

FINANCIAL REVIEW

22 Management's Report	42 Consolidated Balance Sheets
23 Independent Auditor's Report	44 Consolidated Statements of Capitalization
24 Management's Discussion and Analysis of Results of Operations and Financial Condition	46 Consolidated Statements of Common Stockholders' Equity
40 Consolidated Statements of Income	46 Consolidated Statements of Comprehensive Income
41 Consolidated Statements of Cash Flows	47 Notes to Financial Statements
	70 Selected Consolidated Financial and Operating Data 1999-2003

MANAGEMENT'S REPORT

The management of Southern Company has prepared—and is responsible for—the consolidated financial statements and related information included in this report. These statements were prepared in accordance with accounting principles generally accepted in the United States and necessarily include amounts that are based on the best estimates and judgments of management. Financial information throughout this annual report is consistent with the financial statements.

The company maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that the accounting records reflect only authorized transactions of the company. Limitations exist in any system of internal controls, however, based on a recognition that the cost of the system should not exceed its benefits. The company believes its system of internal accounting controls maintains an appropriate cost/benefit relationship.

The company's internal accounting controls are evaluated on an ongoing basis by the company's internal audit staff. The company's independent public accountants also consider certain elements of the internal control system^o in order to determine their auditing procedures for the purpose of expressing an opinion on the financial statements.

The audit committee of the board of directors, composed of four independent directors, provides a broad overview of management's financial reporting and control functions. Periodically, this committee meets with management, the internal auditors, and the independent public accountants to ensure that these groups are fulfilling

their obligations and to discuss auditing, internal controls, and financial reporting matters. The internal auditors and independent public accountants have access to the members of the audit committee at any time.

Management believes that its policies and procedures provide reasonable assurance that the company's operations are conducted according to a high standard of business ethics.

In management's opinion, the consolidated financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of Southern Company and its subsidiary companies in conformity with accounting principles generally accepted in the United States.



H. Allen Franklin

Chairman, President, and Chief Executive Officer



Thomas A. Fanning

*Executive Vice President,
Chief Financial Officer, and Treasurer
March 1, 2004*

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Southern Company

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Southern Company and Subsidiary Companies as of December 31, 2003 and 2002, and the related consolidated statements of income, comprehensive income, common stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of Southern Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. The consolidated financial statements of Southern Company and Subsidiary Companies for the year ended December 31, 2001, were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph that described a change in the method of accounting for derivative instruments and hedging activities in their report dated February 13, 2002.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence

supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements (pages 40 to 69) present fairly, in all material respects, the financial position of Southern Company and Subsidiary Companies at December 31, 2003 and 2002, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, in 2003 Southern Company changed its method of accounting for asset retirement obligations.



Atlanta, Georgia
March 1, 2004

THE FOLLOWING REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS IS A COPY OF THE REPORT PREVIOUSLY ISSUED IN CONNECTION WITH THE COMPANY'S 2001 ANNUAL REPORT AND HAS NOT BEEN REISSUED BY ARTHUR ANDERSEN LLP.

To Southern Company:

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Southern Company (a Delaware corporation) and subsidiary companies as of December 31, 2001 and 2000, and the related consolidated statements of income, comprehensive income, common stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant

estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements (pages 33 through 57) referred to above present fairly, in all material respects, the financial position of Southern Company and subsidiary companies as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

As explained in Note 1 to the financial statements, effective January 1, 2001, Southern Company changed its method of accounting for derivative instruments and hedging activities.



Atlanta, Georgia
February 13, 2002

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

OVERVIEW OF CONSOLIDATED EARNINGS AND BUSINESS ACTIVITIES**Earnings**

Southern Company's financial performance in 2003 was very strong and one of the best in the electric utility industry. This performance reflected our goal to deliver solid results to stockholders and to provide low-cost energy to more than 4 million customers. Net income of \$1.5 billion increased 11.8 percent over income reported in 2002. Net income from continuing operations was \$1.3 billion in 2002 and \$1.1 billion in 2001. This was a 17.6 percent and 12.7 percent increase in 2002 and 2001, respectively. Basic earnings per share from continuing operations in 2003 were \$2.03 per share, \$1.86 in 2002, and \$1.62 in 2001. Dilution—which factors in additional shares related to stock options—decreased earnings per share in 2003, 2002, and 2001 by 1 cent each year.

On April 2, 2001, Southern Company completed the spin off of its remaining 80.1 percent ownership of Mirant Corporation (Mirant) in a tax-free transaction. As a result of the spin off, Southern Company's 2001 financial statements and related information reflect Mirant as discontinued operations.

Dividends

Southern Company has paid dividends on its common stock since 1948. Dividends paid per share on common stock were \$1.385 in 2003, \$1.355 in 2002, and \$1.34 in 2001. In January 2004, Southern Company declared a quarterly dividend of 35 cents per share. This is the 225th consecutive quarter that Southern Company has paid a dividend equal to or higher than the previous quarter. The company's goal for the dividend payout ratio is 70 percent.

Southern Company Business Activities

Discussion of the results of operations is focused on Southern Company's primary business of electricity sales in the Southeast by the retail operating companies—Alabama Power, Georgia Power, Gulf Power, Mississippi Power, and Savannah Electric—and Southern Power. Southern Power is an electric wholesale generation subsidiary with market-based rate authority. Southern Company's other business activities include investments in synthetic fuels and leveraged lease projects, telecommunications, energy-related services, natural gas marketing, and the parent holding company.

Several factors affect the opportunities, challenges, and risk of Southern Company's primary business of selling electricity. These factors include the retail operating companies' ability to maintain a stable regulatory environment, to achieve energy sales growth while containing costs, and to recover costs related to growing demand and increasingly stricter environmental standards. Another major factor is the profitability of the competitive market-based wholesale generating business and federal regulatory policy, which may impact Southern Company's level of participation in this market. Future earnings for the electricity business in

the near term will depend, in part, upon growth in energy sales, which is subject to a number of factors. These factors include weather, competition, new energy contracts with neighboring utilities, energy conservation practiced by customers, the price of electricity, the price elasticity of demand, and the rate of economic growth in the service area.

RESULTS OF OPERATIONS**Electricity Businesses**

Southern Company's electric utilities generate and sell electricity to retail and wholesale customers in the Southeast. A condensed income statement for the six companies that make up the electricity business is as follows:

<i>(in millions)</i>	Amount		Increase (Decrease) From Prior Year	
	2003	2003	2002	2001
Operating revenues	\$10,747	\$541	\$ 300	\$ 46
Fuel	2,998	212	209	13
Purchased power	473	24	(269)	41
Other operation and maintenance	2,858	107	262	19
Depreciation and amortization	972	(16)	(155)	9
Taxes other than income taxes	584	29	22	1
Total operating expenses	7,885	356	69	83
Operating income	2,862	185	231	(37)
Other income, net	2	20	(32)	51
Interest expenses and other, net	595	9	(24)	(25)
Income taxes	845	68	76	(1)
Net income	\$ 1,424	\$128	\$ 147	\$ 40

Revenues

Details of electric operating revenues are as follows:

<i>(in millions)</i>	2003	2002	2001
Retail—prior year	\$ 8,728	\$ 8,440	\$8,600
Change in—			
Base rates	75	33	23
Sales growth	104	98	61
Weather	(135)	158	(177)
Fuel cost recovery and other	103	(1)	(67)
Retail—current year	8,875	8,728	8,440
Sales for resale—			
Within service area	403	393	338
Outside service area	955	775	836
Total sales for resale	1,358	1,168	1,174
Other electric operating revenues	514	310	292
Electric operating revenues	\$10,747	\$10,206	\$9,906
Percent change	5.3%	3.0%	0.5%

Retail revenues increased \$147 million in 2003 and \$288 million in 2002 and declined \$160 million in 2001. The significant factors driving these changes are shown in the table above.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Electric rates—for the retail operating companies—include provisions to adjust billings for fluctuations in fuel costs, the energy component of purchased energy costs, and certain other costs. Under these fuel cost recovery provisions, fuel revenues generally equal fuel expenses—including the fuel component of purchased energy—and do not affect net income.

Sales for resale revenues within the service area for 2003 increased \$10 million, which reflected increased customer growth offset by milder weather, compared with sales in 2002. Revenues from sales for resale within the service area in 2002 increased \$55 million as a result of above normal weather. The same sales for resale category in 2001 was \$338 million, down 10.2 percent from the prior year. This sharp decline resulted primarily from the mild weather experienced in the Southeast during 2001.

Revenues from energy sales for resale outside the service area increased \$180 million as a result of new contracts, higher gas prices, and milder weather. The new contracts reflected some 2,400 megawatts of new generating capacity being placed into service in 2003. As a result of mild weather, more coal-fired generation was available for sale to utilities outside the service area. In general, sales for resale outside the service area can be significantly influenced by weather, which affects both customer demand and generating availability for these type sales. Neighboring utilities that depend heavily on gas-fired generation purchase larger amounts of power as natural gas prices increase. These factors contribute to the large fluctuations in sales from year to year.

In 2002, revenues from energy sales for resale outside the service area were down 7.3 percent after having increased 39 percent in 2001. The decline in 2002 resulted from the expiration of certain short-term energy sales contracts in effect in 2001. Revenues from outside the service area have increased \$355 million since 2000 as a result of growth driven by new longer-term contracts. As Southern Company increases its competitive wholesale generation business, sales for resale outside the service area should reflect steady increases over the near term. Recent wholesale contracts with market-based capacity and energy rates have shorter contract periods than the traditional cost-based contracts entered into in the 1980s. The older contracts are principally unit power sales to Florida utilities. Under the unit power sales contracts, capacity revenues reflect the recovery of fixed costs and a return on investment, and energy is generally sold at variable cost. The capacity and energy components of the unit power contracts and other long-term contracts were as follows:

<i>(in millions)</i>	2003	2002	2001
Unit power—			
Capacity	\$182	\$175	\$170
Energy	211	198	201
Other long term—			
Capacity	111	100	112
Energy	451	306	353
Total	\$955	\$779	\$836

Capacity revenues for unit power contracts in 2003, 2002, and 2001 each varied slightly compared with the prior year as a result of adjustments and true-ups related to contractual pricing. No significant declines in the amount of capacity are scheduled until the termination of the contracts in 2010.

In May 2003, Mississippi Power and Southern Power entered into agreements with Dynege, Inc. (Dynege) that resolved and terminated in 2003 all outstanding matters related to capacity sales contracts with subsidiaries of Dynege. The termination payments from Dynege resulted in an increase in other electric revenues of \$135 million for the year 2003.

