

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF MARTIN	)	CASE NO.
COUNTY WATER DISTRICT FOR AN	)	2021-00154
ALTERNATIVE RATE ADJUSTMENT	)	

ORDER

On April 8, 2021, Martin County Water District (Martin District) filed an application with the Commission requesting to adjust its rates for water service pursuant to the alternative rate adjustment procedure for small utilities as set out in 807 KAR 5:076. In its application, Martin District requested that emergency rates be permitted, pursuant to KRS 278.190(2), while the Commission completed its review of the rate application.

The Commission granted Martin County Concerned Citizens, Inc.'s (MCCC) motion to intervene in an Order entered on April 19, 2021. As of the date of this Order, no other party has moved to intervene.

On May 27, 2021, a public hearing was held at the Commission's offices in Frankfort, Kentucky, for the purpose of addressing Martin District's request for interim emergency rate relief.<sup>1</sup> Evidence was taken for the purpose of determining whether the request for interim relief met the standard set forth in KRS 278.190(2). That standard requires the Commission, in order to approve emergency rates, to make findings that Martin District's credit or operations will be materially impaired or damaged if all or a portion of the proposed rates are not permitted to become effective immediately and

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<sup>1</sup> Hearing Video Transcript (HVT) of the May 27, 2021 Hearing.

subject to refund while Staff and the Commission performs further review of the rate application.

At the hearing, Martin District's Board of Commissioners Chairman Jimmy Don Kerr and Commissioner John Paul Hensley, as well as General Manager Craig Miller of Martin District, gave testimony stating that the utility is operating "in the red" and has a desperate need for a rate increase in order for the utility to continue to operate.<sup>2</sup> Alliance Water Resources, Inc. (Alliance) Director of Operations James Anthony Sneed, Alliance Accountant Ann Perkins, and Auditor Steve Boggiano, CPA, of Wade Stables, P.C, also gave evidence on behalf of Martin District stating under oath that Martin District's credit or operations will be materially impaired or damaged if Martin District is not authorized to implement an emergency rate increase subject to refund.<sup>3</sup> Commission Staff called Department for Environmental Protection (DEP), Kentucky Energy and Environment Cabinet (EEC) Deputy Commissioner Amanda LeFevre to testify at the hearing. Deputy Commissioner LeFevre also filed a letter in this matter on May 25, 2021, describing the Energy and Environment Cabinet Martin County Water District Work Group (Martin Work Group).<sup>4</sup> She confirmed the "significant challenges" that Martin District continues to face that require funding, however, despite improvements, "the hole they are digging out of

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<sup>2</sup> *Id.*, Kerr at 5:47:26–5:49:09; Hensley at 6:03:58–6:04:14, 1:03:43–1:04:29, 1:37:36, 1:45:47, and 1:51:06.

<sup>3</sup> *Id.*, Sneed at 4:05:53–4:06:34; Perkins at 4:54:48–4:55:56; Boggiano at 5:14:34.

<sup>4</sup> Martin Work Group, formed February 2020 by Secretary of the Energy and Environment Cabinet. Martin Work Group participants include representatives from EEC, MCWD, Alliance, Kentucky Rural Water Association, Big Sandy Area Development District, University of Kentucky, Martin County Concerned Citizens, and Bell Engineering. In addition to the main working group, a Technical Subcommittee meets monthly to discuss any technical/operational issues faced by the system in order to identify trends, issues, resources, and any needed assistance. The Alliance Division Manager also meets with DEP Staff each month following MCWD's monthly board meeting to keep staff apprised of issues, concerns, and progress. <https://eec.ky.gov/Environmental-Protection/Water/Pages/Martin-County-Water-District-Workgroup.aspx>

was very deep.”<sup>5</sup> Steven Caudill of Bell Engineering testified at the hearing and filed a presentation in the record detailing the \$55 million estimate that it will take to bring Martin District to a base level of function and reiterated that the deficits that Martin District are experiencing each month are not sustainable.<sup>6</sup> Mr. Caudill also confirmed that the ratepayers fund the day-to-day repairs necessary to maintain a utility and absent outside funding, the large improvements required for the system to operate are funded by the ratepayers as well. He described the consequences of system neglect as a “brutally vicious cycle” when necessary maintenance is not performed routinely.<sup>7</sup> Finally, MCCC called MCCC President Nina McCoy to testify. Ms. McCoy submitted several exhibits regarding recommendations made on behalf of citizens to show that the proposed rate increase will be an extreme amount to ask of a poor county.<sup>8</sup> Ms. McCoy objected to the rate increase and explained that she thought that one of the poorest counties having one of the highest minimum rates when the surcharges are included is “unfair.”<sup>9</sup>

On June 1, 2021, MCCC filed a post-hearing brief protesting the rate increase and explaining the economic hardship of the residents of Martin County.<sup>10</sup> MCCC also requested additional reports be generated by Martin District concerning customer assistance, customer service complaints, late fees, water quality, infrastructure funding,

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<sup>5</sup> LeFevre Letter dated May 25, 2021 (filed May 26, 2021).

<sup>6</sup> HVT of the May 27, 2021 Hearing at 7:10:15; Caudill filed presentation May 25, 2021; “\$63,263,000, including wastewater projects” Alliance Updates 51221 at 17 (The Public Service Commission (PSC) does not regulate Martin County Wastewater.); LeFevre Letter, dated May 25, 2021 (filed May 26, 2021).

<sup>7</sup> *Id.* at 7:11:22.

<sup>8</sup> *Id.*, McCoy at 7:29:00–7:29:40

<sup>9</sup> *Id.*, McCoy at 7:22:18–7:30-67.

<sup>10</sup> MCCC Post-hearing Brief (filed on June 1, 2021) at 2.

and capital improvement planning if an emergency increase is granted to Martin District.<sup>11</sup> On June 3, 2021, Martin District filed its response brief wherein it recognized that as noted by MCCC, affordability was an issue and that in an attempt to address this issue, Martin District requested an increase to its rates that does not fund depreciation expense but requires an increase that is necessary to meet its statutory funding requirements.<sup>12</sup>

### DISCUSSION

As a general matter, prudently managed utilities will not willingly place themselves in a position where interim rate relief during the suspension period is necessary to avoid a material impairment of the utility's credit or operations. While low rates are desirable, this must be balanced against the necessity that a utility remain financially and operationally viable. The extraordinary relief authorized under KRS 278.190(2) is just that — extraordinary. As the Commission has noted, “In other words, only where the financial or operational condition of a utility has deteriorated to a perilous extent has the General Assembly authorized the Commission to utilize the procedures of KRS 278.190(2) . . . .”<sup>13</sup> KRS 278.190(2) states in relevant part:

[I]f the commission, at any time, during the suspension period, finds that the company's credit or operations will be materially impaired or damaged by the failure to permit the rates to become effective during the period, the commission may, after any hearing or hearings, permit all or a portion of the rates to become effective under terms and conditions as the commission may, by order, prescribe.<sup>14</sup>

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<sup>11</sup> *Id.* at 4–10.

<sup>12</sup> Martin District Response Brief (filed on June 3, 2021) at 1.

