two is very much the same. This particular evaluation, often cost drives a solution, but in this particular case essentially the quality of the proposals is driving the decision process more than the cost. Before I go into the proposal pieces, we also checked out all of the references that were provided. Among the committee, we split up and we called folks in Florida, Virginia, Kentucky and Georgia, and we got very good reports from all of the references. We didn't have any negative reports or concerns, so that is good. So you take the reference piece and the cost piece and they are kind of equal essentially, for all practical purposes. Let me go into the actual content of the proposal of what was provided and essentially the thoroughness and new ideas, innovations, and those sorts of things; and the evaluation team when we did the scoring concluded that ESG provided the better proposal and it is a sizable difference in the final scores. The reason essentially, is that there was a significant amount of effort on their part to write a pretty extensive operating plan that was put together and subsequent to the process we went through, I think Roy looked at it as well, on this operating plan that was included in your packet...they did a very good job of putting together an operating plan and how they would manage the system. And like UMG, what they do is they do contract operations on a number of communities throughout the southeast. So the score here essentially...both firms are capable and competent to be able to do this work and we essentially had two good proposals; the cost is about the same based upon the proposal that was on the qualifications component, and specifically the operating plan, the team felt that the better proposal was provided by ESG. So that is that piece of the equation. Obviously we don't have a bid, per se, for actual cost if we were to operate this internally. So what we do is that we have put together a proposal, or cost estimate I should say, that previous you have been briefed on as a board; that has been updated by Mike Spears and if there are any questions on the process for the contract operations part before we go to Mike, now is the time to ask. Are there any questions about the details or anything that you saw in the packet, so if a decision is only between those two options, the committee would them recommend to the Board that we would go with ESG based upon the total value package that was provided in the submittals. Later we will talk about the pros and cons but what we want to do first is get 'what are all the options of record' on the table for you as a Board to make a decision. Are there any questions on the RFP side? There were none.

Mr. Heitzman continued and stated that Ed Wetzel was retained to be independent in this process and I am independent as well. Mike Spears put together previously and updated the proposal, or actual cost I should say, that would be an estimate of what it would cost to operate this internally. It has a series of assumptions in that so he turned the floor over to Mike Spears to go through those assumptions.