Energy Sales

Changes in revenues are influenced heavily by the volume of energy sold each year. Kilowatt-hour sales for 2003 and the percent change by year were as follows:

<i>(billions of kilowatt-hours)</i>	Amount	Percent Change		
	2003	2003	2002	2001
Residential	47.8	(1.9)%	9.5%	(3.6)%
Commercial	48.4	0.3	2.8	1.5
Industrial	54.4	1.0	1.8	(6.8)
Other	1.0	(0.2)	2.3	0.7
Total retail	151.6	(0.2)	4.5	(3.2)
Sales for resale —				
Within service area	9.4	(11.2)	12.9	(2.0)
Outside service area	31.1	41.7	2.7	24.4
Total	192.1	4.2	4.7	(0.5)

Residential energy sales in 2003 reflected a decrease in customer demand as a result of very mild weather partially offset by an increase of 1.6 percent in new customers. Commercial sales continued to show steady growth while industrial sales increased somewhat over the depressed results of recent years. In 2002, the rate of growth in total retail energy sales was very strong. Residential energy sales reflected an increase as a result of hotter-than-normal summer weather and a 1.6 percent increase in customers served. In 2001, retail energy sales registered a 3.2 percent decline. This was the first decrease since 1982 and was driven by extremely mild weather and the sluggish economy, which severely impacted industrial sales. Energy sales to retail customers are projected to increase at an average annual rate of 1.6 percent during the period 2004 through 2014.

Sales to customers outside the service area under contracts and opportunity sales increased by 8.0 billion, 1.0 billion, and 3.9 billion kilowatt-hours in 2003, 2002, and 2001, respectively. In 2003, these sales reflected the expansion of the competitive wholesale contract business discussed earlier, as well as increased availability of coal-fired generation resulting from weather-related lower retail demand coupled with higher natural gas prices, which increase the wholesale market price related to opportunity sales. Unit power energy sales increased 4.0 percent in 2003, decreased 3.3 percent in 2002, and increased 2.7 percent in 2001.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Fluctuations in oil and natural gas prices, which are the primary fuel sources for unit power sales customers, influence changes in sales. However, these fluctuations in energy sales under long-term contracts have minimal effect on earnings because the energy is generally sold at variable cost.

Expenses

Electric operating expenses in 2003 were \$7.9 billion, an increase of \$356 million over 2002 expenses. Electricity production costs exceeded last year's cost by \$210 million as a result of increased electricity sales and a 6.8 percent increase in the average unit cost of fuel. Non-production electricity operation and maintenance costs also increased by \$159 million in 2003. This increase in expenses was primarily driven by additional administrative and general expenses of \$45 million, customer service expenses of \$15 million, and a \$60 million regulatory expense related to Plant Daniel. For more information regarding this regulatory expense, see Note 3 to the financial statements under "Mississippi Power Regulatory Filing." Taxes other than income taxes increased \$29 million in 2003 as a result of new facilities with a higher tax basis for property taxes. Depreciation and amortization declined by \$16 million in 2003, primarily as a result of Georgia Power's 2001 rate order to recognize certain purchased power costs evenly over a three-year period. This amortization reduced depreciation expense by \$49 million in 2003. This expense was partially offset by a higher depreciable plant basis. For more information regarding the 2001 rate action, see Note 3 to the financial statements under "Georgia Power Retail Rate Orders."

In 2002, electric operating expenses were \$7.5 billion, an increase of \$69 million over 2001 expenses. Electricity production costs exceeded 2001 cost by \$88 million as a result of increased electricity sales. Non-production electricity operation and maintenance costs also increased in 2002 by \$109 million. Taxes other than income taxes increased \$22 million in 2002. Depreciation and amortization declined by \$155 million in 2002 primarily as a result of Georgia Power's 2001 rate order to reverse and amortize over three years \$333 million that had been previously expensed related to accelerated depreciation under a previous rate order. This amortization reduced depreciation expense in 2002 by \$111 million.

Electric operating expenses in 2001 increased only \$83 million compared with the prior year. The moderate increase reflected flat energy sales and tighter cost-containment measures, which included lower staffing levels and reductions in certain non-critical expenses. The costs to produce electricity in 2001 increased \$96 million. However, non-production operation and maintenance expenses declined by \$23 million.

Fuel costs constitute the single largest expense for the six electric utilities. The mix of fuel sources for generation of electricity is determined primarily by demand, the unit cost of fuel consumed, and the availability of generating units. The amount and sources of generation, the average cost of fuel per net kilowatt-hour generated, and the average cost of purchased power were as follows:

	2003	2002	2001
Total generation (billions of kilowatt-hours)	189	183	174
Sources of generation (percent)–			
Coal	71	69	72
Nuclear	16	16	16
Gas	9	12	9
Hydro	4	3	3
Average cost of fuel per net kilowatt-hour generated (cents)	1.72	1.61	1.56
Average cost of purchased power per net kilowatt-hour (cents)	3.82	4.17	6.10

Fuel and purchased power costs to produce electricity were \$3.5 billion in 2003, an increase of \$295 million or 7.4 percent above the prior year costs. This increase was attributed to higher unit fuel cost and increased customer demand. The additional demand was met by generating 6 billion and purchasing 1.6 billion more kilowatt-hours than in 2002.

In 2002, fuel and purchased power costs to produce electricity were \$3.23 billion, a decrease of \$79 million or 2.4 percent below the prior year costs. An additional 8.9 billion kilowatt-hours were generated in 2002, at a slightly higher average cost; however, this lowered requirements to purchase more expensive electricity from other utilities. Fuel and purchased power costs in 2001 were \$3.3 billion, an increase of \$54 million. Continued efforts to control energy costs, combined with additional efficient gas-fired generating units, helped to hold the increase in fuel expense to \$13 million in 2001.

Total interest charges and other financing costs in 2003 increased by \$19 million as a result of Southern Power issuing \$575 million of senior notes in both 2003 and 2002 to finance new generating facilities. This increase offset the reduction in interest costs related to the retail operating companies refinancing higher-cost debt in 2003. Total interest charges and other financing costs declined by \$24 million in 2002 and \$25 million in 2001 as a result of much lower interest rates on short-term debt and continued refinancing of higher-cost long-term securities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Other Business Activities

Southern Company's other business activities include the parent company—which does not allocate operating expenses to business units—investments in synthetic fuels and leveraged lease projects, telecommunications, energy services, and natural gas marketing. These businesses are classified in general categories and may comprise one or more of the following subsidiaries. Southern Company Holdings invests in synthetic fuels and leveraged lease projects that receive tax benefits, which contribute significantly to the economic results of these investments; Southern LINC provides digital wireless communications services to the retail operating companies and also markets these services to the public within the Southeast; Southern Telecom provides fiber optics services in the Southeast; and Southern Company Energy Solutions provides energy services, including energy efficiency improvements, for large commercial and industrial customers, municipalities, and government entities. Southern Company GAS is a retail gas marketer serving Georgia.

A condensed income statement for Southern Company's other business activities is shown below:

<i>(in millions)</i>	Increase (Decrease)			
	Amount	From Prior Year		
	2003	2003	2002	2001
Operating revenues	\$ 504	\$161	\$ 94	\$ 43
Operation and maintenance	414	101	41	29
Depreciation and amortization	55	(4)	30	(7)
Taxes other than income taxes	2	—	—	(2)
Total operating expenses	471	97	71	20
Operating income	33	64	23	23
Equity in losses of				
unconsolidated subsidiaries	(185)	(30)	(102)	(31)
Leveraged lease income	66	8	(1)	(2)
Other income, net	7	8	(11)	5
Interest expenses	104	6	(37)	(62)
Income taxes	(233)	16	(105)	(29)
Net income	\$ 50	\$ 28	\$ 51	\$ 86

Southern Company's non-regulated business investments continued to provide financial returns consistent with the company's earnings goals. Non-regulated revenues increased \$161 million in 2003. Southern Company GAS began operations in August 2002 and recorded revenues of \$168 million in 2003 and \$68 million in 2002. Southern LINC's revenues increased \$8 million, \$32 million, and \$12 million in 2003, 2002, and 2001, respectively, as a result of increased wireless subscribers. Revenues from a subsidiary formed in April 2001 that provides services related to synthetic fuel products were \$93 million in 2003, increasing by \$37 million and \$26 million in 2003 and 2002, respectively, as a result of increased production at the facilities. The majority of these revenues relate to transportation services that are billed at cost and, therefore, have no effect on net income.

The increases in 2003 and 2002 operating and maintenance expenses were primarily driven by Southern Company GAS'

increases in operating expenses of \$120 million and \$60 million, respectively. These increases reflect only a partial year of operation in 2002 for Southern Company GAS. Natural gas purchases represent their primary operating expense. Also, the average cost of natural gas per decatherm increased 24 percent in 2003. These increases were partially offset by intersegment eliminations related to synthetic fuels being sold to the retail operating companies. See Note 1 to the financial statements under "Related Party Transactions" for additional information. In 2002, expenses increased \$19 million for Southern LINC as a result of their additional subscribers, and expenses for synthetic fuel product services increased by \$30 million as a result of increased production. In 2001, operation and maintenance expenses increased \$37 million as a result of a subsidiary formed in April 2001 to produce synthetic fuel. This increase was partially offset by a reduction in expenses related to a private security subsidiary that was sold in late 2000.

The changes in depreciation expense in 2002 reflects a \$16 million charge at Southern Company Energy Solutions related to the impairment of assets under contracts to certain customers, as well as the impact of property additions at Southern LINC. The 2001 decreases relate to investment write offs in 2000.

The increases in equity in losses of unconsolidated subsidiaries in 2002 and 2001 reflect the results of additional investments in synthetic fuel partnerships that produce operating losses. These partnerships also claim federal income tax credits that offset these operating losses and make the projects profitable. These credits totaled \$120 million in 2003, \$108 million in 2002, and \$71 million in 2001.

The increase in other income in 2003 reflected a \$15 million gain for a Southern Telecom contract settlement during the year. This gain was offset by an increase of \$7 million in charitable contributions above the amount in 2002 made by the parent holding company.

Interest expenses for 2003 increased \$18 million for the redemption of \$430 million of preferred securities. This increase was partially offset by less short-term debt outstanding at the parent company. Interest expense charges in 2002 and 2001 reflect lower interest rates and less amounts of debt outstanding for the parent company.