<sup>13</sup> Case No. 2007-00472 *General Adjustment of Electric Rates of East Kentucky Power Cooperative, Inc.* (Ky. PSC Apr. 1, 2007), Order at 2.

<sup>14</sup> KRS 278.190(2).

The Commission, thus, must determine whether Martin District's credit or operations will be materially impaired absent the implementation of emergency rates.

The record of this case shows that Martin District cannot continue to operate without an emergency rate increase. The evidence of record in this case and the several cases that Martin District has had before this Commission show that the utility's monthly expenses are more than the rates that that the utility is charging to keep operating.<sup>15</sup> The application submitted shows for 2020, the operating expenses were \$3,447,865, with depreciation and \$2,661,124 without depreciation. The total operating revenue is \$2,503,432.<sup>16</sup> The utility is operating at a loss, using money from the debt service surcharge to pay operating expenses and Alliance is fronting the money to keep the utility running. The baseline funds being requested do not include depreciation funds or anything more than the minimum required for the utility to continue operating. Absent additional monies, estimated to be \$55 million<sup>17</sup> over and above the rate increase and the amount of grants the utility is currently utilizing, the utility will not be able to repair its crumbling infrastructure created by years of mismanagement and incompetence. The Commission has reviewed the numerous public comments already filed in this case record and will attempt to address those in this Order.<sup>18</sup> The Commission acknowledges the exasperation expressed in so many of the comments listing a concern for the ratepayers' ability to pay for the rate increase. Nevertheless, the Commission finds that

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<sup>15</sup> HVT of the May 27, 2021 Hearing, Sneed at 4:05:53–4:06:34.

<sup>16</sup> Application, Attachment 4, Schedule of Adjusted Operations.

<sup>17</sup> HVT of the May 27, 2021 Hearing, Miller at 1:41:52–1:43:16.

<sup>18</sup> The Public Comments for this case are available at [psc.ky.gov](https://psc.ky.gov).

in addition to the information presented above, the three pertinent points below are relevant to the Commission's decision as to the need and reasonableness of Martin District's request for an emergency rate increase.

1. The Utility is Operating at a Loss and Carries Accounts Payable Currently of \$1,170,012.04.

The harsh reality of the situation is that despite operational and financial efficiencies realized with the help of Alliance, absent any rate increase, Martin District simply cannot continue to operate. The May 2021 board packet filed into the record of Case No. 2020-00154 presents in stark detail the dire financial situation of Martin District.<sup>19</sup> On an accrual basis, Martin District had a total net income of \$112,840 for the four months ended April 30, 2021.<sup>20</sup> It should be noted, that in the same period, capital contributions of \$329,639 were recognized by Martin District.<sup>21</sup> Absent these contributions, Martin District would have recorded a net loss of \$(216,799) including depreciation expense.<sup>22</sup> While this figure is staggering, it does not begin to accurately portray the cash flow situation at Martin District, and merely provides a "snapshot" of the situation and excludes certain pertinent information, including but not limited to the fact that the income statement does not recognize principal payments for Martin District's long-term debts to the Kentucky Rural Water Finance Corporation, the Kentucky Infrastructure Authority, or its Kentucky Association of Counties lease. The income

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<sup>19</sup> Case No. 2020-00154, *Electronic Martin County Water District Management and Operation Monitoring Pursuant to KRS 278.250* (filed on June 10, 2021), Notice of Filing Information Packet for June 22, 2021 Board Meeting.

<sup>20</sup> *Id.* at 4A-3.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

statement also does not recognize the amounts Martin District is required to deposit into a separate interest bearing account to come in compliance with its loan covenants. The 2020 audit report of Martin District cited Martin District for not previously maintaining the required balance of \$66,491, which could cause Martin District to be deemed in default by its lenders.<sup>23</sup>

Since the November 15, 2019 Order,<sup>24</sup> Martin District has only successfully made one significant payment towards the outstanding debts that were earmarked to be paid through the debt service surcharge (DSS).<sup>25</sup> Since that time, the collections from the DSS have been swept to ensure the accounts payable to Alliance is kept current. Despite this, outstanding invoices to Alliance remain approximately 45 days past due.<sup>26</sup> While this stopgap has prevented a catastrophic financial failure of Martin District up to this point, it would be unreasonable for the Commission to ignore that the DSS collections are not being used for the purposes stated in the November 5, 2018 and November 15, 2019 Orders.

Martin District maintains a past due balance of \$257,521 for accounts that are not permitted to be paid through the DSS, and those accounts remain outstanding due to lack of funds. The total amount past due, excluding the past due accounts owed to Alliance,

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<sup>23</sup> Application, Attachment 4(e), at 25.

<sup>24</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 15, 2019).

<sup>25</sup> Case No. 2020-00154, *Electronic Martin County Water District Management and Operation Monitoring Pursuant to KRS 278.250* (filed on Aug. 11, 2021). Between August 2020 and September 2020, Evans Hardware was paid \$26,104.67, and CI Thornburg was paid \$1,000, reducing the balance of the past due accounts payable from the DSS to \$475,377.28.

<sup>26</sup> Martin District's Response to Commission Staff's Second Request for Information (filed on May 26, 2021), Item 1.

is \$732,898, which represents approximately 62 percent of Martin Districts total accounts payable of \$1,170,012. Martin District, furthermore, is out of compliance with its loan covenants and it is out of compliance with KRS 65.140, which requires purchases be paid within 30 days of receipt of an invoice.<sup>27</sup> Martin District cannot, and should not, expect outside vendors to carry the weight of an unsustainable rate structure.

Other than the expense of the Alliance contract, Martin District directly pays expenses for purchased power, insurance, and rental expense for its billing office, which in comparison to the expenses incurred and billed through the Alliance contract are minimal. Because Martin District is falling behind on its payments for the management contract, Alliance bears the burden of the expenses incurred by the District which include, but are not limited to, payroll, employee benefits, chemical costs, and any repair costs or capital expenditures that Martin District may require.

## 2. Martin District Continues to Pay for the Mismanagement of the Past.

The Commission has been actively involved in the process to help Martin District become financially solvent and operationally sound.<sup>28</sup> Commission regulation 807 KAR 5:076, Section 3, sets the standard on what the Commission may base its decision, which includes, but is not limited to, the information contained in the utility's annual report for the immediate past year, and the two annual reports for the two prior years.<sup>29</sup>

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<sup>27</sup> Application, Attachment 4(e), 2020 Audit, Martin County Water District, Inez, Kentucky, Annual Financial Report, Year Ended Dec. 31, 2020.

<sup>28</sup> See Case No. 2016-00142, *Electronic Investigation of the Operating Capacity of Martin County Water District pursuant to KRS 278.280* (Ky. PSC July 22, 2020) and the last emergency rate Case No. 2018-00017. *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 15, 2019).

<sup>29</sup> 807 KAR 5:076, Section 3(1).