Mr. Spears distributed copies of the cost estimate packet to the Board. Mr. Spears began his presentation by stating that as you all are aware, during the PSC case in 2014 for the rate, we were asked to do an analysis to run it independently. What I have done is taken those into a little more detail; taken that analysis and expanded it with what things that we know now that we didn't know then. There was some stuff in the data room that was different from...and what I used during that proposal was the direct cost that UMG provided the PSC from the District; no overhead and no profit. Just the direct cost of operations. But there are some items in the data room that were different...utilities, chemicals, water purchased, vehicle expense...that were different from those numbers. So what I did was, the information in the data room, I used the 2015 fiscal year numbers and updated information from the cost previously. Mr. Heitzman stated that the data room is the internet location base so all of the provided external bidders could get access to the same basic set of information, so it ensures a level playing field in preparing the estimates or bids. Mr. Spears stated that in your sheets you'll see that...the front sheet is what we asked bidders to provide and so I put it in the same format basically as what we asked them to do. The second column is source and that tells you where the data came from. Work sheet is what we are going to go over in the following pages. The data room is obviously the data room. The one exception to that is repair and maintenance which we gave the prospective bidders what we needed in those three (3) years and he used those numbers for them to be comparative. Keep in mind, this is not a budget. As a budget, what that would entail, we would have interest expense, and Roy and Carrie's expense is not in here...Commissioner salaries are not in here...those are items that we would have whether we used a contractor or if we don't so don't construe this as a budget and say "Hmmm, you said $7.3M and our budget is $9M or whatever." I just want to make that clear. First category is raw salaries. If you look on page 2 you'll see UMG direct expenditures that they proposed previously or that they had in 2014 fiscal year ended June 30. Those are the items...regular pay, overtime pay, etc. show a total salaries and wages of $1,857,479, which will correspond to year 1 under raw salary on page 1. This is just the detail of the numbers on page 1. The direct labor, overhead, is $924,450. That includes payroll taxes, health insurance, life insurance expense...those are the employee benefits basically....power, lodging, miles...things that are employee related but are not direct pay...$924,450. The next item is utilities that came out of the data room that was 2015 expenditures for utilities...$1.1M. The following item is chemicals that again was in the data room and updated numbers...$254,751. The equipment, we have a little bit of extra in that to give us some room for error. You will see at the bottom I've got a contingency. When we did this for the PSC we had note payments on current vehicles of $69,000 but the note payments for the five (5) additional vehicles...$69,000 was what UMG was paying payments on our behalf. The note payments for the five (5) additional vehicles of $30,000... we have decided since then to buy a couple of vehicles and pay mileage, I think so...The next item is materials and supplies...$45,750. This is uniforms, safety supplies, laboratory supplies...I understand we may have some savings on our uniforms, probably a little bit high there but it is a manageable number and I don't think it will change the equation. Outside services is $2,400. Same item. Repair and maintenance, we require $960,000 from the prospective bidders. We have had about $780,000 in the past but if you recall we approved the buying of some new pumps in addition to what we have done in the past, and that is how we came up to that number. In fact that number should be reflected on bids as that is what we asked them to use. Insurance and bonds...you have the work sheet number, $200,196, I have adjusted that up to $250,000 just to give us....not knowing if we can...their numbers may have had some...where they may have been part of a group or something for awhile, maybe they were discounted some, so I just arbitrarily took 25% of that and added it to it. Water purchases came from the data room for the 2015 yar. Sewage fees...there was one line item...what we paid during that test period. Vehicle expenses came from the data room. Those have been somewhat less than what we had the previous estimate of the previous year but fuel costs are down and it was a driving force in that. It wasn't $30,000 or $40,000. Postage came from the work sheet data in the PSC file, $111,210. Other office costs, you can see the detail on that on the third page...office storage rental, office equipment lease, supplies, janitorial, telephone, and security service, $88,318. We have a solid waste line item and during that period was $6,805. Laboratory testing was a line item on page three (3) as well, $37,171. And then hand tools I just rounded to $14,000. For a total estimate for the first year without the contingency of $7,203,811. I've added a 3% contingency for non-labor items to try to be conservative with this for a $132,656. Total is $7,336,467 the first year. Year 2 and Year 3 I put a 1% increase for the employee raises and adjusted the other items about 1% up as well for a total for the 3 years of $22,424,560. You have some footnotes on assumptions on page 1 and on the 4th page, so if you have any questions, they may answer those questions. Also, there are no professional fees listed. They had on theirs professional fees on their direct cost, but really our doesn't change drastically, so I reduced those out. This doesn't include any capital asset plan or anything of that nature, this is strictly what I have estimated for your daily operations. If you read footnote 1, it kind of gives you a little bit of what I said before. It says "this estimate is only for the cost of daily operations of the district and is not to be construed as a complete budget. No costs outside the contract were considered as those are borne by the district in either scenario (ie. Commissioner salary, legal and accounting, interest expense, etc.) Otherwise those cost would need to be added to the bids to make them comparative to our analysis." We would have to add those to it and I don't think they would have added it so I left those items out. That is all I have.

Mr. Stratton stated that just to clarify, the purpose of this cost structure was to get an 'apples to apples' comparison with the two proposed bids. So, he factored in all of the things that they would have factored in for their costs without factoring in the things that is not their costs but would be our costs anyway.

