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PRACTICE IN KANSAS AND MISSOURI

ARTHUR E. RHODES
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NANCY J. CRAWFORD

February 10, 2009

FILED[2]

FEB 11 2009

Missouri Public Service Commission

Missouri Public Service Commission
ATTN: Data Center
Governor's Office Building
P. O. Box 360
Jefferson City, MO 65102-0360

Re: In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of its Regulatory Plan
Case No. ER-2009-0089

Dear Clerk:

Please accept the original and one copy of the enclosed Direct Testimony of James R. Dittmer . Please return one "filed" stamped copy, at your earliest convenience in the enclosed addressed, stamped envelope.

Thank you for your consideration in this matter.

Very truly yours,

James P. Zakoura

James P. Zakoura
For
SMITHYMAN & ZAKOURA, CHARTERED

JPZ/dmw
Enclosures

Exhibit No.:
Issues:
Witness: *James R. Dittmer*
Sponsoring Party: *Hospital Interveners*
Type of Exhibit: *Direct Testimony*
Case No.: *ER-2009-0089*
Direct Testimony Prepared: *February 11, 2009*

DIRECT TESTIMONY OF
JAMES R. DITTMER
ON BEHALF OF
CARONDELET HEALTH
CHILDREN'S MERCY HOSPITALS AND CLINICS
CRITTENTON CHILDREN'S CENTER
HCA MIDWEST HEALTH SYSTEM
NORTH KANSAS CITY HOSPITAL
RESEARCH MEDICAL CENTER
RESEARCH PSYCHIATRIC CENTER
SAINT LUKE'S CANCER INSTITUTE
SAINT LUKE'S HEALTH SYSTEM
SAINT LUKE'S NORTHLAND HOSPITAL – BARRY ROAD CAMPUS
ST. JOSEPH MEDICAL CENTER, and
SAINT LUKE'S HOSPITAL OF KANSAS CITY
(Collectively Referred to as "Hospital Interveners")

KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2009-0089

February 11, 2009

INTRODUCTION AND SUMMARY

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is James R. Dittmer. My business address is 740 Northwest Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. BY WHOM ARE YOU EMPLOYED?

A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a consulting firm engaged primarily in utility rate work. The firm's engagements include review of utility rate applications on behalf of various federal, state and municipal governmental agencies as well as industrial groups. In addition to utility intervention work, the firm has been engaged to perform special studies for use in utility contract negotiations.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Utilitech, Inc. has been retained by a consortium of hospitals and health centers located within Kansas City Power and Light Company's (hereinafter "KCPL" or "Company") certificated Missouri retail service territory. Those hospitals include– Carondelet Health, Children's Mercy Hospital and Clinics, Crittenton Children's Center, HCA Midwest Health System, North Kansas City Hospital, Research Medical Center, Research Psychiatric Center, Saint Luke's Cancer Institute, Saint Luke's Health System, Saint Luke's Northland Hospital – Barry Road Campus, Saint Joseph Medical Center, and St. Luke's Hospital of Kansas City, collectively referred to as "Hospital Interveners."

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been requested to summarize the highlights of KCPL's Regulatory Plan that was approved by this Commission in Case No. EO-2005-0329, including underlying assumptions and estimates provided by KCPL at the time it was seeking approval of the noted Regulatory Plan. Further, I was requested to compare and contrast those original estimates with KCPL's actual rate experience to date – including its current request in this docket, as well as current and previous cost estimates for Iatan II and other capital projects considered when developing the original Regulatory Plan.

QUALIFICATIONS

Q. BEFORE DISCUSSING IN GREATER DETAIL THE ORIGINAL AND CURRENT PROJECTIONS MADE REGARDING KCPL'S REGULATORY PLAN, PLEASE STATE YOUR EDUCATIONAL BACKGROUND.

A. I graduated from the University of Missouri - Columbia, with a Bachelor of Science Degree in Business Administration, with an Accounting Major, in 1975. I hold a Certified Public Accountant Certificate in the State of Missouri. I am a member of the American Institute of Certified Public Accountants.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.

A. Subsequent to graduation from the University of Missouri, I accepted a position as auditor for the Missouri Public Service Commission ("MPSC"). In 1978, I was promoted to Accounting Manager of the Kansas City Office of the MPSC Staff. In that position, I was responsible for all utility audits performed in the western third of the State of Missouri. During my service with the Missouri Public Service Commission, I was involved in the audits of numerous electric, gas, water and sewer utility companies. Additionally, I was involved in numerous fuel adjustment clause audits, and played an active part in the formulation and implementation of accounting staff policies with regard to rate case audits and accounting issue presentations in Missouri. In 1979, I left the Missouri Public Service Commission to start my own consulting business. From 1979 through 1985 I practiced as an independent regulatory utility consultant. In 1985, Dittmer, Brosch and Associates was organized. Dittmer, Brosch and Associates, Inc. changed its name to Utilitech, Inc. in 1992.

My professional experience since leaving the Missouri Public Service Commission has consisted primarily of issues associated with utility rate, contract and acquisition matters. For the past twenty-nine years, I have appeared on behalf of clients in utility rate proceedings before various federal and state regulatory agencies. In representing those clients, I performed revenue requirement studies for electric, gas, water and sewer utilities and testified as an expert witness on a variety of rate matters. As a consultant, I have filed testimony on behalf of industrial consumers, consumer groups, the Missouri Office of the Public Counsel, the Missouri Public Service Commission Staff, the Indiana Utility Consumer Counselor, the Mississippi Public Service Commission Staff, the Arizona Corporation Commission Staff, the Arizona Residential Utility Consumer Office, the Nevada Office of the Consumer

Advocate, the Washington Attorney General's Office, the Hawaii Consumer Advocate's Staff, the Oklahoma Attorney General's Office, the West Virginia Public Service Commission Consumer Advocate's Staff, municipalities and the Federal government before regulatory agencies in the states of Arizona, Alaska, Florida, Indiana, Maine, Michigan, Missouri, Oklahoma, Ohio, Oregon, Colorado, Hawaii, Iowa, Kansas, Mississippi, New Mexico, Nevada, New York, West Virginia, and Washington, as well as the Federal Energy Regulatory Commission.

HIGHLIGHTS OF KCPL'S ORIGINAL REGULATORY PLAN - INCLUDING ORIGINAL ESTIMATE OF EXPENDITURES AND PROBABLE RATE REQUESTS

Q. PLEASE CONTINUE BY PROVIDING A SUMMARY OF MAJOR COMMITMENTS MADE BETWEEN KCPL AND A NUMBER OF OTHER PARTIES IN CASE NO. EO-2005-0329.