Commission regulation 807 KAR 5:076, Section 9, states that the reasonableness of the proposed rates shall be determined based on the aforementioned 12-month historical period, adjusted for known and measurable changes.<sup>30</sup> Martin District previously was able to present a clear case for the need for a rate increase in Case No. 2018-00017, however, the records could not be verified and were inaccurate, and the exact amount of the total increase required was not known and measurable pursuant to the standard set in 807 KAR 5:076. Absent all of the issues that have been brought to light since the opening Order in Case No. 2016-00142, the Commission was aware that Martin District, in order to gain solid financial footing and work towards operational stability, would require an additional rate increase over what was approved in Case No. 2018-00017. Additionally, in Case No. 2018-00017, the Commission recognized that granting the full rate increase requested without strict oversight and guidance while some of the same leaders that contributed to the destruction of Martin District's system were in charge would not have been fair, just and reasonable.<sup>31</sup> The Commission granted base rates and specific surcharge amounts with strict oversight of the funds knowing that the utility eventually would need additional funds when knowledgeable and competent management was in place.<sup>32</sup> The Commission had no desire to put additional funds into

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<sup>30</sup> 807 KAR 5:076, Section 9.

<sup>31</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 5, 2018) at 8–9, discussing the failure to hire skilled management, at 16–17, discussing the surcharge, at 20, discussing the failure of Martin District to hire a general manager and why the rate increase was structured to require compliance, Concurring Opinion of Chairman Michael J. Schmitt, at 10–11, discussing the fact that the interim manager at the time was a member of the Martin County Water Board at the time the system began to fail and signed an agreed Order to institute changes, but failed to do so, and that same individual planned to apply for the general manager position.

<sup>32</sup> *Id.* (Ky. PSC Nov. 5, 2018) Concurring Opinion, Greg Scott was still employed as a field manager and had been a board member when Martin District agreed to implement the recommendations of the audit and actually did nothing.

the hands of individuals who did not have the ability to manage a water system and who could not reliably implement basic record-keeping and internal controls.<sup>33</sup>

Martin District board chairperson, Jimmy Don Kerr testified that Martin District knew it would need a rate increase at the time of the November 5, 2018 Order in Case No. 2018-00017, when the Commission explained why the full request of a 49 percent rate increase was denied in an effort to address the needs of the utility and provide the most oversight possible. Kerr also acknowledged that the utility required a rate increase regardless of whether a professional management company was hired.<sup>34</sup>

#### 2a. History of Martin District Investigations at the Commission

Context is critical to finding a solution for Martin District. Martin District has a tragic history of mismanagement of the system, and it is clear from the records at the Commission that those in charge of Martin District over the past decades have not maintained its infrastructure or finances in order to maintain an adequate level of service to its customers. Instead, its past managers and board members deliberately refused to follow multiple Commission Orders, advice from professionals, consultants, and recommendations from multiple audits and investigations. No one in charge of Martin District had the training or initiative to pursue sources of revenue and reasonable rate increases needed to fund the periodic replacement of aged infrastructure and equipment

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<sup>33</sup> *Id.* and HVT of the May 27, 2021 Hearing, Boggiano at 5:21:54–5:22:52, stating that the independent accounting firm performing the audit for 2019 could not rely on the financial records, including the ending balances for previous years. 5:23:17–5:23:20, generally speaking the record keeping practices prior to 2020 at Martin District were “awful.”

<sup>34</sup> HVT of the May 27, 2021 Hearing at 5:52:07–5:53:05.

before they ceased to function altogether. As a consequence, much of the system has either totally collapsed or is on the verge of doing so.<sup>35</sup>

Craig Miller explained that with his education, training, and experience, if Martin District had spent depreciation funds on infrastructure and had the management been educated in how to make the necessary investment in infrastructure, the ratepayers of Martin District would not be suffering the effects of a crumbling system now.<sup>36</sup> Mr. Miller went on to explain that there was no indication when he started with the District in January 2020 that former management had ever set aside proper depreciation funds or that there was any plan to do so. He agreed that never raising rates intentionally showed a lack of management skills and the problem now is that it will cost more than \$55 million to completely repair a system that serves 3,300 customers.<sup>37</sup>

Deputy Commissioner LeFevre also described Martin District as presenting the complex issue that “rolls together poor management, system neglect, geographical challenges, economic issues, and a call to action from the citizens and media.”<sup>38</sup> She confirmed the challenges that Alliance faced upon arrival and acknowledged that the professional management group addressed every deficit of the utility that it could control.<sup>39</sup> She also explained the infrastructure, including the failing pipes in the ground

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<sup>35</sup> See Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (KY PSC Nov.5, 2018), Chairman’s Concurring Opinion.

<sup>36</sup> HVT of the May 27, 2021 Hearing, Miller at 1:43:16–1:45:16.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* at 6:14:21–6:14:57.

<sup>39</sup> *Id.*, LeFevre at 6:20:10–6:20:55.

and lines that were not repaired with proper skills over the years, were unknowns or “surprises” that Alliance cannot control and require a great deal of funding.”<sup>40</sup>

Martin District must repair damage due to neglect for several large components of its system in order to provide reasonable service. Because of the failings of local leaders and past management’s refusal to seek gradual rate increases in order to maintain the system, there are a number of long-needed projects required for the utility to function, each of which require capital.

Water Loss and Meters:

Automatic Meter Reading (AMR)/Advanced Metering Infrastructure (AMI), generators for all critical infrastructure, pump redundancy, SCADA and telemetry systems, water line replacements at multiple locations and high service pump repairs make up the immediate needs list of Martin District.<sup>41</sup> Mr. Miller presented the water loss plan explaining the need for replacement and repair of the meters, master meters and telemetry that will cost approximately, \$2,503,000.<sup>42</sup> He specifically described replacement of the 40 East Meter as a specific challenge holding up progress towards a large decrease in water loss.<sup>43</sup> Mr. Miller also explained that not all customer meters were accounted for and many were in service without being tested for accuracy for a period longer than ten years in violation of the Commission regulation 807 KAR 5:066,

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<sup>40</sup> *Id.*, LeFevre at 6:20:10–6:20:55; and LeFevre Letter dated May 25, 2021 (filed May 26, 2021).

<sup>41</sup> Martin District Hearing Exhibit 1, *Alliance Water Resources, Inc. Operations Update Power Point to be utilized at PSC hearing on May 27, 2021* (filed May 25, 2021) at 16–17.

<sup>42</sup> *Id.*

<sup>43</sup> HVT of the May 27, 2021 Hearing, Miller at 1:27:28–1:29:30; Application Attachment 4-g.

Section 16(1).<sup>44</sup> Alliance believes it has located nearly all of the systems meters, but the project to repair or replace them with smart meters will cost \$1,716,000.<sup>45</sup> Mr. Miller explained that AMI/AMR meters will pay for themselves in a year with time saved and increased accuracy and efficiency.<sup>46</sup> The water loss for Martin District in January was 74 percent, and in May, it sits at nearly 65 percent.<sup>47</sup> Anthony Sneed explained that given the state of the infrastructure, it will be at least three years before any significant improvement, decreasing water loss to approximately 40 percent.<sup>48</sup> Mr. Miller explained that despite the water loss, because the number today is verifiable, a better way of looking at the progress made on the water loss plan is to look at the projects that Martin District, with the help of Alliance, has been able to complete, such as the identification of the meters in the system and the improvement of the training and procedures employed to repair lines correctly and identify leaks.<sup>49</sup>

Line Replacement & Raw Water Intake:

Two large projects for which Martin District sought bids after receiving approval for grant money were the line replacement in the Warfield area and the raw water intake system repair. Craig Miller and Jimmy Don Kerr confirmed that both projects had to be bid twice because the bids were too high for the amount the utility received in grants.