Mr. Heitzman stated that essentially we have three (3) options on the table; an option for UMG, an option for ESG, and an option for in-house management. The in-house independent estimate is less than the external contract operations estimate and so what we wanted to do at this point, the decision that you make as a Board is more than just a cost decision. You all are business folks and you know you have the current cost of operations and you have the long term cost of operation, but you also have the ownership perspective versus contract work. Anytime you contract work, essentially you are allocating risk. So next what we would like to go through, and it is in your packet, is that there is a discussion topics that we are going to facilitate here. It is exhibit 7. Ed Wetzel and I put these together because, obviously it is a very important decision as to which way we are going to go and ultimately at the end of the day, our accountability is essentially to our rate payers and so that is why we have to put all of this in the context of who we are accountable to, and that is essentially the people paying their water and sewer bill. I have broken this into 8 categories and what I would like to do is kind of go through here each category, we've prompted some questions for discussion, so we would like to have a little dialog here. If anybody has any concerns, or pros and cons to each scenario, there is no perfect answer here but at the end of the day what we have to do is make a decision based upon the cost aspect but also aspects beyond cost.

1) Cost Efficiency – the annual cost and efficiency for operating and maintaining the District – That is the analysis we have done and Mike Spears has done a very good job to point out that is not the total cost of the enterprise...these are the day to day operations costs typically on a monthly and annual basis.

a) Will in-house operations be more or less expensive than contract operations? Based upon the data that we have presented to you today, we believe that the in-house operations would be more affordable. Essentially would be a lower cost on the best 'apples to apples' comparison we had, but I want to make it clear that it is never perfect. You never have an exact 'apples and apples' because there are different perspective and different risks. But based upon the data, there is a slight benefit to bringing in-house from the estimate that Mike Spears put together. Mr. Stratton stated that just for clarification, we asked for a 3 year bid. The cost of in-house based on Mike Spears' numbers is $1.3M less over three years than the lowest bid. ESG and UMG's bids were $42,000 apart. And so, $1.3M savings is going over a three year period with going to self management. Mr. Heitzman stated that is very important, especially when you look at this over a long term and the very nature of the utility is that we have to think long term, more than just the current. Very good point. So cost wise, essentially we have documented a record that essentially is a $1.3M savings over this three year period with the in-house operations. So a) is pretty clear cut.

b) Are there costs associated with in-house operations that are not being properly considered? The question we always have is "what have we not discovered. What might be included by ESG that we haven't accounted for or vice versa." That is one of the reasons why Mike put in a contingency because there are some elements in there...we are going to run into something that we haven't discovered and in a contract environment if there is something discovered, and it is not covered in the contract language, essentially the contractor has to absorb that through their profit essentially. So that is the risk allocation piece. Whereas in this particular case, if it is in-house operation, and there is something that is unexpected, then obviously the District is going to bear that. So this is essentially a risk allocation process to a large degree. So going through that, we believe, after I have looked at Mike's estimate and what Ed Wetzel and I have looked at...we think, and our professional judgement essentially is that we have done a very job...you have done...the folks you have selected in-house and by contract have done a very good job to identify all of the costs of the operation, so that is my perspective, but I do want...and many of you run businesses, if you have anything that you think we should consider, put it on the table or we need to clarify if it is or is not included, now would be a good time to essentially bring that up. I don't know if anything comes to mind....Chairman Blackburn stated that he thinks that the contingency that Mike has of 3% would cover anything that may pop up like incidentals...Mr. Heitzman stated that by the way, let's say that we are going at this as a first pass, you might use a 15% contingency. But the reality is that we have a lot of data, so a smaller contingency is justified because we have a lot of data on the table and this is not the first time we have been through this exercise.

c) Are there additional costs that the District may incur that are not included in the contract? What happens is every contract has a box surrounded with contract language and there are certain things that are beyond the control of the contractor, and in this particular case ESC put some qualifications in their contract, and every contractor would, that if you are outside that box, and so there are certain caps. What would happen is, if that is something that is not covered in the contract by either UMG or ESG, then the District has to pay for it. The same thing on this side. So I generally look at that as kind of a balance. The only difference is you may have a profit and mark up on one versus an in-house operation. Mr. Stratton stated that under the current UMG contract, they pay for all chemicals, costs of water and sewage costs. Under the ESG contract, they asked for 34 contract amendments, I think it came out to be. Now, the three critical ones in terms of cost management were that they wanted to put a budget on the chemicals, water and sewer costs. And the idea was that if we were under budget, we would get a rebate, and if we were over budget, then it would be on us to pay it. The problem with that is that it passes the risk of an overage onto us. Which if we operate independently we are going to have that anyway, but under their contract, we have to eat it on top of whatever the cost of the contract is. So that is a risk of cost adjustments that we would not...if that was negotiated in the contract we would have to look at a resolution.

d) Who bears the risk of unknown costs? The reality is that at the end of the day it is the District and the Board.