Effects of Inflation

The retail operating companies and Southern Power are subject to rate regulation and long-term contracts, respectively, that are based on the recovery of historical costs. In addition, the income tax laws are also based on historical costs. Therefore, inflation creates an economic loss because the company is recovering its costs of investments in dollars that have less purchasing power. While the inflation rate has been relatively low in recent years, it continues to have an adverse effect on Southern Company because of the large investment in utility plant with long economic lives. Conventional accounting for historical cost does not recognize

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

this economic loss nor the partially offsetting gain that arises through financing facilities with fixed-money obligations such as long-term debt and preferred securities. Any recognition of inflation by regulatory authorities is reflected in the rate of return allowed in the retail operating companies' approved electric rates.

Future Earnings Potential

General

The results of continuing operations for the past three years are not necessarily indicative of future earnings potential. The level of Southern Company's future earnings depends on numerous factors. These factors affect the opportunities, challenges, and risk of Southern Company's primary business of selling electricity. These factors include the retail operating companies' ability to maintain a stable regulatory environment, to achieve energy sales growth while containing costs, and to recover costs related to growing demand and increasingly stricter environmental standards. Another major factor is the profitability of the competitive market-based wholesale generating business and federal regulatory policy, which may impact Southern Company's level of participation in this market. Future earnings for the electricity business in the near term will depend, in part, upon growth in energy sales, which is subject to a number of factors. These factors include weather, competition, new energy contracts with neighboring utilities, energy conservation practiced by customers, the price of electricity, the price elasticity of demand, and the rate of economic growth in the service area.

Industry Restructuring

The retail operating companies operate as vertically integrated companies providing electricity to customers within the service area of the southeastern United States. Prices for electricity provided to retail customers are set by state public service commissions under cost-based regulatory principles. Retail rates and earnings are reviewed and adjusted periodically within certain limitations based on earned return on equity. See Note 3 to the financial statements for additional information about these and other regulatory matters.

The electric utility industry in the United States is continuing to evolve as a result of regulatory and competitive factors. Among the early primary agents of change was the Energy Policy Act of 1992 (Energy Act). The Energy Act allowed independent power producers to access a utility's transmission network and sell electricity to other utilities.

Although the Energy Act does not provide for retail customer access, it was a major catalyst for restructuring and consolidations that took place within the utility industry. Numerous federal and state initiatives that promote wholesale and retail competition are in varying stages. Among other things, these initiatives allow retail customers in some states to choose their electricity provider. Some states have approved initiatives that result in a separation of the ownership and/or operation of generating facilities from the ownership and/or operation of transmission and distribution facilities.

While various restructuring and competition initiatives have been discussed in Alabama, Florida, Georgia, and Mississippi, none have been enacted. Enactment could require numerous issues to be resolved, including significant ones relating to recovery of any stranded investments, full cost recovery of energy produced, and other issues related to the energy crisis that occurred in California, as well as the August 2003 power outage in the Northeast. As a result of these issues, many states, including those in Southern Company's retail service area, have either discontinued or delayed consideration of initiatives involving retail deregulation.

Since 2001, merchant energy companies and traditional electric utilities with significant energy marketing and trading activities have come under severe financial pressures. Many of these companies have completely exited or drastically reduced all energy marketing and trading activities and sold foreign and domestic electric infrastructure assets. Southern Company has not experienced any material adverse financial impact regarding its limited energy trading operations and recent generating capacity additions. In general, Southern Company only constructs new generating capacity after entering into long-term capacity contracts for the new facilities or to meet requirements of Southern Company's regulated retail markets, both of which are optimized by limited energy trading activities.

Southern Company continues to maintain and expand its wholesale energy business in the Southeast. In 2001, Southern Company formed Southern Power to construct, own, and manage wholesale generating assets in the Southeast. Southern Power is the primary growth engine for Southern Company's competitive wholesale energy business. By the end of 2005, Southern Power plans to have approximately 6,000 megawatts of available generating capacity in commercial operation. At December 31, 2003, approximately 4,800 megawatts were in commercial operation.

Continuing to be a low-cost producer could provide opportunities to increase the size and profitability of the electricity sales business in markets that evolve with changing regulation and competition. Conversely, future regulatory changes could adversely affect the company's growth, and if Southern Company's electric utilities do not remain low-cost producers and provide quality service, then energy sales growth could be limited, and this could significantly erode earnings.

To adapt to a less regulated, more competitive environment, Southern Company continues to evaluate and consider a wide array of potential business strategies. These strategies may include business combinations, acquisitions involving other utility or non-utility businesses or properties, internal restructuring, disposition of certain assets, or some combination thereof. Furthermore, Southern Company may engage in new business ventures that arise from competitive and regulatory changes in the utility industry. Pursuit of any of the above strategies, or any combination thereof, may significantly affect the business operations and financial condition of Southern Company.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Environmental Matters**New Source Review Actions**

In November 1999, the Environmental Protection Agency (EPA) brought a civil action against certain Southern Company subsidiaries, including Alabama Power and Georgia Power, and alleged that these subsidiaries had violated the New Source Review (NSR) provisions of the Clean Air Act at five coal-fired generating facilities. Through subsequent amendments and other legal procedures, the EPA added Savannah Electric as a defendant to the original action. The EPA filed a separate action against Alabama Power after it was dismissed from the original action. As of the date of this report, the EPA alleges that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power, Georgia Power, and Savannah Electric. The civil actions request penalties and injunctive relief, including an order requiring the installation of the best available control technology at the affected units. The actions against Alabama Power, Georgia Power, and Savannah Electric have been stayed since the spring of 2001 during the appeal of a very similar NSR action against the Tennessee Valley Authority before the U.S. Court of Appeals for the Eleventh Circuit. The Eleventh Circuit appeal was decided on September 16, 2003, and on February 13, 2004, the EPA petitioned the U.S. Supreme Court to review the Eleventh Circuit's decision. The EPA also filed a motion to lift the stay in the action against Alabama Power. At this time, no party to the Georgia Power and Savannah Electric action, which was administratively closed two years ago, has asked the court to reopen that case. See Note 3 to the financial statements under "New Source Review Actions" for additional information.

In December 2002 and October 2003, the EPA issued final revisions to its NSR regulations under the Clean Air Act. The December 2002 revisions included changes to the regulatory exclusions and the methods of calculating emissions increases. The October 2003 regulations clarified the scope of the existing Routine Maintenance, Repair, and Replacement exclusion. A coalition of states and environmental organizations filed petitions for review of these revisions with the U.S. Court of Appeals for the District of Columbia Circuit. On December 24, 2003, the court of appeals granted a stay of the October 2003 revisions pending its review of the rules and ordered that its review be conducted on an expedited basis. In January 2004, the Bush Administration announced that it would continue to enforce the existing rules until the courts resolve legal challenges to the EPA's revised NSR regulations. In any event, the final regulations must be adopted by the states in the company's service area in order to apply to facilities in the Southern Company system. The effect of these final regulations and the related legal challenges cannot be determined at this time.

Southern Company believes that its retail operating companies complied with applicable laws and the EPA's regulations and interpretations in effect at the time the work in question took place. The Clean Air Act authorizes civil penalties of up to \$27,500 per day, per violation at each generating unit. Prior to January 30, 1997,

the penalty was \$25,000 per day. An adverse outcome in any one of these cases could require substantial capital expenditures that cannot be determined at this time and could possibly require payment of substantial penalties. This could affect future results of operations, cash flows, and possibly financial condition if such costs are not recovered through regulated rates.

Plant Wansley Environmental Litigation

On December 30, 2002, the Sierra Club, Physicians for Social Responsibility, Georgia ForestWatch, and one individual filed a civil suit in the U.S. District Court in Georgia against Georgia Power for alleged violations of the Clean Air Act at four of the units at Plant Wansley. The civil action requests injunctive and declaratory relief, civil penalties, a supplemental environmental project, and attorneys' fees. The Clean Air Act authorizes civil penalties of up to \$27,500 per day, per violation at each generating unit. The case is currently scheduled for trial during the summer of 2004. See Note 3 to the financial statements under "Plant Wansley Environmental Litigation" for additional information.

While the company believes that it has complied with applicable laws and regulations, an adverse outcome could require payment of substantial penalties. The final outcome of this matter cannot now be determined.

Environmental Statutes and Regulations

Southern Company's operations are subject to extensive regulation by state and federal environmental agencies under a variety of statutes and regulations governing environmental media, including air, water, and land resources. Compliance with these environmental requirements will involve significant costs—both capital and operating—a major portion of which is expected to be recovered through existing ratemaking provisions. Environmental costs that are known and estimable at this time are included in capital expenditures discussed under "Capital Requirements and Contractual Obligations." There is no assurance, however, that all such costs will, in fact, be recovered.

Compliance with the federal Clean Air Act and resulting regulations has been and will continue to be a significant focus for the company. The Title IV acid rain provisions of the Clean Air Act, for example, required significant reductions in sulfur dioxide and nitrogen oxide emissions. Title IV compliance was effective in 2000 and associated construction expenditures totaled approximately \$400 million. Some of these expenditures also assisted the company in complying with nitrogen oxide emission reduction requirements under Title I of the Clean Air Act, which were designed to address one-hour ozone nonattainment problems in Atlanta, Georgia and Birmingham, Alabama. The states of Alabama and Georgia adopted regulations that required additional nitrogen oxide emission reductions from May through September of each year at plants in and/or near those nonattainment areas. Seven generating plants in the Atlanta area and two plants in the Birmingham area are currently subject to those requirements, the most recent of which went into effect in 2003. Construction

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

expenditures for compliance with the nitrogen oxide emission reduction requirements are estimated to be approximately \$950 million, of which \$17 million remains to be spent.

On September 26, 2003, the EPA published a final rule, effective January 1, 2004, reclassifying the Atlanta area from a "serious" to a "severe" nonattainment area for the one-hour ozone air quality standard under Title I of the Clean Air Act. The attainment deadline is to be as expeditious as practicable but not later than November 15, 2005. If the Atlanta area fails to attain the one-hour ozone standard by the deadline, all major sources of nitrogen oxides and volatile organic compounds located in the nonattainment area, including Georgia Power's plants McDonough and Yates, could be subject to payment of annual emissions fees for nitrogen oxides emitted above 80 percent of the baseline period. The baseline period is expected to be the calendar year 2005. Based on average emissions at these units over the past three years, such fees could reach \$23 million annually. The final outcome of this matter will depend on the baseline period selected and the development, approval, and implementation of applicable regulations, including new regulations for the eight-hour ozone air quality standard.