A. In Case No. EO-2005-0329 KCPL entered into a Stipulation and Agreement with the Missouri Public Service Commission ("MPSC" or "Commission") Staff, the Missouri Office of the Public Counsel, numerous consumer intervenor groups as well as other Missouri-regulated utilities intending to become a joint owner of a second Iatan Station generating unit. The noted Stipulation and Agreement included the following significant commitments:

- KCPL agreed to undertake reasonable efforts to make major infrastructure investment including construction and ownership of 1) approximately 500 megawatts of a new coal-fired generating unit to be located at the Iatan Station near Weston, Missouri, 2) 100 megawatts of new wind generation, 3) significant replacement and upgrades to KCPL's transmission and distribution facilities, 4) significant environmental investments regarding Iatan I and LaCygne 1 to be made pursuant to environmental regulations, as well as 5) demand response, efficiency and affordability programs.

- The parties agreed to a Rate Plan that would remain in effect during the five-year construction period that provided for specific treatment to be afforded pension expenses, sales of SO_2 allowances, off-system sales, and depreciation expense.
- KCPL agreed to reduce the return on equity component of the Allowance for Funds Used During Construction ("AFUDC") by 2.5% from that being authorized by this Commission in rate cases occurring during the five-year rate plan to be applied to Iatan II construction costs while the facility is being built.
- The parties agreed to a formulaic approach to calculating additional rate relief above than justified under traditional embedded cost recovery regulation that would enable KCPL to maintain interest and cash flow metrics deemed to be necessary to maintain a BBB credit rating (i.e., an investment grade credit rating).

From the customers' perspective, the last noted major element of the Stipulation and Agreement was quite significant. The additional rate relief – above that justified under traditional embedded cost regulation – to maintain a BBB credit rating had the potential to be significant.

Q. DO YOU BELIEVE THE EXPECTATION WAS THAT CUSTOMERS' RATES WOULD BE LOWER IN THE LONG RUN UNDER THE RATEMAKING APPROACHES AGREED TO WITHIN THE NOTED

STIPULATION AND AGREEMENT THAN WOULD OCCUR UNDER TRADITIONAL EMBEDDED COST REGULATION?

A. Yes, I believe so. More specifically, I believe the expectation was there would be savings resulting from building a coal-fired generating unit – with higher front end capital costs – than would occur if a natural gas-fired generating unit with lower capital costs but higher operating (i.e., fuel) costs were constructed. Further, I believe the expectation was that KCPL may not be able to finance a new coal-fired unit under favorable terms without the unique recovery of "amortization expense" designed to enable KCPL to maintain investment grade financial metrics that did not appear possible to maintain under traditional regulation. In other words, I believe the expectation of certain consumer groups signing on to the noted Stipulation and Agreement was that by agreeing to *larger* rate increases *sooner* pursuant to the Regulatory Plan than could be justified under traditional embedded cost regulation that they would, nonetheless, experience a smaller increase *over the long run* than would occur under traditional embedded cost regulation.

Q. AT THE TIME THAT KCPL NEGOTIATED THE STIPULATION AND AGREEMENT DID IT RELEASE ESTIMATES OF THE COST OF ITS PLANNED CONSTRUCTION PROGRAM?

A. Yes. Included as Appendix D-2 to the noted Stipulation and Agreement was KCPL's estimate of major capital projects expected to be constructed or acquired during the five-year Regulatory Plan that consisted of the following elements:

- $776 million for KCPL's portion of a second Iatan Station coal fired generating unit. At the time of entering into the Stipulation and Agreement it was expected that KCPL would own approximately 500 megawatts out of the then-planned 800 – 900 megawatt plant. Thus, the total cost of the plant was estimated to be approximately $1.3 billion - or approximately $1,500 per kW.
- $131 million for 100 megawatts of wind generation
- $272 million for environmental upgrades at Iatan I and the two LaCygne Units.
- $95 million for energy efficiency initiatives, demand management and distributed generation programs.

Appendix D-2 from the Case No. EO-2005-0329 Stipulation and Agreement has been attached as Schedule JRD-1 to this testimony.

Q. AT THE TIME THAT KCPL NEGOTIATED THE STIPULATION AND AGREEMENT DID IT ALSO RELEASE ESTIMATES OF THE LIKELY RATE IMPACT OF ITS FIVE-YEAR REGULATORY PLAN THAT ENCOMPASSED ITS COMPREHENSIVE ENERGY PROGRAM?

A. Yes. The Company stated in a press release that it estimated that "if the entire $1.3 billion anticipated cost of the plan is included in rate base, the rate increases to support the five year energy plan and projected increases in operating costs would average approximately 3 – 4% annually, over the same period." The noted press release has been attached to this testimony in its entirety as Schedule JRD-2. The estimated 3 - 4% annual increases over the entire five-year rate plan work out to be a projected end-of-rate-plan cumulative increase in the range of 15% – 20%.[1]

CONSTRUCTION COST AND RATE RELIEF AWARDED – ACTUAL AND CURRENT PROJECTIONS

Q. WHAT RATE RELIEF HAS KCPL RECEIVED THUS FAR UNDER THE FIVE-YEAR REGULATORY PLAN.

A. In addition to rate relief in Missouri, KCPL has received similar rate relief in Kansas pursuant to a Regulatory Plan that is fairly comparable to that entered into in Kansas. The actual Missouri and Kansas retail rate relief granted KCPL on January 1, 2007 and January 1, 2008 are shown on the table below:

Actual Kansas and Missouri Retail Rate Relief Granted to Date Under the Five-Year Regulatory Plan				
	Missouri Rate Increases		Kansas Rate Increases	
Rate Changes	(Millions)	%	(Millions)	%
Rate Change 1/1/2007	50.6	10.5%	29.0	7.5%
Rate Change 1/1/2008	35.3	6.5%	28.0	6.4%
Cumulative Rate Changes to Date	**85.9**	**17.7%**	**57.0**	**14.4%**

Thus, as can be observed from the table above, the cumulative rate relief in Missouri is already above the low end of the original estimated range of projected increases for the entire *five-year* Regulatory Plan period, and for Kansas, the cumulative rate relief to date is slightly below the low end of the five-year cumulative increases originally projected by KCPL at the beginning of the Regulatory Plan.

[1] It is possible that KCPL was intending to suggest that five years of *compounded* 3% to 4% increases were envisioned. If this is the intended assumption, the end-of-regulatory-plan projected increase calculates to be in the range of 16% to 22% rather than the 15% to 20% noted within the body of this testimony. In any event, even if the end-of regulatory-plan projected increase was intended to be compounded, the fact remains that the cumulative increase after this case can now be expected to be significantly greater than originally envisioned when KCPL was negotiating the regulatory plan.