So the conclusion here, where we want to have the dialog, is that from a cost perspective, we do see an advantage to bringing the operations in house based upon everything that we see today and that is just one aspect but that is where we are today from a cost perspective. It may be a little bit more challenging if there were different costs, higher premium, and value pieces, which are the next sets...but essentially from a cost point of view everything done indicates that there could be some significant savings to the rate payers by bringing the work in house.

Before we go to the next one are there any questions or comments from any of the Board members related to the cost aspect of the operation? There were none.

2) Organization and Leadership – Here is where we are going to get into some elements of risk. Essentially UMG has been operating the management and operations. They have been doing that for the past 10 years, so they have a system set up, they have some economies of scale because they provide and serve others and so that is what we need to focus in on, is making sure the Board is aware that we are taking some risks from external and essentially we are bringing them in house.

a) Does the Board have confidence in the current management to lead the District? So we need to be thinking that we are going to need more management inside of the District to be able to management this operations realistically and prepare for the future. Some of that management resource may not be in a specific person, per se, but when you look at the overhead, you all run businesses whether it is in accounting or finance or HR, you get bits and pieces of resources from a larger organization. Essentially that is going to need to come in house or in some cases, as we discover some things, we may need to go out of house, and we have included some of that, to bring in some of that expertise when it is needed. So that is this whole section around the leadership. So you as a Board that are accountable for this, have to think of the management team that will be assembled with this process. Our proposal is to bring employees over from UMG. My perspective is that the employees that are coming over know the day to day operations, I'm not concerned about that. This is all about the management and the leadership of the District.

b) Is the leadership team adequately prepared to manage the various back office functions, including HR, IT, Finance/Accounting, Public Relocations/Customer Service? I mentioned this earlier that we need to begin to think prospectively...this is a large District and essentially you have about 50 employees. That is kind of one of those sweet spots that if you get much more than that you have to start thinking that we need full financing, or full time accounting, etc. We are not quite there yet but we need to begin to think of that. How do we manage that? So we may have to have a business administrator... through the HR side is going to be a much more significant challenge, because right now we have 2 employees versus 55 to 60 employees.

c) Do the additional resources (management and technical) proposed by the company contract operator strengthen the organization and provide stronger leadership than the MWD team? You currently have contracts with a number of engineering firms. We just earlier approved contracts for insurance, etc. so essentially the competence that is out there in the market, so from observation you have a good understanding and knowledge of how you would use expertise in the market place, whether it is legal, engineering, etc. to be able to manage through. So the question here is, as we go through, there is a risk shifting on the management side from the contract operator to the in-house and the focus is related to what I call the "back office functions". You as the Board, have the accountability essentially to hire the management team that essentially will manage the organization.

Let's pause there. Are there any questions, because some of the things and duties of any contract operator will be shifting over on that management side. Any questions or thoughts? Chairman Blackburn stated that with the exception of Grondall Potter, which Grondall will not be coming over from UMG, but we have got a good group of folks and as you said, they know their jobs. They know how to run the District, so we have confidence in them. And Roy and David, the folks that are already here...David is coming over...we feel comfortable that we should have a seamless transition from UMG management. And I will say this about UMG, they have done a great job...the employees with UMG, of serving the folks of Pike County and managing this District. We do have an environment of shrinking revenues and I think we will have a lot more flexibility as an independent unit to deal with the shrinking customer base without having to wrangle through a contract. So there is some things that we could serve better with in house accounting. Mr. Heitzman stated that he agrees. On this particular here, you will be able to respond with your resources at the direction of the Board and policies, procedures and approval more directly to meet the challenges that will present themselves. The pro of a contract operation is that you shed that risk and put that risk on the contractor and essentially you have that risk around a box or what is defined. But if there is something that arises that is not defined, then you are still accountable for that risk. But you have a competent management team and the many of these employees are coming over. I would have a much different concern if it was 'we need to hire 50 employees'...it would be a completely different scenario. But essentially the employees are competent to run the day to day, so my view is that the risk here is the incremental risk of how will you manage the utility. So that is really all of #2 here. Any questions or comments from any other Board members? There were none.