In 2002, Gulf Power entered into an agreement with the state of Florida to install additional controls on certain units and to retire three older units at a plant near Pensacola to help ensure attainment of the ozone standard in the area. The conditions of the agreement will be fully implemented by 2005 at a cost of approximately \$133 million, of which \$100 million remains to be spent. Gulf Power's costs have been approved under its environmental cost recovery clause.

To help ozone nonattainment areas attain the one-hour ozone standard, the EPA issued regional nitrogen oxide reduction rules in 1998. Those rules required 21 states, including Alabama and Georgia, to reduce and cap nitrogen oxide emissions from power plants and other large industrial sources. Affected sources, including five of the company's coal-fired plants in Alabama, must comply with the reduction requirements by May 31, 2004. Additional construction expenditures for compliance with these rules are currently estimated at approximately \$380 million, of which \$330 million remains to be spent. As a result of litigation challenging the rule, the courts required the EPA to complete a separate rulemaking before the requirements can be applied in Georgia. The final EPA rules have not been issued in Georgia.

In July 1997, the EPA revised the national ambient air quality standards for ozone and particulate matter. These revisions made the standards significantly more stringent. In the subsequent litigation of these standards, the U.S. Supreme Court found the EPA's implementation program for the new eight-hour ozone standard unlawful and remanded it to the EPA for further rulemaking. During 2003, the EPA proposed implementation rules designed to address the court's concerns. The EPA plans to designate areas as attainment or nonattainment with the new eight-hour ozone standard in April 2004 and with the new fine particulate matter standard by the end of 2004. These designations will be

based on air quality data for 2001 through 2003. Several areas within Southern Company's service area are likely to be designated nonattainment under these standards. State implementation plans (SIPs), including new emission control regulations necessary to bring those areas into attainment, could be required as early as 2007. These SIPs could require reductions in sulfur dioxide emissions and could require further reductions in nitrogen oxide emissions from power plants. If so, reductions could be required sometime after 2007. The impact of any new standards will depend on the development and implementation of applicable regulations and cannot be determined at this time.

In January 2004, the EPA issued a proposed Interstate Air Quality Rule to address interstate transport of ozone and fine particles. This proposed rule would require additional year-round sulfur dioxide and nitrogen oxide emission reductions from power plants in the eastern United States in two phases—in 2010 and 2015. The EPA currently plans to finalize this rule by 2005. If finalized, the rule could modify or supplant other SIP requirements for attainment of the fine particulate matter standard and the eight-hour ozone standard. The impact of this rule on the company will depend upon the specific requirements of the final rule and cannot be determined at this time.

Further reductions in sulfur dioxide and nitrogen oxides could also be required under the EPA's Regional Haze rules. The Regional Haze rules require states to establish Best Available Retrofit Technology (BART) standards for certain sources that contribute to regional haze. The company has a number of plants that could be subject to these rules. The EPA's Regional Haze program calls for states to submit SIPs in 2007. The SIPs must contain emission reduction strategies for implementing BART and achieving progress toward the Clean Air Act's visibility improvement goal. In 2002, however, the U.S. Court of Appeals for the District of Columbia Circuit vacated and remanded the BART provisions of the federal Regional Haze rules to the EPA for further rulemaking. The EPA has entered into an agreement that requires proposed revised rules in April 2004 and final rules in 2005. Because new BART rules have not been developed and state visibility assessments for progress are only beginning, it is not possible to determine the effect of these rules on the company at this time.

The EPA's Compliance Assurance Monitoring (CAM) regulations under Title V of the Clean Air Act require that monitoring be performed to ensure compliance with emissions limitations on an ongoing basis. In 2004 and 2005, a number of the company's plants will likely become subject to CAM requirements for at least one pollutant, in most cases particulate matter. The company is in the process of developing CAM plans. Because the plans are still under development, the company cannot determine the costs associated with implementation of the CAM regulations. Actual ongoing monitoring costs are expensed as incurred and are not material for any year presented.

In January 2004, the EPA issued proposed rules regulating mercury emissions from electric utility boilers. The proposal solicits

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

comments on two possible approaches for the new regulations—a Maximum Achievable Control Technology approach and a cap-and-trade approach. Either approach would require significant reductions in mercury emissions from company facilities. The regulations are scheduled to be finalized by the end of 2004, and compliance could be required as early as 2007. Because the regulations have not been finalized, the impact on the company cannot be determined at this time.

Several major bills to amend the Clean Air Act to impose more stringent emissions limitations on power plants have been proposed by Congress. Three of these, the Bush Administration's Clear Skies Act, the Clean Power Act of 2003, and the Clean Air Planning Act of 2003, propose to further limit power plant emissions of sulfur dioxide, nitrogen oxides, and mercury. The latter two bills also propose to limit emissions of carbon dioxide. The cost impacts of such legislation would depend upon the specific requirements enacted and cannot be determined at this time.

Domestic efforts to limit greenhouse gas emissions have been spurred by international discussions surrounding the Framework Convention on Climate Change and specifically the Kyoto Protocol, which proposes international constraints on the emissions of greenhouse gases. The Bush Administration does not support U.S. ratification of the Kyoto Protocol or other mandatory carbon dioxide reduction legislation and has instead announced a new voluntary climate initiative, known as Climate VISION, which seeks an 18 percent reduction by 2012 in the rate of greenhouse gas emissions relative to the dollar value of the U.S. economy. Southern Company is involved in a voluntary electric utility industry sector climate change initiative in partnership with the government. The electric utility sector has pledged to reduce its greenhouse gas intensity 3 percent to 5 percent over the next decade and is in the process of developing a memorandum of understanding with the Department of Energy (DOE) to cover this voluntary program.

Southern Company must comply with other environmental laws and regulations that cover the handling and disposal of waste and releases of hazardous substances. Under these various laws and regulations, the subsidiaries could incur substantial costs to clean up properties. The subsidiaries conduct studies to determine the extent of any required cleanup and have recognized in their respective financial statements the costs to clean up known sites. Amounts for cleanup and ongoing monitoring costs were not material for any year presented. The subsidiaries may be liable for some or all required cleanup costs for additional sites that may require environmental remediation. See Note 3 to the financial statements under "Georgia Power Potentially Responsible Status" for additional information.

Under the Clean Water Act, the EPA has been developing new rules aimed at reducing impingement and entrainment of fish and fish larvae at power plants' cooling water intake structures. On February 16, 2004, the EPA finalized these rules. These rules will require biological studies and, perhaps, retrofits to some intake structures at existing power plants. The impact of these

new rules will depend on the results of studies and analyses performed as part of the rules' implementation.

The company is also planning to install cooling towers at some of its facilities to cool water prior to discharge under the Clean Water Act. Cooling towers for two Georgia Power plants near Atlanta are scheduled for completion in 2004 and 2008 at a total estimated cost of \$160 million, of which \$90 million remains to be spent. Also, Georgia Power is conducting a study of the aquatic environment at another facility to determine if additional controls are necessary.

In addition, under the Clean Water Act, the EPA and state environmental regulatory agencies are developing total maximum daily loads (TMDLs) for certain impaired waters. Establishment of maximum loads by the EPA or state agencies may result in lowering permit limits for various pollutants and a requirement to take additional measures to control non-point source pollution (e.g., storm water runoff) at facilities that discharge into waters for which TMDLs are established. Because the effect on Southern Company will depend on the actual TMDLs and permit limitations established by the implementing agency, it is not possible to determine the effect on the company at this time.

Several major pieces of environmental legislation are periodically considered for reauthorization or amendment by Congress. These include: the Clean Air Act; the Clean Water Act; the Comprehensive Environmental Response, Compensation, and Liability Act; the Resource Conservation and Recovery Act; the Toxic Substances Control Act; the Emergency Planning & Community Right-to-Know Act; and the Endangered Species Act.

Compliance with possible additional federal or state legislation or regulations related to global climate change, electromagnetic fields, or other environmental and health concerns could also significantly affect Southern Company. The impact of any new legislation, changes to existing legislation, or environmental regulations could affect many areas of Southern Company's operations. The full impact of any such changes cannot, however, be determined at this time.

FERC Matters

Transmission

In December 1999, the Federal Energy Regulatory Commission (FERC) issued its final rule (Order 2000) on Regional Transmission Organizations (RTOs). Order 2000 encouraged utilities owning transmission systems to form RTOs on a voluntary basis. Southern Company worked with a number of utilities in the Southeast to develop a for-profit RTO known as SeTrans. In 2002, the sponsors of SeTrans established a Stakeholder Advisory Committee to provide input into the development of the RTO from other sectors of the electric industry, as well as consumers. During the development of SeTrans, state regulatory authorities expressed concern over certain aspects of the FERC's policies regarding RTOs. In December 2003, the SeTrans sponsors announced that they would suspend work on SeTrans because

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

the regulated utility participants, including Southern Company, had determined that it was highly unlikely to obtain support of both federal and state regulatory authorities. Any impact of the FERC's rule on Southern Company and its subsidiaries will depend on the regulatory reaction to the suspension of SeTrans and future developments, which cannot now be determined.

In July 2002, the FERC issued a notice of proposed rulemaking regarding open access transmission service and standard electricity market design. The proposal, if adopted, would among other things: (1) require transmission assets of jurisdictional utilities to be operated by an independent entity; (2) establish a standard market design; (3) establish a single type of transmission service that applies to all customers; (4) assert jurisdiction over the transmission component of bundled retail service; (5) establish a generation reserve margin; (6) establish bid caps for day ahead and spot energy markets; and (7) revise the FERC policy on the pricing of transmission expansions. Comments on the proposal were submitted by many interested parties, including Southern Company, and the FERC has indicated that it has revised certain aspects of the proposal in response to public comments. Proposed energy legislation would prohibit the FERC from issuing the final rule before October 31, 2006, and from making any final rule effective before December 31, 2006. That legislation has been approved by the House of Representatives but remains pending before the Senate. Passage of the legislation now appears in doubt. It is uncertain whether in the absence of legislation the FERC will move forward with any part or all of the proposed rule. Any impact of this proposal on Southern Company and its subsidiaries will depend on the form in which the final rule may be ultimately adopted. However, Southern Company's financial statements could be adversely affected by changes in the transmission regulatory structure in its regional power market.

