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Missouri Public  
Service Commission

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**

*Empire* Exhibit No. 12  
Case No(s). ER-2006-0315  
Date 9-05-06 Rptr PF

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

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

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

5   **Q.   ON WHOSE BEHALF ARE YOU TESTIFYING?**

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

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

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

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

16   A.   Yes it does. In that testimony, I discussed why timely recovery of  
17       prudently incurred fuel and purchased power expenditures is important for  
18       any regulated utility, but especially for one that currently holds a corporate

1 credit rating just above the investment-grade/non-investment-grade

2 dividing line, as does Empire District.

3 **Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?**

4 A. I explain here that the Commission's innovative amortization mechanism

5 for maintaining Empire District's weak corporate credit rating at

6 investment-grade level should not be viewed as a substitute for the

7 Company receiving timely recovery of its prudently-incurred fuel and

8 purchased power expenses.

9 **Q. PLEASE EXPLAIN.**

10 A. The Regulatory Plan involving Empire District, which resulted from

11 Commission Case No. EO-2005-0263, contained an innovative

12 component that has been viewed positively by the financial community: an

13 amortization mechanism designed to provide a degree of protection for

14 both Empire District customers and investors from a potential financially-

15 injurious credit rating downgrade. The mechanism would target S&P ratio

16 guidelines during the construction of the Iatan 2 plant, with the intent that

17 key ratios would be maintained at investment-grade levels. This

18 innovative component, however, should not be used as a substitute for the

19 full and timely recovery in this pending rate case of Empire District's

20 prudently-incurred fuel and purchased power expenses. Such an action

21 would send a very negative message to the financial community and

22 would place in jeopardy Empire District's investment-grade status.

23 **Q. WHY DO YOU SAY THIS?**

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

8 Q. PLEASE EXPLAIN.

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

21 Q. DO YOU SEE A BETTER REGULATORY APPROACH?

22 A. Yes I do. As I stated in my supplemental direct testimony in this  
23 proceeding, I believe that the Commission should work toward

STEVEN M. FETTER  
REBUTTAL TESTIMONY

1 implementing a mechanism through which Empire District will receive  
2 timely recovery of its prudently-incurred fuel and purchased power costs –  
3 or at least deal with such costs in a timely manner on a case-by-case  
4 basis. Timely attention to appropriate recovery of such costs would be  
5 wholly consistent with mainstream regulatory policy across the U.S. Until  
6 a reasonable means of providing such timely recovery is established for  
7 Empire District, the return on equity that the Commission sets for the  
8 Company should be increased to reflect the greater operational risk that  
9 Empire District is facing. Indeed, positive movement on either or both of  
10 these steps would improve the Company's financial standing in the eyes  
11 of the rating agencies and likely mitigate the extent to which amortizations  
12 under the Regulatory Plan in connection with the construction of Iatan 2  
13 would need to be utilized.

14 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

15 **A.** Yes it does.

**AFFIDAVIT OF STEVEN M. FETTER**

STATE OF NEW JERSEY     )  
  ) ss  
COUNTY OF MONMOUTH    )

On the 25th day of July, 2006, before me appeared Steven M. Fetter, to me personally known, who, being by me first duly sworn, states that he is the President of Regulated UnFettered and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

  
\_\_\_\_\_  
Steven M. Fetter

Subscribed and sworn to before me this 25th day of July, 2006

  
\_\_\_\_\_  
Notary Public

My commission expires

**ALEXIS A. MIRANTI**  
**NOTARY PUBLIC OF NEW JERSEY**  
**Commission Expires 7/8/2010**