By the way, doing this is all a part of our appropriate due diligence process to make a decision.

3) Human Resource Management – this is really a subset of #2, it is just a little bit more focused. I had mentioned previously on my previous trip down here, what would be your biggest challenge...the human resource side. I believe that the human resource side will be one of our biggest challenges. Why is that? Because the operations is being done day in and day out. We are not starting something from scratch.

a) Is the Board prepared to take on this responsibility? That is now directly the hiring and firing, recruiting, etc. and managing that. Managing two employees is different than managing 55 or 60 employees and in today's world... 35 years ago the human resource was not that complicated. It was essentially to get folks in and get them to retirement. Today, as everyone is aware, it much more complex; everything from health insurance to liability, etc. and that responsibility will shift over and it's appropriate for the Board to establish through its leadership and management structure how that human resource piece will be managed. And there is a plan to have resources, essentially an HR Administrator, to manage it. So that is the key there. I believe 30 years ago, an organization like this could probably manage that externally, but in today's environment you are going to need someone to manage the day to day human resource piece. That is the training, organization of data, all of the documents that have to be filed, etc. with just the suite of insurance services we talked about earlier. So that is the real key here, so think about the Board is responsible.

b) Is management in place to oversee this function? And we have a plan in place that has been laid out.

c) If not, what is the plan to meet this need? That is not the case. That was an original question we had.

d) Are there any advantages/disadvantages to contract management as it relates to HR? Here is the view that can go both ways. If you are a contract and there is an employee issue with the contract operator, it is really not an employee issue for the District. It essentially doesn't penetrate that wall, so if someone adheres a claim, or there is a disability or discrimination, etc. that is contained within the contract operator. And also I'll mention I understand that we as a District, essentially are subject to open records and we have one set of rules to follow. It is slightly different in the private sector. Both employees would be employees 'at will' on both sides but essentially the rules of engagement are different and that will require Dan Stratton to be able to help us manage through that. But many times you contract high risk operations or expertise in order to be able to manage that in many cases that is human resource risk in the administration. So that responsibility for your employees will move in house if you bring it in. Mr. Stratton stated that as you all know we have contracted out a person to assist in the HR function right now and that is in place. The second thing is that, as you all know, everybody is going to get pressure about "hire my cousin Billy" or you know "my cousin John needs a job" and you all will just have to withstand the pressure to not do that unless there is a viable certified position that has been opened and approved by the Board that has been talked about as a possible method or mechanism. Commissioner Hurley stated that would be the process if we even take it over. Mr. Stratton confirmed that would be the process you would have to follow in that case. Mr. Heitzman stated that the key is establishing policies of the Board with respect to how we recruit, hire and retain qualified employees. And that will be an important step if we need to bring in a number of people. We have already been working on that process. So that would definitely be very important. Are there any questions on the human resource side? Of all of these on here, that is probably the most immediate need. Some of these others from here on out are essentially longer term challenges that you've had all along, but the reality is that the human resource is going to continue in this transition to be the most important, because of the employees being involved.