Q. WHAT RATE RELIEF IS KCPL REQUESTING IN THE CURRENT DOCKET?

A. KCPL seeks an average 17.5% increase in Missouri retail rates. Additionally, KCPL has concurrently sought a 17.5% increase from Kansas retail customers.

Q. WHAT WILL BE THE CUMULATIVE RETAIL RATE INCREASE EXPERIENCED IF KCPL IS GRANTED THE ENTIRETY OF ITS CURRENT RATE REQUEST?

A. The cumulative rate relief to Missouri and Kansas retail customers, assuming KCPL receives 100% of its current 17.5% rate relief request, is shown on the table below:

Cumulative Rate Relief That Will Have Been Granted Within Five-Year Regulatory Plan if KCPL is Awarded 100% of its Requested Retail Rate Relief in Current Rate Cases Filed in Missouri and Kansas				
	Missouri Rate Increases		Kansas Rate Increases	
Rate Changes	(Millions)	%	(Millions)	%
Cumulative Rate Relief Granted Thru 1/1/2008	85.9	17.7%	57.0	14.4%
Pending Rate Relief Requested	101.5	17.5%	71.6	17.5%
Cumulative Rate Changes if KCPL is Awarded 100% of its Currrently Requested Rate Relief	**187.4**	**38.3%**	**128.6**	**34.4%**

As demonstrated in the table above, award of KCPL's full request in this proceeding will result in rates far above the high end of the original range of estimated increases provided by KCPL at the time the Regulatory Plan was being negotiated.

Q. DOES THE CURRENT RATE APPLICATION ENCOMPASS COST SAVINGS THAT WERE NOT ENVISIONED WHEN KCPL MADE ITS

ESTIMATE OF THE PROBABLE RATE IMPACT OF ITS FIVE-YEAR REGULATORY PLAN EMBODIED WITHIN CASE NO. EO-2005-0329?

A. Yes, according to testimony filed in this case by KCPL witness Mr. Darrin Ives. Specifically, Mr. Ives sponsors an adjustment to reflect annualized synergy saving purportedly directly resulting from Great Plains Energy's acquisition of Aquila, Inc.'s Missouri electric properties. According to Mr. Ives' testimony, the Missouri revenue request in this case is approximately $10 million less due to the reflection of synergy savings net of transition costs incurred in the process of achieving such synergy savings. In sum, according to such testimony, the amount by which KCPL originally under estimated the rate impact of its five-year Regulatory Plan would have been greater *but for* claimed Aquila acquisition synergy savings that were never envisioned or predicted when the Case No. EO-2005-0329 Stipulation and Agreement was negotiated.

Q. HOW MANY RATE CASES REMAIN TO BE FILED BY KCPL?

A. One. I would note that pursuant to the Regulatory Plan there was one rate case established to be filed in early 2006 (that resulted in the noted rates that became effective January 1, 2007 in each state jurisdiction), and another case specifically established to be filed in 2009 to provide for rate relief synchronized fairly closely to the commercial operation date of Iatan II. There were two "optional" rate cases provided for within the Regulatory Plan which were, in fact, filed (i.e., the current case plus the immediately preceding case that resulted in new rates effective on January 1, 2008).

Q. HAVE YOU OBSERVED ESTIMATES FOR THE FINAL RATE REQUEST TO BE FILED LATER THIS YEAR THAT WILL PROVIDE FOR RATE RELIEF SYNCHRONIZED WITH COMMERCIAL OPERATION OF IATAN II?

A. No.

Q. IS IT POSSIBLE THAT THE FINAL RATE CASE TO BE FILED LATER THIS YEAR PURSUANT TO THE FIVE-YEAR REGULATORY PLAN MIGHT BE A RATE *REDUCTION* RATHER THAN ANOTHER RATE INCREASE?

A. That is theoretically possible. Specifically, the amount of rate relief that has been thus far been granted, and that is requested to be granted in the instant case, above that which can be justified under traditional embedded cost recovery has been – and continues to be – collected as "amortization expense" and accumulated as "Contributions in Aid of Construction." Upon completion of Iatan II it is not envisioned that such incremental revenues – above that which can be justified under the traditional embedded cost methodology – will continue to be collected. Thus, the money now being collected as "amortization expense" and accrued as "Contributions in Aid of Construction" should be available to offset the traditional embedded cost of service associated with commercial operation of Iatan II (return, depreciation and operations and maintenance expense associated with the new plant). However, the rate relief being sought in the instant case – even if reduced substantially by this Commission – will likely result in cumulative rate relief that is still far above the high end of the original estimated range of rate relief predicted by KCPL when negotiating the five-year Regulatory Plan. Thus, it appears highly unlikely that if a rate reduction were to be implemented in any amount pursuant to the rate case to be filed later this year, that it would be significant enough to result in cumulative rate relief that is even close to the high end of the original rate relief estimate provided by KCPL. Further, given the significant increase in the estimated completion cost of Iatan II from that originally estimated at the time of entering into the Regulatory Plan, it seems highly unlikely that the rate case to be filed later this year will be to capture a needed rate reduction. To the contrary, it would seem that another rate increase in some amount appears probable.

Q. PLEASE EXPLAIN YOUR STATEMENT REGARDING INCREASES IN THE ESTIMATED COST OF IATAN II.

A. As noted previously, at the time that the Regulatory Plan was being negotiated, KCPL predicted that the installed cost of the second Iatan unit would be approximately $1.3 million – or approximately $1,500 per kW. In May 2008 KCPL announced its then-latest revision for the total cost of the plant. I have affixed as Schedule JRD-3 and excerpt from the Company's May 7, 2008 press release. As of May 2008 – which is the latest publicly-released estimated for the plant that I have located – KCPL predicted that the final cost of the plant would be $1.82 to $1.92 billion.[2] In other words, taking the mid-point of the noted estimated range for the revised cost of the plant, the second Iatan unit is now envisioned to cost 44% more

[2] The noted press release provides an estimate of KCPL's ownership investment to be in the range of $994 million and $1.051 billion. KCPL is now expected to be a 55% owner in the plant which calculates to be a total Iatan II plant investment cost of $1.82 to $1.92 billion.

than originally predicted at the time the Regulatory Plan was negotiated. Given the significant run up in the cost of the second Iatan unit, with higher attendant return and depreciation requirements, it would seem unlikely that the amortization expense associated with currently collecting Contributions in Aid of Construction will exceed the revenue requirements associated with Iatan II.