Market-Based Rate Authority

Southern Power currently has general authorization from the FERC to sell power to nonaffiliates at market-based prices. In addition, each of the retail operating companies has obtained FERC approval to sell power to nonaffiliates at market-based prices under specific contracts. Southern Power and the retail operating companies also have FERC authority to make short-term opportunity sales at market rates. Specific FERC approval must be obtained with respect to a market-based contract with an affiliate. In November 2001, the FERC modified the test it uses to consider utilities' applications to charge market-based rates and adopted a new test called the Supply Margin Assessment (SMA). The FERC applied the SMA to several utilities, including Southern Company, and found Southern Company and others to be "pivotal suppliers" in their service areas and ordered the implementation of several mitigation measures. Southern Company and others sought rehearing of the FERC order, and the FERC delayed the implementation of certain mitigation measures. Southern Company and others submitted comments to the FERC in 2002 regarding these issues. In December 2003, the FERC issued a staff paper

discussing alternatives and held a technical conference in January 2004. Southern Company anticipates that the FERC will address the requests for rehearing in the near future. Regardless of the outcome of the SMA proposal, the FERC retains the ability to modify or withdraw the authorization for any seller to sell at market-based rates, if it determines that the underlying conditions for having such authority are no longer applicable. In that event, Southern Power would be required to obtain FERC approval of rates based on cost of service, which may be lower than those in negotiated market-based rates. The final outcome of this matter will depend on the form in which the SMA test and mitigation measures' rules may be ultimately adopted and cannot be determined at this time.

Purchased Power Agreements (PPAs) by Georgia Power and Savannah Electric for Southern Power's Plant McIntosh capacity were certified by the Georgia Public Service Commission in December 2002 after a competitive bidding process. In April 2003, Southern Power applied for FERC approval of these PPAs. Interveners opposed the FERC's acceptance of the PPAs, alleging that the PPAs do not meet the applicable standards for market-based rates between affiliates. In July 2003, the FERC accepted the PPAs to become effective as scheduled on June 1, 2005, subject to refund, and ordered that hearings be held. For additional information, see Note 3 to the financial statements under "FERC Matters."

Income Tax Matters

Synthetic Fuel Tax Credits

As discussed in Note 3 to the financial statements under "Synthetic Fuel Tax Credits," Southern Company has investments in two entities that produce synthetic fuel and receive tax credits under Section 29 of the tax code. Both entities have received private letter rulings from the Internal Revenue Service (IRS) concluding that significant chemical change occurred based on the procedures and results submitted. From the inception of Southern Company's investment in these entities through December 31, 2003, Southern Company has recognized through income approximately \$274 million (net of approximately \$37 million reserved) in tax credits related to its share of the synthetic fuel production at these entities. However, if the IRS were to challenge these credits, there could be a significant tax liability due for tax credits previously taken, which could have a significant impact on earnings and cash flows.

Leveraged Lease Transactions

As discussed in Note 1 to the financial statements under "Leveraged Leases," Southern Company participates in four international leveraged lease transactions. Southern Company receives federal income tax deductions for rent, depreciation and amortization, as well as interest on related debt. The IRS has proposed to disallow the tax losses for one of the lease transactions, as discussed in Note 3 to the financial statements under "Leveraged Lease Transactions," resulting in additional taxes and interest of

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

approximately \$30 million. Southern Company accounted for this payment as a deposit and filed a refund claim that the IRS has proposed to disallow. If Southern Company is unsuccessful in defending its position, additional taxes and interest would be assessed that could have a material impact on earnings and cash flows. Although the IRS has not proposed any disallowances related to the three other lease transactions, subsequent audits may do so. The final outcome of these matters cannot now be determined.

Other Matters

In accordance with Financial Accounting Standards Board (FASB) Statement No. 87, *Employers' Accounting for Pensions*, Southern Company recorded non-cash pension income, before tax, of approximately \$99 million, \$117 million, and \$124 million in 2003, 2002, and 2001, respectively. Future pension income is dependent on several factors including trust earnings and changes to the plan. The decline in pension income is expected to continue and become an expense as early as 2006. Postretirement benefit costs for Southern Company were \$101 million, \$99 million, and \$96 million in 2003, 2002, and 2001, respectively, and are expected to continue to trend upward. A portion of pension income and postretirement benefit costs is capitalized based on construction-related labor charges. For the retail operating companies, pension income or expense and postretirement benefit costs are a component of the regulated rates and generally do not have a long-term effect on net income. For more information regarding pension and postretirement benefits, see Note 2 to the financial statements.

On December 8, 2003, President Bush signed into law the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Act). The Medicare Act introduces a prescription drug benefit for Medicare-eligible retirees starting in 2006, as well as a federal subsidy to plan sponsors like Southern Company that provide prescription drug benefits. In accordance with FASB Staff Position No. 106-1, Southern Company has elected to defer recognizing the effects of the Medicare Act for its postretirement plans under FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other than Pension* until authoritative guidance on accounting for the federal subsidy is issued or until a significant event occurs that would require remeasurement of the plans' assets and obligations. Southern Company anticipates that the benefits it pays after 2006 will be lower as a result of the Medicare Act; however, the retiree medical obligations and costs reported in Note 2 to the financial statements do not reflect these changes. The final accounting guidance could require changes to previously reported information.

Georgia Power is required to file a general retail rate case in July 2004. The outcome will have a significant impact on future earnings. See Note 3 to the financial statements under "Georgia Power Retail Rate Orders" for additional information.

On May 21, 2003, Mississippi Power and Southern Power entered into agreements with Dynegy that resolved and terminated in 2003 all outstanding matters related to capacity sales contracts

with subsidiaries of Dynegy. The termination payments from Dynegy resulted in a one-time gain to Southern Company of approximately \$88 million after tax—\$38 million for Mississippi Power and \$50 million for Southern Power. As a result of the Dynegy capacity contract terminations, Southern Power is completing limited construction activities on Plant Franklin Unit 3 to preserve the long-term viability of the project but has deferred final completion until the 2008-2011 period. The length of the deferral period will depend on forecasted capacity needs and other wholesale market opportunities. Southern Power is continuing to explore alternatives for its existing capacity. On December 5, 2003, Mississippi Power filed a request with the Mississippi Public Service Commission (MPSC) to include 266 megawatts of Plant Daniel units 3 and 4 generating capacity in jurisdictional cost of service. See Note 3 to the financial statements under "Uncontracted Generating Capacity" and "Mississippi Power Regulatory Filing" for additional information.

On July 14, 2003, Mirant filed for voluntary reorganization under Chapter 11 with the U.S. Bankruptcy Court. Southern Company has certain contingent liabilities associated with guarantees of contractual commitments made by Mirant's subsidiaries discussed in Note 7 to the financial statements under "Guarantees" and with various lawsuits related to Mirant discussed in Note 3 to the financial statements under "Mirant Related Matters." Also, Southern Company has joint and several liability with Mirant regarding the joint consolidated federal income tax return as discussed in Note 5 to the financial statements. If Southern Company is ultimately required to make any payments related to these potential obligations, Mirant's indemnification obligation to Southern Company would represent an unsecured pre-bankruptcy claim, subject to compromise pursuant to Mirant's final reorganization plan.

Nuclear security legislation was recently introduced and considered in Congress both as a free-standing bill in the Senate and as a part of comprehensive energy legislation in a House-Senate Conference Report. Neither of the proposals has been enacted. The Nuclear Regulatory Commission (NRC) also ordered additional security measures for licensees in 2003. Southern Company is in the process of implementation and must be in full compliance with these orders by October 29, 2004. The requirements of the latest orders will have an impact on Southern Company's nuclear power plants and result in increased operation and maintenance expenses as well as additional capital expenditures. The precise impact of the new requirements will depend upon the details of the implementation of the new requirements, which have not been finalized.

Southern Company is involved in various matters being litigated, regulatory matters, and significant tax related issues that could affect future earnings. See Note 3 to the financial statements for information regarding material issues.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

ACCOUNTING POLICIES**Application of Critical Accounting Policies and Estimates**

Southern Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States. Significant accounting policies are described in Note 1 to the financial statements. In the application of these policies, certain estimates are made that may have a material impact on Southern Company's results of operations and related disclosures. Different assumptions and measurements could produce estimates that are significantly different from those recorded in the financial statements. Senior management has discussed the development and selection of the critical accounting policies and estimates described below with the Audit Committee of Southern Company's Board of Directors.

Electric Utility Regulation

Southern Company's retail operating companies, which comprise approximately 85 percent of Southern Company's total earnings, are subject to retail regulation by their respective state public service commissions and wholesale regulation by the FERC. These regulatory agencies set the rates the retail operating companies are permitted to charge customers based on allowable costs. As a result, the retail operating companies apply FASB Statement No. 71, Accounting for the Effects of Certain Types of Regulation.

Through the ratemaking process, the regulators may require the inclusion of costs or revenues in periods different than when they would be recognized by a non-regulated company. This treatment may result in the deferral of expenses and the recording of related regulatory assets based on anticipated future recovery through rates or the deferral of gains or creation of liabilities and the recording of related regulatory liabilities. The application of Statement No. 71 has a further effect on the company's financial statements as a result of the estimates of allowable costs used in the ratemaking process. These estimates may differ from those actually incurred by the retail operating companies; therefore, the accounting estimates inherent in specific costs such as depreciation, nuclear decommissioning, and pension and post-retirement benefits have less of a direct impact on the company's results of operations than they would on a non-regulated company.

As reflected in Note 1 to the financial statements, significant regulatory assets and liabilities have been recorded. Management reviews the ultimate recoverability of these regulatory assets and liabilities based on applicable regulatory guidelines. However, adverse legislation and judicial or regulatory actions could materially impact the amounts of such regulatory assets and liabilities and could adversely impact the company's financial statements.

Contingent Obligations

Southern Company and its subsidiaries are subject to a number of federal and state laws and regulations, as well as other factors and conditions that potentially subject them to environmental, litigation, income tax, and other risks. See "Future Earnings Potential" and Note 3 to the financial statements for more informa-

tion regarding certain of these contingencies. Southern Company and its subsidiaries periodically evaluate their exposure to such risks and record reserves for those matters where a loss is considered probable and reasonably estimable in accordance with generally accepted accounting principles. The adequacy of reserves can be significantly affected by external events or conditions that can be unpredictable; thus, the ultimate outcome of such matters could materially affect Southern Company's financial statements or those of its subsidiaries. These events or conditions include the following:

- Changes in existing state or federal regulation by governmental authorities having jurisdiction over air quality, water quality, control of toxic substances, hazardous and solid wastes, and other environmental matters.
- Changes in existing income tax regulations or changes in IRS interpretations of existing regulations.
- Identification of additional sites that require environmental remediation or the filing of other complaints in which Southern Company or its subsidiaries may be asserted to be a potentially responsible party.
- Identification and evaluation of other potential lawsuits or complaints in which Southern Company or its subsidiaries may be named as a defendant.
- Resolution or progression of existing matters through the legislative process, the court systems, the IRS, or the EPA.