4) Asset Management – This is an industry term we are using more and more to be stewards of our assets because these facilities have to last 20,30,40 years and in some

cases we are replacing some of our aging assets. So what we tend to have is larger firms, larger water utility, wastewater, or larger type operators often have available to them software, management principles, processes available to be able to manage the big picture long term, as opposed to looking day to day. In other words, what are we doing long term strategically to be good stewards of our assets?

a) Will in-house operations do a better or worse job at long-term asset management and system growth than contract operations? The tendency is that contract operations focus on the day to day operations and sometimes decisions are made with cost constraints or time constraints that may not be in the best interest long term, but you have to deal with it right away. Generally what you'll have is, if you are able to bring that in-house, at the direction of the Board and if the Board provides the resources, you can look at the long term viability of whether you are making a capital investment or whether you are making an operating expenditure. The key to understanding is that it will be the responsibility of the Board to look at that longer term picture. The reason I bring this up is that the regulating agencies and the EPA are all focused for the past 5 to 10 years on "what are we doing to make sure our utilities are sustainable and viable for the long term?" because many were only reacting to a situation instead of doing more to be proactive with preventative maintenance programs, proactive programs, proactive capital programs.

b) Who is best prepared to address the non-revenue water issue and PSC requirement to reduce water loss from 30% to 15%? I put that on there because essentially that is a major issue that has been on the PSC report. My recommendation to you as a Board is that we need to develop a defined plan because we have got to show progress in the coming years, related to how we are going tackle this. We discussed this earlier with the fire departments, etc. We need a holistic approach. That is something that I think may in the District's interests to bring in some expertise once we assess the resource we have today. You have resource today, but you pull them off to do the proactive thing, going out and looking, then you are pulling off your day to day operations. So many times what a utility will do is bring in expertise that have done this before and that is their specialty, to be able to go in and find where these challenges are; to be able to start trimming back your non-revenue water or your water loss.

c) Does MWD currently have an asset management framework to include condition assessment, preventative maintenance, scheduled asset replacements and the like? This is looking forward. In future budget cycles you may want to think about that. I have not done an assessment on what you currently have. I suspect what you have right now is dependent upon what UMG has right now with respect to asset management. That can be a future assessment to begin looking long term.

d) Does MWD possess adequate engineering/technical resources to address this area or do resources need to be hired or outsourced? From everything I have seen you use the professional engineering community. You get proposals in, and have capable and competent engineers doing your engineering. If we get into some specific scenarios or expertise we can always go out and bring that to the table. At some point, the larger you get, you may want to have an engineering resource in house on staff. That might complement and they can work in multiple different areas because of this asset management challenge.

So the asset management, think 5, 10, 15, 40 years out versus operations maintenance which is day to day. Are there any questions or concerns about the asset management component? There were none.

5) Capital Improvements – This could be a sub set of Asset Management – These are the capital improvements are essentially the capital improvements that you are authorizing; placing a pump station, replacing a pipe, extending the system out to meet new development in the area, replacing aging infrastructure.

a) Which management structure creates the best incentive to plan and execute long term capital improvements? Again, there is pros and cons on each side but if you are focused on an operations and maintenance contract that is going to be your primary focus. Whereas, capital, that is a different variable to show depreciation over a period of time with your capital investments, and those are longer term, and what has happened in the past is, under the current arrangement, essentially the capital improvements are the responsibility of the District to be able to manage. So essentially you have that system in place, you would have to do a different contract approach with operations if you wanted the contract operator to manage your capital program as well. So essentially understand those balances, pluses and minuses.

b) Which management structure provides the best system to do so?

c) Who will be responsible to develop the justification/business case for regulatory approval for rate increases to fund capital improvements and future increases in operating costs? So if you do a major investment, you are going to have to submit that to the Public Service Commission as you are aware, and in the past, some of that information would come from your contract operator, the operation piece. Your engineer assembles what the capital cost is going to be and then ultimately how it gets into the rate base or drives the percentage of rate increase. So that responsibility is going to shift from part of it coming from the contract operator to you as the District, under the leadership of the District Manager. So that is an extension of the asset management. The asset management is the long term, the capital is the annual, and operations is the day to day.

Any questions about that component? There were none.