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<sup>44</sup> 807 KAR 5:066, Section 16(1).

<sup>45</sup> Martin District Hearing Exhibit 1, *Alliance Water Resources, Inc. Operations Update Power Point to be utilized at PSC hearing on May 27, 2021* (filed May 25, 2021) at 16–17.

<sup>46</sup> HVT of the May 27, 2021 Hearing, Miller at 2:12:55–2:14:04.

<sup>47</sup> *Id.*, Sneed at 4:20:05–4:21:05.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*, Miller at 2:49:14–2:50:18.

Ultimately, the utility prioritized the raw water intake project and is seeking to use the funds approved for the Warfield area line repair to combine with the funds approved for the raw water intake repair for the later project. If the pipes had been replaced on a regular basis and money not wasted on unprofessional temporary fixes, the cost of repair today would not be so crippling. If the initial construction, or even subsequent construction, of the raw water intake system had been planned better and properly maintained, the cost of repair and replacement for that system would not be so high or no repair or replacement would be necessary today. The cost of poor planning and improper asset management is immense, the burden of which current and future ratepayers are effectively forced to bear.

Theft:

Craig Miller explained that in his years of experience in the water industry, he has “never seen water theft like this.”<sup>50</sup> When counsel for MCCC questioned Mr. Miller about the ways that theft is indicated to a water professional, he explained that there are instances when a meter that averages a regular amount suddenly indicates a much lower usage. He also indicated that he is aware of approximately 21 instances in the past couple of weeks of this occurring. He also acknowledged that those approximately 21 instances of recent theft are only the ones Martin District personnel are catching and he estimates that based on his observations and the number of observed instances of theft, there are many more occurring. Mr. Miller explained that the utility has found registers off the top of the meter indicating that an individual knows enough about how a meter

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<sup>50</sup> *Id.*, Miller at 2:14:40–2:20:19.

works to steal water while keeping the meter in place.<sup>51</sup> Mr. Miller explained that a water professional understands that when a meter has a negative read it is an indication that it has been tampered with in order to steal water.<sup>52</sup> Mr. Miller explained, under questioning by counsel for MCCC that it is not a priority at this time to catch people stealing, because the utility has to prioritize improving its system.<sup>53</sup> The Commission acknowledges a history of open water theft within the Martin County system, but with little recourse for those found committing the theft. Such an outcome over a prolonged period is an indication of a history of poor local leadership and poor management. Management and local leaders were aware that theft devices were sold in the local hardware stores and customer bills were issued in the past with no water usage or issued after a “negative” meter read.

Higher Rates:

When asked about why the rates are so high for this relatively small water utility, Craig Miller clearly explained: (1) there has been a lack of management of infrastructure; (2) there has been no depreciation fund; (3) there is no capital improvement plan; (4) there has not been a regular evaluation of rates every three years to allow for a capital improvement plan; (5) the terrain makes it challenging to get water to certain areas in the system; and (6) the amount of water line required per customer is above the average. For example, in some cases the required amount of water line to serve five customers is

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<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at 2:18:12–2:20:19.

<sup>53</sup> *Id.*

approximately 1,000 linear feet. In summary, he stated that the current system has just not been maintained.<sup>54</sup>

Martin District has to battle misinformation as well. Despite the testimony explaining that Alliance rents office space for an administrative office at the Collier Center for Martin District and Alliance's corporate office rents an office there separately for its own purposes, an editorial in *The Mountain Citizen*, June 2, 2021, incorrectly claimed "the water district pays rent for two offices located within a half mile from one another."<sup>55</sup> That claim is false.<sup>56</sup> Additionally, the editorial claimed that Martin District submitted "sewer district expenses in the report they presented to the Public Service Commission for use in setting the price of our water." That claim is false as well. The Commission does not regulate the Martin County sewer and the numbers submitted do not include expenses for the sewer district.<sup>57</sup> Finally, the editorial explains an expectation of "the level of professionalism that Alliance brings" to Martin District, then explains that there is not an expectation to pay the "highest water rate in the state."<sup>58</sup> To be clear, the record shows that Martin District's operating expenses are less since being managed by Alliance than the expenses were previously without professional management.<sup>59</sup> This rate increase is not required due to Alliance managing Martin District; rather Alliance has implemented

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<sup>54</sup> *Id.* at 2:42:12–2:44:44.

<sup>55</sup> Editorial, *The Mountain Citizen*, Wednesday, June 2, 2021.

<sup>56</sup> HVT of the May 27, 2021 Hearing, Miller at 2:47:20.

<sup>57</sup> Editorial, *The Mountain Citizen*, Wednesday, June 2, 2021; Application.

<sup>58</sup> Editorial, *The Mountain Citizen*, Wednesday, June 2, 2021.

<sup>59</sup> HVT of the May 27, 2021 Hearing, Sneed at 4:11:36–4:11:54

policies to mitigate the damages that existed at Martin District when Alliance began managing the utility.

2b. Alliance Has No Part in the Troubled History of Martin District.

Martin District was ordered by the Commission to hire a professional management company in order comply with the terms of receiving the surcharge funds in the November 5, 2018 Order in Case No. 2018-00017.<sup>60</sup> In the November 15, 2019 Order of that same case, as new invoices from the utility continued to appear and the amount of debt reported by Martin District changed regularly, the Commission found that it could “not rely upon the assumptions made in Martin District’s cost and rate impact analysis in the final determination of rates, or in the determination of the reasonableness of the pending contract.”<sup>61</sup> In addition to this finding, the Commission structured the rate increase approved in its November 5, 2018 Order to amend the previously approved, but not implemented, \$3.16 Management Infrastructure Surcharge to \$4.72 per customer, per month, and reduced the Debt Service Surcharge to \$2.63 per customer, per month, to reduce the total impact to Martin District’s ratepayers.<sup>62</sup> For ratemaking purposes, depreciation expense was excluded in the final calculation of the overall revenue requirement until further Order from the Commission.<sup>63</sup>

It was also ordered that Martin District, with the assistance of Alliance, would perform an evaluation whether a rate decrease or increase would be necessary one year

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<sup>60</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 5, 2018).

<sup>61</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 15, 2019) at 29.

<sup>62</sup> *Id.* at 29–30.

<sup>63</sup> *Id.* at 30.

following the commencement of the management contract with Alliance.<sup>64</sup> On April 1, 2021, Martin District filed the notice of intent to file an alternative rate filing in the pending case in compliance with the Commission's Order and subsequent Order of March 9, 2021, in Case No. 2020-00154.<sup>65</sup> On April 8, 2021, Martin District filed its application, which includes the analysis performed by Martin District, with the assistance of Alliance employees.