Plant Daniel Capacity

As discussed in Note 3 to the financial statements, Mississippi Power requested and received an interim accounting order from the MPSC on December 16, 2003. The order directed Mississippi Power to expense and record in 2003 a regulatory liability of \$60 million pending the conclusion of the MPSC's evaluation of Mississippi Power's request to include an additional 266 megawatts of Plant Daniel units 3 and 4 generating capacity in jurisdictional cost of service. The MPSC is not expected to complete its evaluation and issue a final order until the second quarter of 2004. Management believes that the interim accounting order represents a probable liability and that recognition of the expense in 2003 is appropriate. However, if the MPSC ultimately refuses Mississippi Power's request, the regulatory liability will be required to be reversed.

New Accounting Standards

Prior to January 2003, Southern Company accrued for the ultimate cost of retiring most long-lived assets over the life of the related asset through depreciation expense. FASB Statement No. 143, Accounting for Asset Retirement Obligations established new accounting and reporting standards for legal obligations associated with the ultimate cost of retiring long-lived assets. The present value of the ultimate costs for an asset's future retirement is recorded in the period in which the liability is incurred. The costs are capitalized as part of the related long-lived asset and depreciated over the asset's useful life. Additionally, non-regulated companies

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

are no longer permitted to continue accruing future retirement costs for long-lived assets that they do not have a legal obligation to retire. For more information regarding the impact of adopting this standard effective January 1, 2003, see Note 1 to the financial statements under "Asset Retirement Obligations and Other Costs of Removal."

FASB Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, which further amends and clarifies the accounting and reporting for derivative instruments, became effective generally for financial instruments entered into or modified after June 30, 2003. Current interpretations of Statement No. 149 indicate that certain electricity forward transactions subject to unplanned netting—including those typically referred to as "book outs"—may only qualify as cash flow hedges if an entity can demonstrate that physical delivery or receipt of power occurred. Southern Company's forward electricity contracts continue to be exempt from fair value accounting requirements or to qualify as cash flow hedges, with the related gains and losses deferred in other comprehensive income. The implementation of Statement No. 149 did not have a material effect on Southern Company's financial statements.

In July 2003, the Emerging Issues Task Force (EITF) of FASB issued EITF No. 03-11, which became effective on October 1, 2003. The standard addresses the reporting of realized gains and losses on derivative instruments and is being interpreted to require book outs to be recorded on a net basis in operating revenues. Adoption of this standard did not have a material impact on Southern Company's financial statements.

FASB Interpretation No. 46, Consolidation of Variable Interest Entities, which was originally issued in January 2003, requires the primary beneficiary of a variable interest entity to consolidate the related assets and liabilities. Southern Company's previous interest in a variable interest entity related to Mississippi Power's lease arrangement for certain facilities at Plant Daniel was restructured prior to the original effective date of July 1, 2003, and is no longer subject to Interpretation No. 46. See Note 7 to the financial statements under "Operating Leases" for additional information. In December 2003, the FASB revised Interpretation No. 46 and deferred the effective date until March 31, 2004, for interests held in variable interest entities other than special purpose entities.

Current analysis indicates that the trusts established by Southern Company and the retail operating companies to issue preferred securities are variable interest entities under Interpretation No. 46, and that Southern Company and the retail operating companies are not the primary beneficiaries of these trusts. If this conclusion is finalized, effective March 31, 2004, the trust assets and liabilities—including the preferred securities issued by the trusts—will be deconsolidated. The investments in the trusts and the loans from the trusts to Southern Company and the retail operating companies will be reflected as equity method investments and as long-term notes payable to affiliates, respectively, on the Consolidated Balance Sheets. Based on

December 31, 2003 values, this treatment would result in an increase of approximately \$59 million to both total assets and total liabilities. See Note 6 to the financial statements under "Mandatorily Redeemable Preferred Securities" for additional information.

Southern Company has also identified certain other significant variable interest investments. These include two entities that produce synthetic fuel and are further described in Note 3 to the financial statements under "Synthetic Fuel Tax Credits." Southern Company is not the primary beneficiary of these entities. Southern Company also holds an 85 percent limited partnership investment in an energy/telecom venture capital fund that is currently accounted for under the equity method. At December 31, 2003, this investment totaled \$17 million; the company has committed to a maximum investment of \$75 million. Southern Company is continuing to review its transactions in light of the revised Interpretation No. 46; however, adoption is not currently expected to have a material impact on Southern Company's financial statements.

In May 2003, the FASB issued Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, which requires classification of certain financial instruments within its scope, including shares that are mandatorily redeemable, as liabilities. Statement No. 150 was effective for financial instruments entered into or modified after May 31, 2003, and otherwise on July 1, 2003. In accordance with Statement No. 150, mandatorily redeemable preferred securities are reflected in the Consolidated Balance Sheets as liabilities. The adoption of Statement No. 150 had no impact on the Consolidated Statements of Income and Cash Flows.

FINANCIAL CONDITION AND LIQUIDITY

Overview

Southern Company's financial condition continues to be strong. At December 31, 2003, each of the retail operating companies was within its allowed range of return on equity. They operated at high levels of reliability while achieving industry-leading customer satisfaction levels and continuing to have retail prices below the national average. Also, earnings from the competitive generation business and other business activities made a significant contribution to the company's earnings goal of 5 percent average long-term growth.

At the close of 2003, the market value of Southern Company's common stock was \$30.25 per share, compared with book value of \$13.13 per share. The market-to-book value ratio was 230 percent at the end of 2003, compared with 233 percent at year-end 2002.

Gross property additions to utility plant were \$2.0 billion in 2003. The majority of funds needed for gross property additions since 2000 has been provided from operating activities. The Consolidated Statements of Cash Flows provide additional details.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Sources of Capital

Southern Company intends to meet its future capital needs through internal cash flow and externally through the issuance of debt, preferred securities, and equity. The amount and timing of additional equity capital to be raised in 2004—as well as in subsequent years—will be contingent on Southern Company's investment opportunities. The company does not currently anticipate any equity offerings in 2004. Equity capital can be provided from any combination of the company's stock plans, private placements, or public offerings.

The retail operating companies plan to obtain the funds required for construction and other purposes from sources similar to those used in the past, which were primarily from operating cash flows. However, the type and timing of any financings—if needed—will depend on market conditions and regulatory approval. In recent years, financings primarily have utilized unsecured debt and preferred securities.

Southern Power will use both external funds and equity capital from Southern Company to finance its construction program. External funds are expected to be obtained from the issuance of unsecured senior debt and commercial paper or through existing credit arrangements from banks.

Southern Company and each operating company obtain financing separately without credit support from any affiliate. Currently, Southern Company provides limited credit support to Southern Power. See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information. The Southern Company system does not maintain a centralized cash or money pool. Therefore, funds of each company are not commingled with funds of any other company. In accordance with the Public Utility Holding Company Act, most loans between affiliated companies must be approved in advance by the Securities and Exchange Commission (SEC).

Southern Company's current liabilities exceed current assets because of the continued use of short-term debt as a funding source to meet cash needs as well as scheduled maturities of long-term debt.

To meet short-term cash needs and contingencies, Southern Company has various internal and external sources of liquidity. At the beginning of 2004, Southern Company and its subsidiaries had approximately \$311 million of cash and cash equivalents and \$3.5 billion of unused credit arrangements with banks, as shown in the following table. In addition, Southern Company has substantial cash flow from operating activities and access to the capital markets, including commercial paper programs, to meet liquidity needs. Cash flows from operating activities were \$3.1 billion in 2003, \$2.8 billion in 2002, and \$2.4 billion in 2001.

At the beginning of 2004, bank credit arrangements are as follows:

(in millions)	Total	Unused	Expires	
			2004	2005 & Beyond
	\$3,496	\$3,476	\$2,806	\$670

Approximately \$2.25 billion of the credit facilities expiring in 2004 allow for the execution of term loans for an additional two-year period and \$265 million allow for the execution for one-year term loans. See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information.

Financing Activities

During 2003, Southern Company and its subsidiaries issued \$3.5 billion of long-term debt and \$125 million of preferred securities. In addition, Southern Company issued 18 million new shares of common stock through the company's stock plans and realized proceeds of \$470 million. The issuances were used to refund \$3.0 billion of long-term debt and \$480 million of mandatorily redeemable preferred securities and to provide \$575 million of permanent financing for Southern Power's new generating facilities. The remainder was used to reduce short-term debt, provide capital contributions to subsidiaries, and fund Southern Company's ongoing construction program.

Subsequent to December 31, 2003, the retail operating companies have issued \$850 million of securities to redeem \$400 million of long-term debt and mandatorily redeemable preferred securities and for other corporate purposes.

Off-Balance Sheet Financing Arrangements

In May 2001, Mississippi Power began the initial 10-year term of a lease agreement signed in 1999 for a combined cycle generating facility built at Plant Daniel. The facility cost approximately \$370 million. In 2003, the generating facility was acquired by Juniper Capital L.P. (Juniper), a limited partnership whose investors are unaffiliated with Mississippi Power. Simultaneously, Juniper entered into a restructured lease agreement with Mississippi Power. Juniper has also entered into leases with other parties unrelated to Mississippi Power. The assets leased by Mississippi Power comprise less than 50 percent of Juniper's assets. Mississippi Power is not required to consolidate the leased assets and related liabilities, and the lease with Juniper is considered an operating lease under FASB Statement No. 13. The lease also provides for a residual value guarantee—approximately 73 percent of the acquisition cost—by Mississippi Power that is due upon termination of the lease in the event that the company does not renew the lease or purchase the assets and that the fair market value is less than the unamortized cost of the assets. See Note 7 to the financial statements under "Operating Leases" for additional information regarding this lease.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Credit Rating Risk

Southern Company and its subsidiaries do not have any credit agreements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. There are contracts that could require collateral—but not accelerated payment—in the event of a credit rating change to below investment grade. These contracts are primarily for physical electricity purchases and sales, fixed-price physical gas purchases, and agreements covering interest rate swaps. At December 31, 2003, the maximum potential collateral requirements under the electricity purchase and sale contracts were approximately \$415 million. Generally, collateral may be provided for by a Southern Company guaranty, a letter of credit, or cash. At December 31, 2003, there were no material collateral requirements for the gas purchase contracts or other financial instrument agreements.

Market Price Risk

Southern Company is exposed to market risks, including changes in interest rates and certain energy-related commodity prices. To manage the volatility attributable to these exposures, the company nets the exposures to take advantage of natural offsets and enters into various derivative transactions for the remaining exposures pursuant to the company's policies in areas such as counterparty exposure and hedging practices. Company policy is that derivatives are to be used primarily for hedging purposes. Derivative positions are monitored using techniques that include market valuation and sensitivity analysis.