6) Customer Service – Essentially customer service operation is handled here at this location. I don't see major concerns with that because essentially it is the same people, but what we have is will there be, and as a Board I would recommend you thinking, will there be a different set of perceptions from your customers operating in-house versus contract operations.

a) How do the customers perceive their level of service under contract management? Right now if your customers have a high regard of your current contract operator, UMG, and there is a shift, there may be a perception associated with it, being better or worse. An example would be is if this operation shifts in house, and let's say there is a major event 6 months from now. How are we going to manage and mitigate that risk from a customer communication, elected officials, to the regulators, as well as to the public? The questions here are to get us to think that now we are accountable and are the face and brand in front, if we bring the operations in house.

b) Can independent management influence and improve service levels? There is an existing service level there whether we measure it or not, and we need to begin to think about establishing what is that base line, and looking at how we measure to make sure we are doing better this year than last year. We need to be thinking about that and that is the accountability to assure the PSC that we are doing a good job of providing service levels. No longer is it just about the cost. It can include service levels. It can be a great cost but if nobody has water if it isn't working, then we have an issue from the service level perspective.

c) Is MWD prepared to manage the monthly and annual reporting requirements? There is going to be some things right now that the contract operator be the responsibility... if we contract operate the role of reports, they could get submitted in, whether it is to the Board or whether it is to regulatory officials. So essentially those will roll through the process and will be the accountability and the signatures on the bottom for accounting purposes, auditing purposes, etc.

That is the area of customer service. Again day to day I am not concerned about. It would be the management piece of this and what will this message be to the community and I would recommend if there is a change, even if there is a change in contract operators, there is a message that needs to go out to the community once the decision is made. Are there any questions on the customer service aspect? There were none.

7) Technology and Innovation – We all recognize that technology is moving very quickly and as we mentioned earlier our entire water industry, we are all selling less water per capita, whether it is because of the economy, low flow fixtures, America is moving from a manufacturing base economy, in this case with the coal industry, you may have some scenarios that they are higher water users and we are moving to a service based economy that uses less water. And every low flow fixture that goes in or every shower head, etc. all the per capita consumption is going down all across the Eastern US and we have not seen the end to that. We are tracking this industry and we haven't seen the bottom of it yet. So what that means is we have fixed costs of operation, and what we have is the debt. That fixed cost of operation, it doesn't matter how many gallons we sell. We still have to pay, if we have debt, or if we have a contract operator, we still have to pay essentially a fixed cost. When you are growing and your revenue is growing, fixed costs are great. But essentially the industry is being de-leveraged and that is an issue all across the Easter United States, whether it is a small system or its Cincinnati or Louisville. We need to be thinking, how do we manage that more efficiently. The first thing you do is look inside your operations and technology. You are a business folks, you are bringing in new technology. Technology will be able to leverage the technology to be able to do things more efficiently. So that saves us costs with internal operations. Many times contract operators, because they are operating on a much larger scale, they will invest in technology across multiple platforms because they can make that investment because they are providing that service to multiple communities, so they can justify a larger piece of technology, whether it is GPS tracking, Automated meter reading or AMI, or whether it is tracking fuel systems, asset management, etc. That is the type of technology. The smaller a utility is, you don't tend to have the economy of scale that a

larger utility may have. The solution for that, is that if you bring it in house, you recognize that and you see 'where can I invest some technology'. There are a lot of partners, and Kentucky Rural Water Association does a good job of saying "we've got this group of utilities, could we form a co-op, or could we all get together to be able to make an investment in a similar software technology so we can do what a larger entity can do, but do it cost effectively." So a couple of things; so have to keep your eyes open for technology, and another is that you need to be prepared as a Board to invest in the technology that may be a given with a contract operator that you may not have here. That may be the actual widget, but it also may be the training and the people.

a) Does MWD have adequate resources and expertise to manage the technology necessary to operate the system?

b) Does contract management bring better options? In some cases, that could be the case. A larger entity could have access to existing programs, procedures, data systems, etc. that you may not currently have. So we need to do that assessment. If it is brought in house, we have got to mitigate that risk which could be an investment. Those tend to be capital investments because they will have a life of more than 5 years, as an example. So you need to be thinking about how we leverage this enterprise because of declining revenues, because of declining consumption, how we essentially save money and become more efficient on a per unit basis in house.