Alliance has presented audited numbers and improved internal controls, providing verifiable figures in Martin District's current application. Alliance has improved the management and integrity of the records so that the records of expenses and revenues are accurate. The testimony at the hearing on May 28, 2021, proves that Alliance has complied with its contracted services and beyond. Martin District's commissioners, MCCC, Deputy Commissioner LeFevre, and Mr. Caudill of Bell Engineering also testified to the many positive steps Alliance has taken at Martin District. Martin District representatives also confirmed that Alliance has been carrying the utility by paying \$65,989 of expenses that were not a part of the contract and fulfilling its part of the contract despite not being paid for months, "fronting payroll," and paying for repairs that would have come from its fee that it has not received.<sup>66</sup> Anthony Sneed and Ann Perkins of Alliance both explained that Alliance expended \$65,989 without expectation of

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<sup>64</sup> Case No. 2018-00017, *Electronic Application of Martin County Water District for an Alternative Rate Adjustment* (Ky. PSC Nov. 15, 2019) at 30–31, ordering paragraph 11.

<sup>65</sup> Case No. 2020-00154, *Electronic Martin County Water District Management and Operation Monitoring Pursuant to KRS 278.250* (Ky. PSC Mar. 9, 2021).

<sup>66</sup> HVT of the Mary 27, 2021 Hearing at 2:45:21-2:47:20, Miller explaining that Alliance has fronted payroll, repair cap, and chemicals despite not being paid; Hensley at 6:07:21, Perkins at 5:00:25–5:01:37.

repayment, purchasing new billing software, new vehicles, and equipment in good faith as a commitment to the job.<sup>67</sup>

The evidence shows that Alliance addressed the fundamental failings of the utility and has made tremendous progress in just less than an 18-month period, specifically in performing the audits for the utility for 2018, 2019, and 2020.<sup>68</sup> These audits are critical to the utility in obtaining state and federal funding that other water districts are able to seek and receive, and that Martin District had effectively cut itself off from, because essential business records were not completed or available. Alliance improved the integrity of the business records and the business relationships in every aspect during a time of intense scrutiny by ratepayers, state regulators, citizen groups, and the public at-large through national media coverage.<sup>69</sup> Martin District Board Chairman, Jimmy Don Kerr, testified that “it is clearly better” since the Alliance team took over management of Martin District. Mr. Kerr explained that he did not understand or appreciate what professionals in the water industry could do before Alliance starting working at Martin District.<sup>70</sup> Steven Caudill of Bell Engineering also testified at the hearing to the excellent job that Alliance has done since it has been in place.<sup>71</sup>

Alliance has proven its commitment to customers and respect for the needs of the community. Its commitment to the ratepayers of Martin District is clear in its complete

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<sup>67</sup> *Id.*, Sneed at 4:19:32–4:19:46; Perkins at 5:00:25–5:02:44.

<sup>68</sup> *Id.* at 4:42:08–4:51:45, Perkins explaining savings on casualty insurance, internal audits, performing the 2018, 2019, and 2020 audits, billing software; 4:50:50–4:52:48, Perkins explaining cost cutting measures.;

<sup>69</sup> *Id.*, LeFevre at 6:18:00–6:21:50; Sneed at 4:37:50–4:38:26;

<sup>70</sup> *Id.*, Kerr at 5:44:35–5:47:03.

<sup>71</sup> *Id.* at 7:06:42–7:06:54.

transparency and proven ability to improve the utility under intense scrutiny.<sup>72</sup> Alliance continues customer education outreach through social media and has explained processes and shared information with MCCC during informal conferences with Commission Staff.<sup>73</sup> Anthony Sneed explained that Alliance requested the minimum amount required in this rate case because of the burden a rate increase to the ratepayers of Martin District would represent, stating that the money saved from the improvements in water loss and cost savings Alliance creates will make up the difference to prevent future rate increases,<sup>74</sup> and because the Commission allowed Martin District to exclude depreciation at this time of recovery, the capital projects being funded through grants will account for some of the work that would have been paid for through a proper depreciation fund.<sup>75</sup> Additionally, Alliance has gone above and beyond to obtain rate assistance by filling out forms for ratepayers who received relief during the COVID-19 pandemic.<sup>76</sup>

Alliance started its contract in January 2020 and immediately began realizing cost savings for Martin District with a 32 percent discount on chemicals<sup>77</sup> and a reduction of \$25,000 for property casualty lines of insurance that Alliance was able to eliminate.<sup>78</sup> Martin District could not possibly receive competitive prices for equipment and materials

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<sup>72</sup> *Id.* at 1:26:46–1:27:27.

<sup>73</sup> *Id.* at 1:20:50–1:22:35.

<sup>74</sup> *Id.*, Sneed at 4:26:41–4:28:48.

<sup>75</sup> *Id.* at 4:26:41–4:28:48.

<sup>76</sup> *Id.* at 1:20:50–1:22:35.

<sup>77</sup> *Id.*, Miller at 59:30–1:00.

<sup>78</sup> *Id.*, Perkins at 4:50:50–4:51:31.

because vendors did not trust they would be paid.<sup>79</sup> Anthony Sneed testified to the fact that expenses are less currently for Martin District with Alliance, than they were previously without professional management.<sup>80</sup> Alliance has also improved Martin District's ability to purchase in bulk and cut costs on equipment and materials.<sup>81</sup> The utility was compelled to remain in relationships with creditors it owed so they would not seek judgements to collect.<sup>82</sup> Additionally, part of the work of the Commission since the last rate case has been to help negotiate with Martin District's creditors and point out potential practices that subject the utility to higher interest rates than acceptable.<sup>83</sup> The result has been that that some of the creditors have waived interest fees and reduced interest rates on the existing debt.<sup>84</sup>

3. \$55 Million Dollars Is the Estimated Cost Required to Rehabilitate Martin District's System and That Does Not Include This Rate Increase, the Grants and Loans It Has Currently, or the Cost of New Water Treatment Plant.

When asked to assess the current state of Martin District's infrastructure, Mr. Caudill confirmed that in his expert opinion, the utility requires an estimated \$55 million<sup>85</sup> in additional funds for system repairs outside of this rate case and on top of the current

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<sup>79</sup> *Id.*, Miller at 1:01:43–1:03:00.

<sup>80</sup> *Id.*, Sneed at 4:11:36–4:11:54

<sup>81</sup> *Id.*

<sup>82</sup> *Xylem Dewatering Solutions, Inc. v. Martin County Water District*, United States District Court, E.D. Kentucky, Pikeville Div., 7:2021-cv-00045 (filed May 27, 2021), Complaint.

<sup>83</sup> Case No. 2020-00154, *Electronic Martin County Water District Management and Operation Monitoring Pursuant to KRS278.250*, (KY PSC July 22, 2020), Report Regarding Interest Charged By and Paid to Evans Hardware & CI Thornburg, filed Aug.11, 2020.

<sup>84</sup> *Id.*

<sup>85</sup> Martin District Hearing Exhibit 1, *Alliance Water Resources, Inc. Operations Update Power Point to be utilized at PSC hearing on May 27, 2021* (filed May 25, 2021) at 16–17, \$55,920,000 is the amount listed in Alliance's exhibit and Mr. Caudill confirmed the amount when questioned by the Chairman, HVT, Caudill at 7:06:54-7:07:24.