Q. IS IT POSSIBLE THAT THE SECOND IATAN UNIT WILL HAVE A FINAL PRICE TAG IN EXCESS OF THE $1.82 TO $1.92 BILLION NOTED WITHIN THE MAY 2008 NEWS RELEASE?

A. Yes. At the time that it issued its revised forecast of Iatan II costs KCPL's President Bill Downey acknowledged that the Company "may raise the price again when more engineering on the project is completed at the end of the year."[3] I further note that pursuant to a Great Plains Energy presentation to EEI made in November 2008 that the Company was predicting that it would spend in excess of $400 million in 2008 and 2009 for its ownership share of Iatan II.

Q. HAVE ECONOMIC CONDITIONS CHANGED SINCE THE PARTIES ENTERED INTO THE STIPULATION AND AGREEMENT THAT ESTABLISHED A "REGULATORY PLAN" WITH AN ATTENDANT PRICE TAG – IN TERMS OF INCREASE IN RATES TO CUSTOMERS – OF 15% TO 20%?

A. Yes, very significantly. Since 2005, and in particular in the latter half of 2008, unemployment has risen dramatically, corporate earnings for most industries have

[3] May 8, 2008 news article.

fallen precipitously and are predicted to continue to fall, retirement savings for most have plummeted, and governmental bodies are experiencing difficulties in balancing budgets. News of the current dire economic times is prevalent. I have affixed as Schedule JRD-4 but a small sample of recent news articles highlighting current and projected economic conditions.

Rate increases of the magnitude that KCPL originally projected in 2005 would no doubt have caused *some* economic hardship for at least certain bodies of ratepayers in the more vibrant economic times of 2005 when the original Regulatory Plan was entered into. KCPL's significantly-higher-than-originally-projected rates in conjunction with much higher unemployment, generally lower corporate profits, smaller retirement savings, and governmental deficits is no doubt casting a much wider net of severe economic hardship for large bodies of ratepayers.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

AFFIDAVIT

STATE OF MISSOURI)
) SS.
COUNTY OF JACKSON)

BEFORE ME, the undersigned notary public, this day personally appeared JAMES R. DITTMER, to me known, who being duly sworn according to law, deposes and says:

"My name is JAMES R. DITTMER. I am of legal age and a resident of the State of Missouri. I certify that the foregoing testimony and exhibits, offered by me on behalf of the Hospital Interveners, are true and correct to the best of my knowledge and belief."

James R. Dittmer

SUBSCRIBED AND SWORN to before me, a notary public, on this 9th day of February, 2009.

Notary Public in and for the State of Missouri

My Commission Expires:
Sept 25, 2010

DANA MATTHEWS
Notary Public - Notary Seal
State of Missouri, Jackson County
Commission # 06943133
My Commission Expires Sep 25, 2010

REGULATORY INITIATIVES
CAPITAL/AMORTIZATIONS PROJECTS
($000's)

PROJECT	2005	2006	2007	2008	2009*	TOTAL
IATAN 2	13,027	30,912	138,421	246,136	347,761	776,257
WIND GENERATION	19,215	111,623	0	0	0	130,838
ENVIRONMENTAL	8,387	44,949	107,900	101,225	9,352	271,813
ASSET MANAGEMENT	4,000	5,696	8,501	11,309	12,820	42,326
DSM PROGRAMS	6,442	8,935	10,132	11,863	15,410	52,782
TOTAL	51,071	202,115	264,954	370,533	385,343	1,274,016

* Iatan 2 numbers includes $148,680(000) of expenditures in 2010

Media:	Tom Robinson (816) 556-2902
Investor:	Todd Kobayashi (816) 556-2312

FOR IMMEDIATE RELEASE

KANSAS CITY POWER & LIGHT FILES AGREEMENT WITH MISSOURI FOR LONG-TERM ENERGY PLAN

Agreement is the result of a collaborative process to secure long-term supply and improve air quality

Kansas City, Mo. (March 29, 2005) — Kansas City Power & Light (KCP&L), a subsidiary of Great Plains Energy (NYSE: GXP), has filed an agreement recommending the approval and implementation of a long-term energy plan with the Missouri Public Service Commission (MPSC). The comprehensive plan contained in the agreement is designed to meet the growing demand for additional electricity while delivering significant economic and environmental benefits to the Kansas City area.

The agreement is supported by the staffs of the MPSC and the Office of the Public Counsel in Missouri. Representatives of certain key constituencies who participated in the regulatory workshops to shape the plan also support the agreement's provisions. The MPSC is expected to hold hearings prior to its ruling. KCP&L is pursuing a similar, comprehensive agreement in Kansas and hopes to reach an agreement with Kansas soon.

"We feel that this is a comprehensive plan that provides a clean, low-cost supply of electricity to the region while protecting the customer from the high cost and volatility of natural gas-based generation," said Mike Chesser, Chairman and Chief Executive Officer of Great Plains Energy. "It features a portfolio of initiatives, each playing an important role in ensuring affordable, reliable energy for years to come. In addition, the plan will stimulate economic development, improve air quality, and incorporate renewable wind

-more-

energy. And, the plan provides customers with tools to manage their energy costs. We applaud the staffs of the MPSC and the Office of the Public Counsel for their foresight in supporting this plan."

Key benefits of the agreement include:

- **A long-term plan for affordable electricity** — avoiding increased reliance on high-cost, volatile fuels for generation by adding new high-efficiency coal-fired and wind-powered capacity. KCP&L anticipates owning approximately 500 megawatts of a new, high-efficiency 800-900 megawatt coal plant on the existing Iatan plant site in Missouri. The agreement includes 100 megawatts of new wind generation planned in Kansas, with the potential to add an additional 100 megawatts at a future date. This regulated generation will serve KCP&L customers in both Missouri and Kansas;
- **Investment in the local economy** — adding jobs in the region. During the four years it will take to build the new coal plant, up to 1,000 jobs will be created at the peak of the construction activity, plus 50 to 100 permanent positions once the plant is finished. That translates into approximately $300 million in direct payroll over the four-year period for the Kansas City region, as well as significant tax revenues;
- **Improved air quality in the Kansas City area** — investing approximately $280 million in technologies to substantially reduce certain air emissions at existing power plants, ensuring KCP&L meets or exceeds existing and anticipated federal air quality standards. Even with the addition of a new coal unit, on a system-wide basis under the plan, NO_x emissions are projected to decline by 54%, SO_2 by 29%, particulate matter by 31% and mercury by 26% by 2011. The environmental initiatives outlined in the agreement are included in the regional air quality plan developed by the Mid-America Regional Council, which is taking a leadership role in keeping Kansas City's air clean and in compliance with anticipated tougher air quality standards;

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- **Top tier reliability** — constructing, replacing and/or upgrading existing transmission and distribution facilities to accommodate new generation, and incorporating new technologies for faster diagnosis and repair of service interruptions;
- **Partnerships with customers to save energy and money** — implementing proposed efficiency and demand response programs that leverage new technologies to help customers more effectively use electricity. In addition, affordability programs will assist customers in managing their energy costs; and
- **Regulatory authority** — supporting the investment plan and maintaining key credit ratios through future rate increases, the treatment of certain revenue and expense items and a mechanism to better match revenue with the cost of fuel and purchased power.