To mitigate exposure to interest rates, the company has entered into interest rate swaps that have been designated as hedges. The weighted average interest rate on \$1.0 billion variable long-term debt that has not been hedged at December 31, 2003 was 1.5 percent. If Southern Company sustained a 100 basis point change in interest rates for all unhedged variable rate long-term debt, the change would affect annualized interest expense by approximately \$10 million at December 31, 2003. The company is not aware of any facts or circumstances that would significantly affect such exposures in the near term. For further information, see notes 1 and 6 to the financial statements under "Financial Instruments."

Due to cost-based rate regulations, the retail operating companies have limited exposure to market volatility in interest rates, commodity fuel prices, and prices of electricity. In addition, Southern Power's exposure to market volatility in commodity fuel prices and prices of electricity is limited because its long-term sales contracts shift substantially all fuel cost responsibility to the purchaser. To mitigate residual risks relative to movements in electricity prices, the retail operating companies and Southern Power enter into fixed price contracts for the purchase and sale of electricity through the wholesale electricity market and, to a lesser extent, into similar contracts for gas purchases. The retail operating companies have implemented fuel-hedging programs at the instruction of their respective public service commissions. Southern Company GAS also has gas-hedging programs to substantially mitigate its exposure to price volatility for its gas purchases.

The fair value of changes in energy-related derivative contracts and year-end valuations were as follows at December 31:

<i>(in millions)</i>	Changes in Fair Value	
	2003	2002
Contracts beginning of year	\$47.3	\$ 1.3
Contracts realized or settled	(73.2)	(32.2)
New contracts at inception	—	—
Changes in valuation techniques	—	—
Current period changes	41.7	78.2
Contracts end of year	\$15.8	\$47.3

<i>(in millions)</i>	Source of 2003 Year-End Valuation Prices		
	Total Fair Value	Maturity	
		2004	2005-2006
Actively quoted	\$15.8	\$16.9	\$(1.1)
External sources	—	—	—
Models and other methods	—	—	—
Contracts end of year	\$15.8	\$16.9	\$(1.1)

Unrealized gains and losses from mark to market adjustments on derivative contracts related to the retail operating companies' fuel hedging programs are recorded as regulatory assets and liabilities. Realized gains and losses from these programs are included in fuel expense and are recovered through the retail operating companies' fuel cost recovery clauses. In addition, unrealized gains and losses on energy-related derivatives used by Southern Power and Southern Company GAS to hedge anticipated purchases and sales are deferred in other comprehensive income. Gains and losses on derivative contracts that are not designated as hedges are recognized in the income statement as incurred. At December 31, 2003, the fair value of derivative energy contracts was reflected in the financial statements as follows:

<i>(in millions)</i>	Amounts
Regulatory liabilities, net	\$14.9
Other comprehensive income	1.5
Net income	(0.6)
Total fair value	\$15.8

Unrealized pre-tax gains (losses) of \$(2) million, \$(5) million, and \$9 million were recognized in income in 2003, 2002, and 2001, respectively. Southern Company is exposed to market price risk in the event of nonperformance by counterparties to the derivative energy contracts. Southern Company's policy is to enter into agreements with counterparties that have investment grade credit ratings by Moody's and Standard & Poor's or with counterparties who have posted collateral to cover potential credit exposure. Therefore, Southern Company does not anticipate market risk exposure from nonperformance by the counterparties. For additional information, see notes 1 and 6 to the financial statements under "Financial Instruments."

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Capital Requirements and Contractual Obligations

The construction program of Southern Company is currently estimated to be \$2.2 billion for 2004, \$2.2 billion for 2005, and \$2.6 billion for 2006. Environmental expenditures included in these amounts are \$349 million, \$403 million, and \$646 million for 2004, 2005, and 2006, respectively. Actual construction costs may vary from this estimate because of changes in such factors as: business conditions; environmental regulations; nuclear plant regulations; FERC rules and transmission regulations; load projections; the cost and efficiency of construction labor, equipment, and materials; and the cost of capital. In addition, there can be no assurance that costs related to capital expenditures will be fully recovered.

Southern Company has approximately 1,200 megawatts of new generating capacity scheduled to be placed in service by 2005. The additional new capacity will be dedicated to the wholesale market and owned by Southern Power. In addition, capital improvements, including those needed to meet the environmental standards previously discussed for the retail operating companies' generation, transmission, and distribution facilities are ongoing.

As a result of requirements by the NRC, Alabama Power and Georgia Power have established external trust funds for nuclear decommissioning costs. For additional information, see Note 1 to the financial statements under "Nuclear Decommissioning." Also, as discussed in Note 1 to the financial statements under "Revenues and Fuel Costs," in 1993 the DOE implemented a special assessment over a 15-year period on utilities with nuclear plants to be used for the decontamination and decommissioning of its nuclear fuel enrichment facilities.

In addition, as discussed in Note 2 to the financial statements, Southern Company provides postretirement benefits to substantially all employees and funds trusts to the extent required by the retail operating companies' respective regulatory commissions.

Other funding requirements related to obligations associated with scheduled maturities of long-term debt and preferred securities, as well as the related interest and distributions, preferred stock dividends, leases, and other purchase commitments are as follows. See notes 1, 6, and 7 to the financial statements for additional information.

<i>(in millions)</i>	2004	2005-2006	2007-2008	After 2008	Total
Long-term debt and preferred securities^(a)—					
Principal	\$ 741	\$ 1,842	\$1,448	\$ 8,795	\$12,826
Interest and distributions	614	1,116	968	8,468	11,166
Preferred stock dividends ^(b)	22	44	44	—	110
Operating leases	128	208	143	262	741
Purchase commitments^(c)—					
Capital ^(d)	2,121	4,799	—	—	6,920
Coal and nuclear fuel	2,409	3,198	1,675	182	7,464
Natural gas ^(e)	814	1,029	619	2,763	5,225
Purchased power	139	355	367	918	1,779
Long-term service agreements	54	98	169	988	1,309
Trusts—					
Nuclear decommissioning	29	58	58	317	462
Postretirement benefits ^(f)	15	75	—	—	90
DOE	8	16	—	—	24
Total	\$7,094	\$12,838	\$5,491	\$22,693	\$48,116

(a) All amounts are reflected based on final maturity dates. Southern Company and the subsidiaries will continue to retire higher-cost securities and replace these obligations with lower-cost capital if market conditions permit. Variable rate interest obligations are estimated based on rates as of January 1, 2004, as reflected in the Consolidated Statements of Capitalization.

(b) Preferred stock does not mature; therefore, amounts are provided for the next five years only.

(c) Southern Company generally does not enter into non-cancelable commitments for other operation and maintenance expenditures. Total other operation and maintenance expenses for the last three years were \$3.2 billion, \$3.1 billion, and \$2.8 billion, respectively.

(d) Southern Company forecasts capital expenditures over a three-year period. Amounts represent current estimates of total expenditures excluding those amounts related to contractual purchase commitments for uranium and nuclear fuel conversion, enrichment, and fabrication services. At December 31, 2003, significant purchase commitments were outstanding in connection with the construction program.

(e) Natural gas purchase commitments are based on various indices at the time of delivery. Amounts reflected have been estimated based on the New York Mercantile future prices at December 31, 2003.

(f) Southern Company forecasts postretirement trust contributions over a three-year period. No contributions related to Southern Company's pension trust are currently expected during this period. See Note 2 to the financial statements for additional information related to the pension plans.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Cautionary Statement Regarding Forward-Looking Information

Southern Company's 2003 Annual Report includes forward-looking statements in addition to historical information. Forward-looking information includes, among other things, statements concerning the strategic goals for Southern Company's wholesale business, estimated construction and other expenditures, and Southern Company's projections for energy sales and its goals for future generating capacity, dividend payout ratio, earnings per share, and earnings growth. In some cases, forward-looking statements can be identified by terminology such as "may," "will," "could," "should," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential," or "continue" or the negative of these terms or other comparable terminology. Southern Company cautions that there are various important factors that could cause actual results to differ materially from those indicated in the forward-looking statements; accordingly, there can be no assurance that such indicated results will be realized. These factors include:

- the impact of recent and future federal and state regulatory change, including legislative and regulatory initiatives regarding deregulation and restructuring of the electric utility industry and also changes in environmental, tax, and other laws and regulations to which Southern Company and its subsidiaries are subject, as well as changes in application of existing laws and regulations;
- current and future litigation, regulatory investigations, proceedings, or inquiries, including the pending EPA civil actions against certain Southern Company subsidiaries and current IRS audits;
- the effects, extent, and timing of the entry of additional competition in the markets in which Southern Company's subsidiaries operate;
- the impact of fluctuations in commodity prices, interest rates, and customer demand;
- available sources and costs of fuels;
- ability to control costs;
- investment performance of Southern Company's employee benefit plans;
- advances in technology;
- state and federal rate regulations and pending and future rate cases and negotiations;
- effects of and changes in political, legal, and economic conditions and developments in the United States, including the current soft economy;
- the performance of projects undertaken by the non-traditional business and the success of efforts to invest in and develop new opportunities;
- internal restructuring or other restructuring options that may be pursued;
- potential business strategies, including acquisitions or dispositions of assets or businesses, which cannot be assured to be completed or beneficial to Southern Company or its subsidiaries;
- the ability of counterparties of Southern Company and its subsidiaries to make payments as and when due;
- the ability to obtain new short- and long-term contracts with neighboring utilities;
- the direct or indirect effects on Southern Company's business resulting from the terrorist incidents on September 11, 2001, or any similar incidents or responses to such incidents;
- financial market conditions and the results of financing efforts, including Southern Company's and its subsidiaries' credit ratings;
- the ability of Southern Company and its subsidiaries to obtain additional generating capacity at competitive prices;
- weather and other natural phenomena;
- the direct or indirect effects on Southern Company's business resulting from the August 2003 power outage in the Northeast, or any similar incidents;
- the effect of accounting pronouncements issued periodically by standard-setting bodies; and
- other factors discussed elsewhere herein and in other reports (including the Form 10-K) filed from time to time with the SEC.