\$8,558,073 million it has been pledged in grants. He explained that the infrastructure is in poor condition due to inadequate installation and planning. He described the instance where they found a 2-inch line feeding a 4-inch line and areas of multiple mains where a single new line would cut down on water loss.<sup>86</sup> Mr. Caudill also agreed that the burden of day-to-day repairs falls on the ratepayers. Absent outside assistance with funding, the large improvements necessary to fortify Martin District's failing infrastructure must also be borne by the ratepayers. The "brutally vicious cycle" he described occurs when prudent repairs are not performed routinely and the costs of repair are much more than if the system had been maintained.<sup>87</sup>

Despite the large amount of resources being utilized to help Martin District, the expense may be too great to overcome. Mr. Caudill explained that in his 28 years in the water industry, he has never seen a response to a utility in distress like the response from the utility, the citizens, and the agencies helping the utility.<sup>88</sup> Mr. Miller and Deputy Commissioner LeFevre also agreed they, in their experience in the water industry, had not seen the amount of resources being focused on a single utility to rehabilitate its system, like the resources currently being made available to Martin County. Deputy Commissioner LeFevre also discussed the coordination of the resources through the Martin District Work Group and the high level of scrutiny under which Martin District and Alliance operate now.<sup>89</sup> She commended Alliance on the "triage" performed since it

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<sup>86</sup> *Id.* at 7:06:54–7:08:33.

<sup>87</sup> *Id.* at 7:11:22.

<sup>88</sup> *Id.* at 7:04:24–7:05:17.

<sup>89</sup> *Id.* at 6:15:10.

arrived and the improvements Alliance made to address critical deficiencies in information.<sup>90</sup> She also commended Alliance on addressing all that was within its control to improve, including training its operators, water loss, metering, developing Standards Operating Procedures (SOPs), and improving communication with agencies that can help the water utility.<sup>91</sup>

Craig Miller's presentation noted the cost of the improvements outside this request for a rate increase needed to bring the water utility up to functioning at a baseline level. Mr. Miller explained during his presentation that he is "not talking about making things pretty."<sup>92</sup> Miller's plans are to rehabilitate the utility to operate on a basic level. The Commission does not regulate the sewer operations in Martin County and costs to upgrade the sewer system were not included in the application for a rate increase in this matter. The reality, however, is that many of the same ratepayers burdened with the required repairs to the water system will have the burden to repair the wastewater treatment plant. The estimated repairs to the wastewater treatment plant were \$7,200,000 in the May presentation to the Martin Work Group.<sup>93</sup> Miller also admitted, upon questioning by the Vice Chairman of the Commission, that the estimated amounts do not include replacement of the water treatment plant, which he described as "one major

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<sup>90</sup> *Id.* at 6:18:22-6:20:55.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 1:41:52-1:43:16.

<sup>93</sup> Martin Work Group, <https://eec.ky.gov/Environmental-Protection/Water/Pages/Martin-County-Water-District-Workgroup.aspx>; "\$63,263,000, including wastewater projects Inez WWTP-\$5,200,000 and Warfield WWTP \$2,000,000" Alliance Updates 51221 at 17 (The PSC does not regulate Martin County Wastewater.)

disaster away from a catastrophe.”<sup>94</sup> The cost of replacing a water treatment plant of a comparable size plant is approximately \$16 million to \$18 million. It is general knowledge that bids for this type of work in the industry are running high after the pandemic as resources and supply chains are constrained. It is difficult for contractors to get labor and component parts and the price of steel, concrete and lumber is significantly higher than in previous years.

Despite some progress, the existing debt remains and the estimates required for minimum rehabilitation of the utility are \$55 million, excluding the cost of replacing a water treatment plant that is near, or even beyond, the end of its useful life at an estimated cost of \$16 million to -18 million and the estimated cost of sewer improvements to serve the same community. An estimated total of \$80 million of very significant work is looming on the horizon for one small water district that does not have a customer base that could possibly pay a cost that high. Of course, this estimate does not take into account that of the projects for which Martin District has funding for, and for which it has recently received bids, the returned bids were in excess of the initial costs estimates and allocated funds. The Commission finds that Martin District cannot survive as a solitary entity with 3,501 customers<sup>95</sup> facing \$55 million of essential repairs, much less the possibility of \$25 million more for new water and wastewater treatment plants. Moreover, the Commission cannot ignore the indications that the window of opportunity to reverse the damage at even the current estimated expense, may be closing. During the consideration of this emergency rate case, the Commission was notified of a case filed against Martin District to collect a

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<sup>94</sup> HVT of the May 27, 2021 Hearing, Miller at 2:04:26–2:05:47.

<sup>95</sup> Application, Attachment 4(e).

judgement on a debt for chemicals.<sup>96</sup> The potential for Martin District's creditors to seek judgments to collect has always been a looming threat that the Commission has recognized could bring the utility to financial ruin and require the utility to enter receivership or bankruptcy. It is the threat also recognized by all of the other state agencies involved in the work to repair the system and ensure clean and reliable water service for the people of Martin County. The Commission is concerned that if other creditors follow suit, the current plan for recovery may not be an option, thus clearly impeding Martin District's credit, and ultimately, its ability to provide adequate, efficient and reasonable service.

After careful consideration of the facts and evidence herein, the expert opinions expressed on these issues, including the results of the Commission's investigations of Martin District and cases over the last five years, and the relevant history of Martin District explained in great detail by the Chairman of the Commission in Case No. 2018-00017, the Commission is of the opinion that Martin District cannot survive and provide adequate service as a standalone entity.

### CONCLUSION

After one year of operations through contract management, Martin District, with the assistance of Alliance, has an audit for the calendar year ended December 31, 2020, which received an unqualified opinion from its independent auditor. Despite multiple operational efficiencies that were obtained and noted by Alliance staff members in the hearing on May 27, 2021, the audited financial statements and supporting documents

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<sup>96</sup> *Xylem Dewatering Solutions, Inc. v. Martin County Water District*, United States District Court, E.D. Kentucky, Pikeville Div., 7:2021-cv-00045 (filed May 27, 2021) Complaint at paragraphs 7–9. Debt created from October 2018-August 2019.

filed in the present case provide a clear picture of the present state of Martin District. Absent an emergency rate increase approved by the Commission in this case, Martin District will fall further behind on its accounts payable to Alliance, will not be able to make progress on its past due accounts payable that should be paid through the debt service surcharge, and will fall into further financial and operational disrepair.

The Commission, after consideration of the evidence of record and being otherwise sufficiently advised, finds that:

1. Based on the present financial condition of Martin District, as presented in its most recently filed annual report, and based on the testimony of Martin District officials and the record, an emergency exists and Martin District's credit or operations will be materially impaired unless an interim rate increase is granted prior to the final Order of the Commission in this proceeding.

2. Based on a review of Martin District's application and its current financial condition, Martin District should be granted the requested interim rates sufficient to generate revenues of approximately \$250,834, or 11.68 percent annually.

