Exhibit No.
Issue: Fuel and Purchased Power
Witness: Steven M. Fetter
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District
Case No. ER-2006-0315

Before the Public Service Commission of the State of Missouri

Rebuttal Testimony

of

Steven M. Fetter

July 2006

**REBUTTAL TESTIMONY
OF
STEVEN M. FETTER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2006-0315**

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Steven M. Fetter. I am President of Regulation UnFettered. My business address is 1489 W. Warm Springs Rd., Suite 110, Henderson, NV 89014.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of The Empire District Electric Company, which I shall refer to as “Empire District” or the “Company”.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am President of Regulation UnFettered, a utility advisory firm I started in April 2002. Prior to that, I was employed by Fitch, Inc. (“Fitch”), a credit rating agency based in New York and London. Prior to that, I served as Chairman of the Michigan Public Service Commission (“Michigan PSC”).

Q. DOES THIS REBUTTAL TESTIMONY FOLLOW UPON THE SUPPLEMENTAL DIRECT TESTIMONY YOU PREVIOUSLY FILED IN THIS PROCEEDING?

A. Yes it does. In that testimony, I discussed why timely recovery of prudently incurred fuel and purchased power expenditures is important for any regulated utility, but especially for one that currently holds a corporate credit rating just above the investment-grade/non-investment-grade dividing line, as does Empire District.

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. I explain here that the Commission's innovative amortization mechanism for maintaining Empire District's weak corporate credit rating at investment-grade level should not be viewed as a substitute for the Company receiving timely recovery of its prudently-incurred fuel and purchased power expenses.

Q. PLEASE EXPLAIN.

A. The Regulatory Plan involving Empire District, which resulted from Commission Case No. EO-2005-0263, contained an innovative component that has been viewed positively by the financial community: an amortization mechanism designed to provide a degree of protection for both Empire District customers and investors from a potential financially-injurious credit rating downgrade. The mechanism would target S&P ratio guidelines during the construction of the Iatan 2 plant, with the intent that key ratios would be maintained at investment-grade levels. This innovative component, however, should not be used as a substitute for the full and timely recovery in this pending rate case of Empire District's prudently-incurred fuel and purchased power expenses. Such an action would send a very negative message to the financial community and would place in jeopardy Empire District's investment-grade status.

Q. WHY DO YOU SAY THIS?

A. Ironically, while the goal of the amortization mechanism is to maintain the Company's weak, but still investment-grade corporate credit rating, a failure by the Commission to provide timely relief for prudently-incurred fuel and purchased power expenses in this case could lead to a downgrade to junk bond status for Empire District regardless of the fact that the key ratios supported by the amortization remained consistent with "BBB-" ratings targets.

Q. PLEASE EXPLAIN.

A. The failure by the Commission to allow Empire District to timely recover its reasonable fuel and purchased power expenditures would lead to rating agency concern that under-recovery of such costs could turn into a longer-lasting financial drag on the Company. Such a continuing problem could result in the agencies reassessing Empire District's business profile in a negative direction, reflecting a greater degree of operational risk. Under such circumstances, at best, stronger ratios would be needed to maintain Empire District's ratings at its current lowest investment-grade level, and, at worst, rating agency focus on Empire District's qualitative rating factors could become so negative that the Company's adequate financial ratios might not be sufficient to keep the Company from falling into non-investment-grade status.

Q. DO YOU SEE A BETTER REGULATORY APPROACH?

A. Yes I do. As I stated in my supplemental direct testimony in this proceeding, I believe that the Commission should work toward implementing a mechanism through which Empire District will receive timely recovery of its prudently-incurred fuel and purchased power costs – or at least deal with such costs in a timely manner on a case-by-case basis. Timely attention to appropriate recovery of such costs would be wholly consistent with mainstream regulatory policy across the U.S. Until a reasonable means of providing such timely recovery is established for Empire District, the return on equity that the Commission sets for the Company should be increased to reflect the greater operational risk that Empire District is facing. Indeed, positive movement on either or both of these steps would improve the Company's financial standing in the eyes of the rating agencies and likely mitigate the extent to which amortizations under the Regulatory Plan in connection with the construction of Iatan 2 would need to be utilized.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes it does.