Any questions on technology? There were none.

8) Risk Management – I think we have already covered that.

a) What are the pros and cons of in-house management vs. contract operations concerning overall risk management? We have already discussed contract operations. Any contract you have is essentially risk management. It is allocating that risk to another party. In this case you have more responsibility. What that means in a public setting is that you and your management team will be accountable for those decisions, as opposed to "I've got a contract operator and those decisions fall on them".

So those are the issues that we identified. What we should do is get some perspective from each of the Board members on this. You have heard the pricing pieces, the pros and cons of soft side, the reality...because of the timing, I believe today it is the desire of the Chairman and others to make a decision of record here today that needs to be documented.

7. Decision on Independent or Contractual Management

Mr. Heitzman stated that he will answer any questions but Mr. Tackett, maybe we can start with you, do you have a perspective after hearing all of this one way or another, because there is pushes and pulls and pros and cons with each one. Commissioner Tackett stated that there is risk either way you go with it, but in looking at that, we are sitting right now on over a million debt that we are in debt to the contractor, UMG, right now. Am I correct on that? Chairman Blackburn confirmed that as correct. Commissioner Tackett continued by saying that Mike Spears has given to us, he is showing somewhat of a saving there, and I think that the Board is capable. I think the employees are capable and it is good to be able to bring those employees in with us, if we decide to go independent. And whatever cost, that money that we spend, we are passing on to our customers right now, and our customer base is declining. We have some bad infrastructure out there that is going to have to be replaced, with a current contractor that we are in debt to for a million dollars. Where is this going to go and how is it going to fall? I don't know and I don't have an answer for that right now other than the fact that we are in debt to this company. I think we are capable and if we go into a contract with another contractor we are looking at a 3 year contract on it, and that is regardless. They don't care how much our customer base goes down, they won't give us any break on that. We will owe them X amount of money. Mr. Stratton stated that it is a fixed price that escalates slightly each year, so we would have a fixed cost for 3 years with an option to extend it if we wanted to. Commissioner Tackett stated that for 3 years we are in a lock with that. That is another concern with me, with businesses and customer base. That is my opinion.

Commissioner Hurley stated that he didn't have a problem with it. I think we are all capable of managing this. We all have...any business can have problems and you just have to solve them. I think we are all willing to do it, if it comes to that.

Commissioner Casey stated that he feels that same way as Mr. Hurley and Mr. Tackett do. I think every one of us is very capable of doing and making right decisions on behalf of all of our customers in Pike County. I think the explanation that you gave on all of the pros and all of the cons...and I tried to listen to it carefully, and I enjoyed the presentation and I think that this Board is very prepared to do the right thing.

Commissioner Friend stated that he agrees also on pretty much the way it was coming across. I think everybody is capable of the transition. I am ready for it.

Chairman Blackburn stated I think everybody here on this Board is comfortable with the management team and the skill level of the employees. And we are all well aware of the economics of our region and the fact that we may be sitting here in 2 years, with who knows what the number is. But we have watched it for the past 18 months steadily decline. We tracked it for well over a year and we feel that that in itself gives us pause before entering into another contract, shifting the responsibility of managing the system to a contractor and be locked into an escalating 3 year deal with a diminishing base.

We are confident that we'll come to the right decision and with that I'd like to put it to a vote if we could get a motion. Mr. Stratton stated that it would be a motion to opt to go to independent management or to award one of the firms a contract. Commissioner Tackett made a motion that we go to independent in-house management. Commissioner Hurley seconded the motion. Commissioner voting as follows:

Ancie Casey	Aye
Kelsey Friend	Aye
Michael Blackburn	Aye
Eddie Hurley	Aye
Johnny Tackett	Aye

Upon Commissioner voting, the motion was carried and passed.
Resolution No. 16-06-016