4. The approved rates will increase a typical residential customer's<sup>97</sup> bill from \$50.18 to \$56.04, an increase of \$5.86, or 11.68 percent.

5. The interim base rate increase should be subject to refund pending final determination of Martin District's request for permanent rate relief.

6. Martin District should be required to maintain its records in such a manner as will enable it, or the Commission, or any of Martin District's customers, to determine

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<sup>97</sup> Application, Attachment 1, a typical residential customer purchases 4,000 gallons of water per month through a 5/8-inch x 3/4-inch meter.

the amounts to be refunded and to whom any refund is due in the event that a refund of any portion of the interim base rate increase is ordered by the Commission.

IT IS THEREFORE ORDERED that:

1. Martin District is authorized to place into effect the interim base rate increase, subject to refund, and the surcharge set forth in the Appendix to this Order, for service rendered on and after the date of this Order.

2. Martin District shall maintain its records in such a manner as will enable it, or the Commission, or any of Martin District's customers, to determine the amounts to be refunded and to whom any refund is due in the event that a refund of any portion of the interim base rate increase is ordered by the Commission.

3. Should Martin District fail to comply with the terms and conditions of this Order, any, and all amounts collected as a result of the interim base rate increase granted hereunder shall be subject to refund, and both Martin District and the Board of Commissioners shall be subject to all applicable penalties under KRS 278.990.

By the Commission



ATTEST:

  
\_\_\_\_\_  
Executive Director

Concurring Opinion of Chairman Michael J. Schmitt in Case No. 2021-00154

Emergency Rate Increase Required

The emergency rate increase requested by the Martin County Water District (hereinafter sometimes referred to as “Martin District” or “the district”) is the second in three years. It should come as no surprise since the previous emergency rate Order entered in April 2018 was followed by a final Order in Case No. 2018-00017, which did not grant the full rate increase requested by the district. While the commission believed that a larger rate increase was probably needed the full amount was withheld because of several factors. Martin District’s financial records were incomplete. There was an absence of invoices needed to reasonably support the past purchase of goods and services and there had been no audit of its financial records since sometime before 2014. Although the district’s board members had been almost entirely replaced, the new interim general manager had no expertise or experience in operating a water utility and had served as a Martin District board member, including in the position of chairman, when past agreed Orders executed between the district and the Public Service Commission had been ignored. Moreover, testimony elicited at several hearings presented a picture of rampant theft and possible fraud. Under the circumstances, the Commission had no intention of awarding a substantially larger rate increase than was in fact granted until the district had obtained professional management to operate its day-to-day affairs.

The present condition of the Martin District is perilous. Although a water district is required by Kentucky law to pay all debts to current vendors within 30 days of receipt of

the invoice,<sup>1</sup> Martin District has failed to meet this requirement for at least the past five years.<sup>2</sup> The district has sustained operating losses for the past five fiscal years and losses probably go back much further, but since the district has no audits or financial records, which can be reviewed, one will never know. By the time the present rate case was filed and the hearing on the requested emergency increase was held, Martin District's debt totaled \$1,170,012.04 with much of that amount being owed for years. Unable or unwilling to deposit the required amount into a depreciation and replacement reserve account, the district was and is in technical default of at least one outstanding loan. On May 27, 2021, the date of the Commission's hearing on Martin District's request for an emergency rate increase, the district was sued in United States District Court for the Eastern District of Kentucky in Pikeville, by Xylem Dewatering Solutions, Inc. for collection of a \$93,739.10 debt plus interest. It is not an understatement to say with a high degree of certainty that Martin District at present is both broken and broke. Without an emergency rate increase, its ability to continue to operate at all is in substantial doubt.

#### Reasons Why the System Failed

The success or failure of a water utility, including Martin District, like any business, is based on merit. Failure is the inevitable result of poor management and in the case of Martin District, management's obvious lack of concern for the long-term financial health of the county's most important asset—its water utility system. It is a universal truth that the best interests of utility customers are served when the utility is financially healthy, can

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<sup>1</sup> KRS 65.140.

<sup>2</sup> See Audit Reports for Martin District for fiscal years 2016, 2017, 2018, 2019, and 2020.

maintain its infrastructure and reliably deliver clean drinking water to every one of its customers at a reasonable price.

The Public Service Commission tries to balance the interest of water district customers in reasonable rates with the financial needs of the utility so that it can consistently provide quality drinking water at an affordable price. Artificially low prices are not in the customers' long term best interests as they serve only to ensure that in the long run, both service and water quality will deteriorate and prices will become much higher than they should be. Water rates approved by the commission include revenue sufficient to fund day-to-day operations as well as funds sufficient to replace pipes, pumps, meters, valves and other infrastructure before they completely wear out and cease to function. For more than 20 years Martin District failed to undertake a timely review of its rates to determine whether or not their rates were adequate, seek periodic rate increases or set aside any revenue derived from rates for the purpose of replacing aging infrastructure. Martin District had no capital improvement plan. As costs continually rose from year to year, its rates remained artificially low and significantly below those of surrounding water districts<sup>3</sup>. The district was unable to keep an adequate level of inventory or to purchase and pay for goods and services within the time required by Kentucky law. Non-revenue or unaccounted for water loss which was found to be 51 percent in the 2007 Management and Process Audit Report rose to 76 percent in January 2021. Optimally, water loss should be at or below 15 percent. As a consequence of years of local mismanagement, Martin District's infrastructure is close to collapse and

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<sup>3</sup> Management and Improvement Audit of Martin County Water District, Final Report, March 19, 2007 at I-10.

system wide failure. So much of its infrastructure is in disrepair that Bell Engineering now estimates that it will require a financial infusion of \$55 million to bring the system up to a baseline level. Craig Miller, division manager, Alliance Water Resources, Inc. testified at the May 27th hearing before the Public Service Commission that the present water treatment plant was only one major disaster away from catastrophe. He estimated that replacement of the plant would cost between \$15 and 18 million dollars. These amounts total upwards of \$73 million dollars and exclude both the amount of any rate increase awarded in this case and the \$8.5 million dollars, which has been provided to Martin District in the form of grants. In short, the total anticipated cost to rehabilitate the Martin District's water system is approximately \$81 million dollars, an amount that is more than four times the present depreciated value of all of its assets combined.<sup>4</sup> Martin District has approximately 3,500 customers, the vast majority of which are residential ratepayers. Customer rates after the emergency increase becomes effective will represent the fifth highest among Kentucky's regulated water utilities. It is more likely than not that a final order to be issued at the conclusion of this case will elevate rates to an even higher level since the emergency request for an increase did not include any amount for depreciation.

### Three Unassailable Facts

- (1) The systemic failure of Martin District represents in fact a failure on the part of local government representatives on the fiscal court and the Martin County Water Board to competently manage the water utility for the benefit of their citizens and customers. Malfeasance and political influence have simply

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<sup>4</sup> Martin County Water District Annual Financial Audit Report for Year Ended December 31, 2020 at page 8. The total assets of the Martin County Water District are listed as \$18,797,637.