William Downey, President & CEO of KCP&L, commented, "We are very pleased with the level of community support and collaboration. Participants helped in identifying the issues and shaping the plan, which was much more productive than the traditional process. It has been a very inclusive process and the level of involvement has resulted in a much stronger plan."

Addressing The Growing Need For More Electricity

The plan is designed to meet the area's growing need for more electricity. According to forecasts developed by KCP&L, the demand for electricity in the Kansas City area is anticipated to grow 2% annually over the next 10 years. More generation capacity will be needed in the region. The plan's new generation facilities will add 15% to KCP&L's current generation capacity.

Because the availability of reliable, affordable energy is a key factor in business expansion and relocation, the plan is expected to make the Kansas City area an even more attractive place to live and do business. The plan has been endorsed by local labor unions, the Kansas City Area Development Council, as well as numerous local economic development agencies and chambers of commerce.

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The plan was developed from input received through an open, collaborative process that began more than a year ago and included numerous strategic planning sessions, public forums, and regulatory workshops to gather input from hundreds of people, including employees, customers, environmentalists, industry experts, community leaders and other utilities.

Regulatory Authority Supporting the Plan

KCP&L anticipates that the agreement, if approved by the MPSC, will result in the expenditure of approximately $1.3 billion over the next five years. The agreement recognizes that KCP&L will make major investments in infrastructure and environmental improvements, requiring the company to increase both debt and equity. The agreement gives KCP&L regulatory mechanisms to be able to recover the prudent costs of its investments as they enter service and to maintain necessary credit quality over the five-year term of the agreement.

Current rates will remain in place until 2007, unless significant events impact KCP&L. The first rate case will be filed in 2006, with any rate adjustments going into effect for customers in 2007. The last rate case defined in the agreement is expected to be filed in 2009, with rates effective when the coal plant goes into service. Two additional rate cases could be filed in 2007 and 2008. The agreement allows KCP&L to recover — on a dollar-for-dollar basis with no profit to the company — fuel and purchased power expense through an interim energy charge, based upon projected costs and subject to refund, that would take effect for both Kansas and Missouri customers in 2007.

The actual amount of costs to be recovered through rates will be determined by the MPSC in these rate cases. KCP&L projects that, if the entire $1.3 billion anticipated cost of the plan is included in rate base, the rate increases to support the five year energy plan and projected increases in operating costs would average approximately 3-4% annually, over the same period. Regulatory Plan

-more-

KCP&L-MO AGREEMENT/5-5-5-5

The agreement also allows KCP&L to sell emission allowances and authorizes regulatory treatment of certain revenue and expense items, including pension expenses, designed to support the investment in the plan and the company's credit quality.

The company will be conducting a conference call to discuss the agreement on Tuesday, March 29, 2005 at 1 p.m. EST. To listen to webcast call, please access the investor relations section of our website at www.greatplainsenergy.com.

Great Plains Energy Incorporated (NYSE:GXP), headquartered in Kansas City, Missouri, is the holding company for Kansas City Power & Light Company, a leading regulated provider of electricity in the Midwest; and Strategic Energy LLC, a competitive electricity supplier. The Company's web site is www.greatplainsenergy.com.

CERTAIN FORWARD-LOOKING INFORMATION -- Statements made in this release that are not based on historical facts are forward-looking, may involve risks and uncertainties, and are intended to be as of the date when made. In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company is providing a number of important factors that could cause actual results to differ materially from the provided forward-looking information. These important factors include future economic conditions in the regional, national and international markets, including but not limited to regional and national wholesale electricity markets; market perception of the energy industry and the Company; changes in business strategy, operations or development plans; effects of current or proposed state and federal legislative and regulatory actions or developments, including, but not limited to, deregulation, re-regulation and restructuring of the electric utility industry and constraints placed on the Company's actions by the Public Utility Holding Company Act of 1935; adverse changes in applicable laws, regulations, rules, principles or practices governing tax, accounting and environmental matters including, but not limited to, air quality; financial market conditions and performance including, but not limited to, changes in interest rates and in availability and cost of capital and the effects on the Company's pension plan assets and costs; credit ratings; inflation rates; effectiveness of risk management policies and procedures and the ability of counterparties to satisfy their contractual commitments; impact of terrorist acts; increased competition including, but not limited to, retail choice in the electric utility industry and the entry of new competitors; ability to carry out marketing and sales plans; weather conditions including weather-related damage; cost, availability and deliverability of fuel; ability to achieve generation planning goals and the occurrence of unplanned generation outages; delays in the anticipated in-service dates of additional generating capacity; nuclear operations; ability to enter new markets successfully and capitalize on growth opportunities in non-regulated businesses; performance of projects undertaken by the Company's non-regulated businesses and the success of efforts to invest in and develop new opportunities; and other risks and uncertainties. This list of factors is not all-inclusive because it is not possible to predict all factors.

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GREAT PLAINS ENERGY

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GREAT PLAINS ENERGY ANNOUNCES FIRST QUARTER FINANCIAL RESULTS

Kansas City, MO., May 7, 2008 – Great Plains Energy Incorporated (NYSE:GXP) today announced first quarter 2008 reported earnings of $47.1 million or $0.55 per share, compared to first quarter 2007 reported earnings of $23.0 million or $0.28 per share. Core earnings, which exclude net mark-to-market gains and losses on energy contracts and other items, were $13.0 million or $0.15 per share for the first quarter 2008, compared to a loss of $11.0 million or $0.13 per share in the first quarter of 2007. Reported earnings are reconciled to core earnings in attachment B.

Compared to 2007, first quarter 2008 core earnings were favorably impacted by new retail rates, favorable weather, increased wholesale revenues and litigation settlement proceeds at Kansas City Power & Light (KCP&L), as well as higher delivered volumes at Strategic Energy. These positive factors were somewhat offset by the impact of higher purchased power expense due to plant outages and increased depreciation and amortization expense at KCP&L.

On April 2, 2008, Great Plains Energy announced the entry into a definitive agreement with Direct Energy Services, LLC ("Direct Energy"), a subsidiary of Centrica plc (LSE: CNA), under which Direct Energy will acquire from Great Plains Energy all of the outstanding ownership interests in Strategic Energy, L.L.C. for $300 million in cash, subject to closing adjustments.

"In the first quarter of 2008, we followed through on our plans to increase our focus on regulated operations by reaching an agreement to sell Strategic Energy," commented Chairman and CEO Mike Chesser. "Also, we are pleased that this quarter represented a marked improvement over last year. We are, however, experiencing challenges in our generation fleet performance and are taking steps to continue to improve plant availability."

Earnings Guidance

Due to the status and timing of the Aquila transaction as well as the pending sale of Strategic Energy, Great Plains Energy is not issuing 2008 guidance or confirming future years' guidance at this time.

BUSINESS SEGMENTS:

Kansas City Power & Light

First quarter 2008 reported earnings were $17.0 million or $0.20 per share compared to $2.1 million or $0.02 per share in first quarter last year. Core earnings at KCP&L were $15.1 million or $0.18 per share for the first quarter 2008 compared to $2.1 million or $0.02 per share in 2007.

Revenues for the first quarter 2008 increased to $297.6 million, a 16 percent increase over first quarter 2007. Retail revenues rose to $248.7 million in first quarter 2008 compared to $216.9 million in 2007 due primarily to new retail rates, favorable weather and increased usage. Wholesale revenues rose to $43.1 million, a 26 percent increase from the 2007 level of $34.2 million. The increase in wholesale revenues was attributable mainly to increased volumes at higher prices.

Partially offsetting the retail and wholesale revenue growth in the first quarter 2008 were the following factors:

- an increase in purchased power expense due to increased purchased power volumes primarily from plant outages and increased prices; and
- higher operating expenses due to increased depreciation and amortization expense.

Iatan Project Update

KCP&L has completed a cost and schedule update for the Iatan 1 environmental project and the Iatan 2 coal plant construction project. This updated assessment was driven by several factors, including (a) the combined projects reaching a milestone of 70% - 75% of the engineering work completed; (b) the integration of the Iatan 2 "Balance of Plant" schedule and quantity estimates from Kiewit Industrial Corporation into the master schedule and budget; and (c) continued challenging construction market trends, including rapidly escalating costs for construction materials and services, the level of global investment in power production facilities, the decline in the value of the U.S. dollar, and constrained labor availability.

KCP&L recently completed the update and key results were as follows:

- Based on the top end of the new estimate ranges, the combined increase in projected costs of the latan 1 environmental project and the new latan 2 unit is approximately 19 percent.
- Compared to the previous estimate of $837 million - $914 million issued in December 2006, KCP&L's approximate 55 percent share of the total projected cost of latan 2 has increased to a range of $994 million - $1.051 billion, with the top end of the range representing a 15 percent increase. Excluding approximately $47 million of certain items not typically included in a cost per kilowatt (kW) calculation, the cost of latan 2 is estimated to range from $2,083 / kW to $2,204 / kW.
- The in-service date for latan 2 continues to be the summer of 2010.
- KCP&L's 70 percent share of the projected cost of the latan 1 environmental project has increased to a range of $330 million - $350 million. This represents an increase of 33 percent compared to the top end of the previous range estimate of $255 million - $264 million for latan 1 included in KCP&L's December 2006 projection of Total Environmental Retrofits under its Comprehensive Energy Plan.
- The in-service date for the latan 1 project is now expected to be February 2009 compared to the previous estimate of year-end 2008.

"Though we are seeing cost increases in the latan projects, they are in line with what the industry as a whole is experiencing," commented Bill Downey, President and Chief Executive Officer of KCP&L. "The updated assessment reflects our intent to manage the cost of the projects prudently while, at the same time, holding as closely as possible to the original schedule. We continue to believe that when in service, latan 2 will be competitive with other coal plants under construction and will serve our region well for years to come."

Strategic Energy

Reported earnings for the first quarter 2008 were $52.9 million or $0.62 per share compared to $27.1 million or $0.33 per share in 2007. Strategic Energy's first quarter 2008 core earnings were $5.2 million or $0.06 per share compared to a core loss of $6.9 million or $0.08 per share in 2007. Higher core earnings in the first quarter of 2008 compared to the same period in 2007 were driven by higher delivered volumes at a higher average retail gross margin per MWh, excluding unrealized net mark-to-market impacts. Margins in the first quarter of 2007 were negatively impacted by customer attrition and a resettlement charge.

CNNMoney.com

Fed: Economy continues to sour

Central bank's Beige Book says the economy continued to deteriorate across the nation amid grim retail sales and depressed real estate markets.

By Ben Rooney, CNNMoney.com staff writer
Last Updated: January 14, 2009: 4:13 PM ET

NEW YORK (CNNMoney.com) -- Economic weakness continued to spread across the nation as real estate markets remained in distress and consumers kept their pocketbooks closed, according to the latest Federal Reserve report on regional economic conditions.

"Most districts noted reduced or low activity across a wide range of industries, although a few districts noted some exceptions in some sectors," the Fed said Wednesday in the January edition of its Beige Book.

The Beige Book, published eight times a year, is a summary of economic conditions in the central bank's twelve districts.

Wednesday's report noted that retail sales during the last six weeks, even during the heavily-discounted holiday period, were "generally weak," with eight of the 12 districts reporting "heavy discounting."

Meanwhile, the residential real estate market remained under pressure in most districts, with two-thirds reporting weak or declining home sales. Furthermore, home sale cancellations increased and new home construction declined.

Things were not much better in the commercial real estate market, with contacts in the Boston district calling the market "grim and depressing." And the New York district reported that Manhattan's office vacancy rate climbed to its highest level in two years.

While tight credit has impeded overall lending activity, refinancing of home loans increased in several districts, including Cleveland and Chicago, as mortgage rates have eased.

Overall lending activity softened as "credit quality remained a concern in several districts," according to the report.

Unemployment remains a concern with several districts reporting a "general weakening of labor market conditions." Layoffs, hiring freezes and reduced hours were reported in many districts.

Manufacturing activity continued to deteriorate in most regions. Half of the districts reported that businesses have reduced capital spending plans for the next six months.

Bucking the trend, defense and medical device manufactures reported some improvement in the Minneapolis district. And aerospace manufacturing in the San Francisco district held up, according to the report.

In another bright spot, lower energy prices were reported in several districts as oil and gas prices have plummeted from their July highs. And prices for raw materials fell, which resulted in lower input prices for manufacturers in the districts of Kansas, Atlanta and Boston.