- combined with incompetence to result in substantial portions of the system going into failure. The present district board and its individual members are doing their best under trying circumstances and are exempt from and not included in this criticism.
- (2) The deterioration of Martin District's infrastructure took more than 20 years to reach its current dilapidated condition and improving water quality and service will take at least several years under the best of circumstances. There is no quick fix.
  - (3) The district needs, according to experts, approximately \$81 million dollars to achieve at least a baseline level of performance. Although more money can reasonably be expected to flow into the utility from federal and state funding sources for infrastructure improvement as time goes by, the reality is that for the time being operational and maintenance expenses will be the ratepayers' burden to carry. The money to keep water flowing, patching pipes, replacing meters, old pumps and valves has to come from someone and that someone, at least for the present, is the ratepaying customer.

Rates and Service

Customers are rightfully concerned about rising rates for water service, which many consider to be inferior and not worth the price they are required to pay. The Public Service Commission cannot satisfactorily address these concerns for two important reasons. First, the top priority of the Commission is to ensure that jurisdictional utilities like the Martin District remain viable to the extent they can continue to provide services to which the public is entitled. Unless the requested emergency rate increase is placed

into effect, substantial doubt exists as to whether Martin District can continue to operate at all. At present, it is unable to pay its current bills for needed supplies and services, which it must have in order to produce, treat and distribute water. It is one creditor's lawsuit away from receivership or bankruptcy, neither of which is likely to benefit ratepayers. On the contrary, receivership and bankruptcy are likely to result in even higher rates and diminished quality of service, at least over the short term. Second, the Commission does not have the legal authority to reduce rates to which a utility is found to be legally entitled just because it provides poor service to its customers. In *South Central Bell Telephone Company vs. Utility Regulatory Commission*, 637 S.W.2d 649 at 653, the Kentucky Supreme Court stated that:

“We believe that granting the Commission the authority, in a rate case, to penalize the utility for poor service would be an improper extension of the statutory procedure. ...In addition, we concur with the trial judge that the quality of service is not germane to the normal time tested factors that go into the determination of a proper rate for the services rendered by a utility.”

It should also be noted that KRS 278.170(1) prohibits the creation of a rate structure on the basis of income or ability to pay.<sup>5</sup> Any solution to the problem of affordability lies not with the Public Service Commission but with the General Assembly.<sup>6</sup>

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<sup>5</sup> KRS 278.170(1) provides that: “No utility shall as to rates or service give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions.”

<sup>6</sup> The Public Service Commission's attempt to eliminate the collection by water districts and water associations of customer late fees was reversed by the Kentucky General Assembly by the enactment of KRS 278.0154 which statutorily permitted the collection of an arbitrary 10% late fee while prohibiting the Public Service Commission from modifying, rejecting, discontinuing, abolishing or suspending of a late payment charge.

In the comprehensive Management and Process Audit performed on Martin District in 2007, its authors pointed out a systemic weakness, which has turned out to be a substantial contributing factor to the current crisis. The district lacks a sufficient customer base to support ongoing operations. The management audit noted that the district:

- (1) Lacked adequate scale to provide consistently all professional functions necessary, such as engineering, laboratory, bookkeeping and pollution control;
- (2) Relies on free or low cost services not under its control for technical services. These services are provided by the Division of Water, Kentucky Rural Water Association, and Big Sandy Area Development District;
- (3) Lacks significant scale to leverage lower costs from suppliers and cannot maintain a full inventory of material.<sup>7</sup>

The audit report advised Martin District to consider increased regionalization to achieve economies of scale and reduce vulnerabilities to supply and personnel interruption.<sup>8</sup>

#### The Need for Regionalization

Martin County has an estimated population of just over 11,000 people and its water utility has a customer base of around 3,500. The vast majority of those customers are residential ratepayers. Martin County cannot realistically be expected to financially support and adequately maintain an independently operated standalone water utility. Martin District and the rural water districts and small municipal water systems in adjacent

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<sup>7</sup> Management and Process Audit of Martin County Water District, Final Report, March 19, 2007, at V-16.

<sup>8</sup> *Id.*

counties face similar problems—declining water usage and shrinking populations. For at least 30 years, state and local officials have recognized that regionalization in planning and infrastructure development is the key to successful economic development in eastern Kentucky.<sup>9</sup> Multi county cooperation in the area is not unknown. The city of Prestonsburg in Floyd County provides water along with Martin District to the federal prison and the adjacent Honey Branch Industrial Park. The city of Paintsville, in Johnson County, provides sewer service to those same locations. The Big Sandy Regional Jail Authority located in Paintsville is a joint public enterprise of several counties, which replaced local county jails in Martin, Johnson, Magoffin and Lawrence counties.

Now would seem to be the appropriate time to consider the regionalization of eastern Kentucky's water utilities. Federal and state funds now available for municipal water utilities and rural water districts should first be spent on an assessment of regional needs and solutions to regional problems. Focus on the Martin County Water District in terms of possible consolidation with surrounding water systems would appear to be a good place to start. At the very least, a comprehensive study should be authorized to analyze the possibility of combining a number of local water systems into one large utility operated by a regional water commission. Pike, Floyd, and Martin County's rural water districts, together with municipal systems operated by Pikeville, Prestonsburg and

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<sup>9</sup> The General Assembly in KRS 74.361(1) has stated that "the reduction in the number of operating water districts is in the public interest as merger would tend to eliminate wasteful duplication of costs and efforts, result in sounder and more businesslike degree of management, and ultimately result in greater economies, less cost, and a higher degree of service to the general public and that the public policy favors the merger of water districts wherever feasible."

Paintsville, if combined, would provide a large customer base<sup>10</sup> capable of supporting in-house engineering, planning and professional management. The General Assembly should consider legislation that would at least make such regionalization of water utility resources possible. Absent consolidation into larger more efficient utilities outside the scope of purely local political influence, the act of simply pouring vast sums of money into small non-viable water systems will likely prove in the end to be a costly failure.

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<sup>10</sup> 2018 population estimates for the above counties is as follows: Martin County 11,323; Floyd County 35,845; Johnson County 22,386; and Pike County 58,402. The combined population of the four counties based on 2018 estimates was 127,956.

Chairman Michael J. Schmitt Concurring



ATTEST:

  
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Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2021-00154 DATED JUL 09 2021

Monthly Water Rates

5/8- x 3/4-Inch Meter

First	2,000 Gallons	\$37.32	Minimum Bill
Over	2,000 Gallons	0.00936	per Gallon

1-Inch Meter

First	5,000 Gallons	\$68.59	Minimum Bill
Over	5,000 Gallons	0.00936	per Gallon

1 1/2-Inch Meter

First	10,000 Gallons	\$120.70	Minimum Bill
Over	10,000 Gallons	0.00936	per Gallon

2-Inch Meter

First	20,000 Gallons	\$224.93	Minimum Bill
Over	20,000 Gallons	0.00936	per Gallon

3-Inch Meter

First	30,000 Gallons	\$329.17	Minimum Bill
Over	30,000 Gallons	0.00936	per Gallon

4-Inch Meter

First	50,000 Gallons	\$537.63	Minimum Bill
Over	50,000 Gallons	0.00936	per Gallon

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