Fed action: In response to the challenges facing the economy, which has been officially mired in recession since December 2007, the Fed has been on a drastic rate-cutting campaign.

Interest rate reductions are the central banks main tool for combating economic weakness and limiting the damage from the recession.

Last month, the Fed slashed its benchmark interest rate to a range between 0% and 0.25%, and said it expects to keep rates near that unprecedented low level for some time.

With its main tool nearly exhausted, however, the Fed has taken a number of unconventional steps to increase liquidity and loosen tight credit markets. The central bank launched a program aimed at buying up commercial paper - short-term corporate debt - in an effort to thaw the credit markets. It has also been considering buying long-term Treasurys to bring down mortgage rates.

The Fed's next policy-making meeting is slated for Jan. 27-28. The Beige Book is released two weeks ahead of those meetings.

On Tuesday, Fed chairman Ben Bernanke said that economic stimulus plans being discussed by the incoming Obama administration and the newly elected Congress "could provide a significant boost to economic activity." But he also warned that further bank bailouts may be necessary to bring about a sustained economic recovery. ▪

First Published: January 14, 2009: 2:26 PM ET

CNNMoney.com

Warning: Falling price zone ahead

Deflation has become the No. 1 fear of a growing number of economists, who worry that lower prices will further hurt the economy.

By Chris Isidore, CNNMoney.com senior writer
Last Updated: January 15, 2009: 9:24 AM ET

NEW YORK (CNNMoney.com) -- Rarely has the potential for lower prices been so scary.

While many cash-strapped Americans would welcome paying less for what they need to buy, many economists now say the possibility of deflation, or lower prices, is the greatest threat to the U.S. economy.

And more deflation warning bells are ringing.

On Thursday, the government reported that the Producer Price Index, which measures inflation on the wholesale level, fell on a year-over-year basis for the first time in five years.

The Consumer Price Index, the government's key inflation reading, is due out Friday. Economists expect a decline in overall prices for the month of December.

Some economists are forecasting the first year-over-year drop in the CPI since 1955. As recently as July, the CPI was up 5.5% over the previous 12-months.

Economists worry about deflation because it is a sign of the ever-weakening demand for products. But it can also be a further drag on economic activity by cutting into the willingness of both businesses and consumers to start spending again.

Businesses worried that the price of their products may continue to drop would be likely to cut back production. That can lead to additional plant closings and even more job losses. And even consumers who don't lose their jobs are likely to delay purchases, particularly of large-ticket items, if they think lower prices lay ahead.

Deflation was evident in both the Great Depression and the so-called "lost decade" that left Japan with a stagnant economy in the 1990s and earlier this decade.

"The mere concern ofadeflationary cycle taking hold can cause it to become a reality," said Bernard Baumohl, chief global economist for the Economic Outlook Group. "And once you fall into the cycle, it's very difficult to get out."

Investors have quietly have started pricing in deflationary expectations for the coming year. According to a market run by financial information firm Tullett Prebon Information, investors are now betting on a 4.25% drop in U.S. prices over the next year, and lower prices lasting for the following three years as well.

In addition, the five-year Treasury note now has a slightly lower yield than its inflation-protected counterpart, signaling that investors are betting that overall pricesin 2014 will be at or a bit below today's levels.

So far, recent price declines in the CPI and PPI have been driven primarily by lower oil and gasoline prices. Some economists say that the falling price of one commodity, like oil, can not cause a deflationary cycle, especially at a time that the Federal Reserve and other central banks are pumping so much money into the financial markets.

Charles Plosser, president of the Federal Reserve Bank of Philadelphia, dismissed the threat of deflation in a speech Wednesday.

"I am not particularly concerned about the possibility of persistent deflation," he said. "When oil and commodity prices stabilize, the negative rates of inflation we have seen in the CPI are likely to disappear."

Deflation not here yet but it's getting closer

But other economists worry the deflationary pressures are already spilling over into other sectors.

The so-called core CPI was down 0.1% in October and was unchanged in November. While the consensus forecast is for a 0.1% increase in December, if it's flat or lower in the month, it would be only the second three-month drop in that closely watched reading in the 52 years the number has been tracked.

"Those who think this is just about oil, I'd say, stick around and watch. It's going to reach all levels of the economy," said Kevin Giddis, managing director of fixed income at Morgan Keegan. "This is going to affect the day-to-day business of just about everything."

Baumohl said he's still hopeful a deflationary cycle can be avoided with the help of the unprecedented actions by the Federal Reserve and a potential stimulus package from Congress. But he concedes that if that if those efforts to spur spending aren't successful, then the risk of deflation soars.

To be sure, even deflation hawks agree that it's premature to say that falling prices are a major problem just yet. A few months of narrowly declining consumer prices don't necessarily indicate the start of a deflationary cycle.

And the price declines of the past few moths are relatively mild when compared to what happened during the Great Depression. There were year-over-year drops of about 10% every month from March 1931 to April 1933.

But Lena Komileva, head of G7 market economics for Tullett Prebon, said that by the time year-over-year CPI does turn negative, policymakers "won't be able to respond fast enough to prevent deflation from developing."

She said economists have generally underestimated the risks to global economic growth for much of the last year, and warned that it is very dangerous not to take the threat of deflation seriously.

And while the Fed and other central banks are usually able to combat inflation effectively by raising interest rates, there is no simple cure for deflation, especially when interest rates already are near zero as they are in the U.S.

"Deflation is a self-feeding phenomenon and the world simply lacks ability to fight deflation the way it can fight hyperinflation," she said. ■

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http://money.cnn.com/2009/01/14/news/economy/deflation/index.htm

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Slim chance of a turnaround in 2009

Consumers and businesses have retrenched so deeply that it will take a long time for the economy to stage a meaningful comeback.

By Anthony Karydakis, contributor
Last Updated: January 30, 2009: 4:00 PM ET

NEW YORK (Fortune) -- At first glance, the fourth-quarter GDP report released earlier today produced a moderate surprise in that it didn't show a contraction quite as deep as had generally been expected by most private economists. The so-called consensus forecast, based on various surveys, had been looking for a decline of around 5.5%. However, there is little overall reason to cheer simply because the economy contracted at a rate of "only" 3.8% last quarter (following a 0.5% decline in the third quarter), according to the Commerce Department's preliminary calculations.

Here's some key reasons for which, in reality, the data offer very little encouragement for the medium-term prospects of the economy.

1. The consumer pullback is severe and enduring. Personal consumption declined at a rate of 3.5%, which alone subtracted two and a half percentage points from GDP last quarter and followed another sizable decline of 3.8% in the prior quarter. Back-to-back declines of that magnitude are very rare and can only be compared to the cumulative decline in spending in the first two quarters of 1980, when the economy was experiencing a particularly sharp and deep (although short-lived) recession.

By way of comparison, during the historically severe and long recession of 1981-82, consumption contracted in only a single quarter by a more moderate 3%. In the 1990-91 recession, spending fell by

2.8% and 1.7% in two consecutive quarters, while there was no single-quarter drop during the 2001 recession.

2. Warehouses are filling up at a fast rate. A major reason for which the decline in GDP in the fourth quarter was contained is the sharp buildup in the rate of inventory accumulation, to the tune of $36 billion, which added 1.3 percentage points to GDP growth. Such a sizable rise in inventory accumulation in the midst of a major retrenchment in consumer spending does not bode well for growth in the early part of this year, as companies are likely to cut back on production further as they meet the weak consumer demand by drawing down on their inventory levels.

3. Companies have slashed their budgets. Capital spending, one of the key pillars of economic activity in normal times, appears to be caving in precipitously, consistent with the tone of the broader economic and financial environment in recent quarters. It is certainly true that capital spending is a highly cyclical component of GDP and tends to pull back quickly in periods of economic downturn. However, once again, it is the magnitude of the decline in the fourth quarter (19.1%) that is troubling. If that number stands after the subsequent revisions (or, if it is revised lower still), it will exceed the 18.8% contraction in capital spending during the second quarter of the infamous 1980 recession.

4. The numbers may get worse. Finally, it is important to remember that today's GDP number is only a preliminary estimate, subject to two back-to-back revisions in late February and late March, as the Commerce Department gathers more complete data for the various components. Recent history shows a strong pattern of very substantial revisions to the preliminary GDP estimate and, in that light, a considerable risk exists that today's 3.8% number may be revised somewhat lower in the end rather than higher.

The bottom line from the fourth-quarter GDP report is that it has already set the stage for more contraction in economic activity in the first quarter of 2009, as consumer spending remains weak, capital spending continues to shrink and last quarter's inventory bulge will probably not be repeated again. One slight consolation is that consumer spending is unlikely to register such a big decline as in the second half of last year, given that some pent-up demand will help contain the pace of further retrenchment.

There was little reason, based on the fourth-quarter GDP report, to alter expectations regarding the basic trajectory of economic activity later in the year. While the pace of contraction could moderate somewhat as the year progresses, given the dynamic already in place and a still unfolding banking crisis around us, the prospects for any meaningful turnaround before the end of the year remain pretty slim.

Anthony Karydakis is a former chief U.S. economist for JPMorgan Asset management and currently an adjunct professor at New York University's Stern School of Business. ■

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Economy: Sharpest decline in 26 years

How to manage your business in a recession

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Find this article at:
http://money.cnn.com/2009/01/30/news/economy/Karydakis_turnaround.fortune/index.htm

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Economy: Sharpest decline in 26 years

Economic activity shrank by 3.8% in last three months of 2008, according to the government's gross domestic product report.

By Chris Isidore, CNNMoney.com senior writer
Last Updated: January 30, 2009: 11:10 AM ET

NEW YORK (CNNMoney.com) -- The U.S. economy suffered its biggest slowdown in 26 years in the last three months of 2008, according to the government's first reading about the fourth quarter released Friday.

Gross domestic product, the broadest measure of the nation's economic activity, fell at an annual rate of 3.8% in the fourth quarter, adjusted for inflation.

That's the largest drop in GDP since the first quarter of 1982, when the economy suffered a 6.4% decline.

The decline was less than the 5.5% drop forecast by economists surveyed by Briefing.com. The fourth quarter plunge followed a more modest decline of 0.5% in the third quarter.

Still, some economists cautioned that the smaller than expected drop in economic activity wasn't good news, but a warning sign about further weakness ahead.

"Today's GDP report is no cause for celebration," said Jay Bryson, global economist for Wachovia. "The economy is even weaker than the number would suggest."

Hit by tight credit and soaring job losses, Americans slammed the brakes on spending in the quarter.

Consumer spending fell at a 3.5% annual rate, which was the seventh biggest drop on record. Spending on big-ticket durable goods plunged at a 22% pace, the largest decline since 1987. Consumer spending accounts for more than two-thirds of overall economic activity.

But it wasn't just consumers pulling back. Fixed investment in equipment and software, taken as an indication of business spending, plunged at an annual 28% rate. That's the biggest drop in 50 years.

Healthy export demand helped to lift U.S. economic growth earlier in 2008, but that strength vanished in the fourth quarter, as exports fell at nearly a 20% annual rate, the sharpest decline since 1974. That set off more concerns about the slowdown in the global economy.

"I don't want to say we were counting on the global economy to bail us out. But if it turns into a big drag, we've got more of a problem," said Gus Faucher, director of macroeconomics for Moody's Economy.com.

More warning signs

Faucher and other economists noted that the biggest surprise in the report was the sharp growth in business inventories.

Economists say that was false growth brought about by businesses being unable to sell the goods they had on hand. Excluding the growth in inventories, GDP would have fallen by 5.1%

"When the economy is dropping fast it is hard for firms with plummeting sales to halt inventory accumulation," said Robert Brusca of FAO Economics.

Since companies are likely to respond to the excess inventories by slashing production at the start of this year, GDP could be weaker in the next few quarters.

"As bad as this quarter was, it means the first quarter will be worse," said Faucher.

In addition, prices for goods and services fell more than expected during the quarter. That limited the decline in GDP, which is adjusted lower to account for inflation.

The prices paid by consumers during the quarter fell at an annual 5.5% rate in the quarter, due primarily to lower gas prices. That's the biggest such decline in that key price measure since the Commerce Department started calculating it on a quarterly basis in 1947.

While lower prices may provide some relief for consumers, economists warn that this phenomenon, known as deflation, can hurt economic activity.

Businesses worried that falling prices will cause them to lose money will cut back on production, which can lead to additional job losses. And even consumers who keep their jobs can hold off on purchases if they hope that prices of the goods they want will fall further if they wait.

The report comes as the Senate prepares for a vote on an economic stimulus package that is designed to pump more than $800 billion into the economy. The House passed the measure on a party-line vote

Wednesday.

Christina Romer, chair of the White House's Council of Economic Advisors, issued a statement saying the weak GDP report is another argument in favor of the stimulus package.

"This widespread decline emphasizes that the problems that began in our housing and financial sector have spread to nearly all areas of the economy," she said in the statement. "Immediate action to support both the financial sector and overall demand is essential." ■

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