CONSOLIDATED STATEMENTS OF INCOME *FOR THE YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001*

<i>(in millions)</i>	2003	2002	2001
Operating Revenues:			
Retail sales	\$ 8,875	\$ 8,728	\$ 8,440
Sales for resale	1,358	1,168	1,174
Other electric revenues	514	310	292
Other revenues	504	343	249
Total operating revenues	11,251	10,549	10,155
Operating Expenses:			
Fuel	3,031	2,767	2,577
Purchased power	473	449	718
Other operations	2,302	2,118	1,899
Maintenance	937	965	862
Depreciation and amortization	1,027	1,047	1,173
Taxes other than income taxes	586	557	535
Total operating expenses	8,356	7,903	7,764
Operating Income	2,895	2,646	2,391
Other Income and (Expense):			
Allowance for equity funds used during construction	25	22	22
Interest income	36	22	27
Equity in losses of unconsolidated subsidiaries	(184)	(154)	(52)
Leveraged lease income	66	58	59
Interest expense, net of amounts capitalized	(527)	(492)	(557)
Distributions on mandatorily redeemable preferred securities	(151)	(175)	(169)
Preferred dividends of subsidiaries	(21)	(17)	(18)
Other income <i>(expense)</i> , net	(53)	(64)	(26)
Total other income and <i>(expense)</i>	(809)	(800)	(714)
Earnings From Continuing Operations Before Income Taxes	2,086	1,846	1,677
Income taxes	612	528	558
Earnings From Continuing Operations Before Cumulative Effect of Accounting Change	1,474	1,318	1,119
Cumulative effect of accounting change—less income taxes of less than \$1	—	—	1
Earnings From Continuing Operations	1,474	1,318	1,120
Earnings from discontinued operations, net of income taxes of \$93	—	—	142
Consolidated Net Income	\$ 1,474	\$ 1,318	\$ 1,262
Common Stock Data:			
Earnings per share from continuing operations—			
Basic	\$2.03	\$1.86	\$1.62
Diluted	2.02	1.85	1.61
Earnings per share including discontinued operations—			
Basic	\$2.03	\$1.86	\$1.83
Diluted	2.02	1.85	1.82
Average number of shares of common stock outstanding— <i>(in millions)</i>			
Basic	727	708	689
Diluted	732	714	694
Cash dividends paid per share of common stock	\$1.385	\$1.355	\$1.34

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001

<i>(in millions)</i>	2003	2002	2001
Operating Activities:			
Consolidated net income	\$ 1,474	\$ 1,318	\$ 1,262
Adjustments to reconcile consolidated net income to net cash provided from operating activities –			
Less earnings from discontinued operations	–	–	142
Depreciation and amortization	1,163	1,136	1,358
Deferred income taxes and investment tax credits	451	166	(22)
Plant Daniel capacity	60	–	–
Deferred capacity revenues	(15)	(8)	–
Equity in losses of unconsolidated subsidiaries	94	91	52
Leveraged lease income	(66)	(58)	(59)
Pension, postretirement, and other employee benefits	(19)	(65)	(101)
Tax benefit of stock options	30	23	–
Settlement of interest rate hedges	(116)	(16)	–
Other, net	11	38	(98)
Changes in certain current assets and liabilities –			
Receivables, net	7	(121)	327
Fossil fuel stock	(17)	105	(199)
Materials and supplies	(12)	8	(43)
Other current assets	27	(58)	(12)
Accounts payable	(68)	108	(51)
Accrued taxes	19	(49)	91
Other current liabilities	43	235	21
Net cash provided from operating activities of continuing operations	3,066	2,853	2,384
Investing Activities:			
Gross property additions	(2,002)	(2,717)	(2,617)
Investment in unconsolidated subsidiaries	(72)	(90)	(50)
Cost of removal net of salvage	(80)	(109)	(99)
Other	(40)	(52)	30
Net cash used for investing activities of continuing operations	(2,194)	(2,968)	(2,736)
Financing Activities:			
Increase (decrease) in notes payable, net	(366)	(968)	223
Proceeds –			
Long-term debt	3,494	2,914	1,999
Mandatorily redeemable preferred securities	–	1,315	30
Preferred stock	125	–	–
Common stock	470	428	395
Redemptions –			
Long-term debt	(3,009)	(1,370)	(1,185)
Mandatorily redeemable preferred securities	(480)	(1,171)	–
Preferred stock	–	(70)	–
Payment of common stock dividends	(1,004)	(958)	(922)
Other	(64)	(86)	(33)
Net cash provided from (used for) financing activities of continuing operations	(834)	34	507
Net Change in Cash and Cash Equivalents	38	(81)	155
Cash and Cash Equivalents at Beginning of Year	273	354	199
Cash and Cash Equivalents at End of Year	\$ 311	\$ 273	\$ 354

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEETS AT DECEMBER 31, 2003 AND 2002

Assets (in millions)	2003	2002
Current Assets:		
Cash and cash equivalents	\$ 311	\$ 273
Receivables –		
Customer accounts receivable	696	712
Unbilled revenues	275	277
Under recovered regulatory clause revenues	188	174
Other accounts and notes receivable	339	370
Accumulated provision for uncollectible accounts	(30)	(26)
Fossil fuel stock, at average cost	316	299
Vacation pay	97	98
Materials and supplies, at average cost	571	560
Prepaid expenses	124	126
Other	30	66
Total current assets	2,917	2,929
Property, Plant, and Equipment:		
In service	40,340	37,486
Less accumulated depreciation	14,304	13,505
	26,036	23,981
Nuclear fuel, at amortized cost	223	223
Construction work in progress	1,275	2,362
Total property, plant, and equipment	27,534	26,566
Other Property and Investments:		
Nuclear decommissioning trusts, at fair value	808	639
Leveraged leases	838	791
Other	238	243
Total other property and investments	1,884	1,673
Deferred Charges and Other Assets:		
Deferred charges related to income taxes	874	898
Prepaid pension costs	911	786
Unamortized debt issuance expense	152	145
Unamortized loss on reacquired debt	326	313
Other	447	411
Total deferred charges and other assets	2,710	2,553
Total Assets	\$35,045	\$33,721

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED BALANCE SHEETS (CONTINUED) AT DECEMBER 31, 2003 AND 2002

Liabilities and Stockholders' Equity <i>(in millions)</i>	2003	2002
Current Liabilities:		
Securities due within one year	\$ 741	\$ 1,679
Notes payable	568	972
Accounts payable	700	797
Customer deposits	189	169
Accrued taxes—		
Income taxes	154	81
Other	249	219
Accrued interest	187	158
Accrued vacation pay	129	130
Accrued compensation	437	440
Other	263	342
Total current liabilities	3,617	4,987
Long-term debt <i>(See accompanying statements)</i>	10,164	8,714
Mandatorily redeemable preferred securities <i>(See accompanying statements)</i>	1,900	2,380
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	4,586	4,203
Deferred credits related to income taxes	409	450
Accumulated deferred investment tax credits	579	607
Employee benefit obligations	765	661
Asset retirement obligations	845	—
Other cost of removal obligations	1,269	1,944
Miscellaneous regulatory liabilities	576	464
Other	264	303
Total deferred credits and other liabilities	9,293	8,632
Total liabilities	24,974	24,713
Cumulative preferred stock of subsidiaries <i>(See accompanying statements)</i>	423	298
Common stockholders' equity <i>(See accompanying statements)</i>	9,648	8,710
Total Liabilities and Stockholders' Equity	\$35,045	\$33,721
Commitments and Contingent Matters <i>(See notes)</i>		

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF CAPITALIZATION AT DECEMBER 31, 2003 AND 2002

<i>(in millions)</i>		2003	2002	2003	2002
Long-Term Debt of Subsidiaries:					
First mortgage bonds—					
<u>Maturity</u>	<u>Interest Rates</u>				
2006	6.50% to 6.90%	\$ 45	\$ 45		
2023 through 2026	6.88% to 7.45%	60	93		
Total first mortgage bonds		105	138		
Long-term senior notes and debt—					
<u>Maturity</u>	<u>Interest Rates</u>				
2003	4.69% to 7.85%	—	847		
2004	4.88% to 7.25%	580	579		
2005	5.49% to 7.25%	379	383		
2006	1.60% to 6.20%	679	154		
2007	4.88% to 7.13%	905	905		
2008	3.13% to 6.55%	458	208		
2009 through 2048	4.35% to 8.12%	4,284	3,227		
Adjustable rates:					
2003	1.52% to 1.53%	—	517		
2004	1.27% to 2.44%	89	512		
2005	1.25% to 2.44%	492	211		
2006	1.37%	195	—		
2007	2.57% to 4.13%	72	50		
Total long-term senior notes and debt		8,133	7,593		
Other long-term debt—					
Pollution control revenue bonds—					
<u>Maturity</u>	<u>Interest Rates</u>				
Collateralized:					
2006	5.25%	12	12		
2007	5.80%	—	1		
2023 through 2026	5.50% to 5.80%	24	86		
Variable rates (at 1/1/04)					
2015 through 2017	1.27% to 1.33%	90	90		
Non-collateralized:					
2012 through 2034	1.20% to 5.45%	850	789		
Variable rates (at 1/1/04)					
2011 through 2038	1.05% to 1.45%	1,565	1,564		
Total other long-term debt		2,541	2,542		
Capitalized lease obligations		107	106		
Unamortized debt (discount), net		(21)	(26)		
Total long-term debt (annual interest requirement – \$485 million)		10,865	10,353		
Less amount due within one year		701	1,639		
Long-term debt excluding amounts due within one year		10,164	8,714	45.9%	43.4%

CONSOLIDATED STATEMENTS OF CAPITALIZATION (continued) AT DECEMBER 31, 2003 AND 2002

<i>(in millions)</i>	2003	2002	2003	2002
Mandatorily Redeemable Preferred Securities:				
Maturity				
	Interest Rates			
\$25 liquidation value—2028 through 2042	6.85% to 7.63%	944	1,380	
\$1,000 liquidation value—2027 through 2042	4.75% to 8.19%	996	1,040	
Total mandatorily redeemable preferred securities				
(annual distribution requirement—\$182 million)	1,940	2,420		
Less amounts due within one year	40	40		
Total mandatorily redeemable preferred securities				
excluding amounts due within one year	1,900	2,380	8.6	11.8
Cumulative Preferred Stock of Subsidiaries:				
\$100 par or stated value—4.20% to 7.00%	98	98		
\$25 par or stated value—5.20% to 5.83%	200	200		
\$100,000 stated value—4.95%	125	—		
Total cumulative preferred stock of subsidiaries				
(annual dividend requirement—\$22 million)	423	298	1.9	1.5
Common Stockholders' Equity:				
Common stock, par value \$5 per share —				
Authorized—1 billion shares				
Issued—2003: 735 million shares				
—2002: 717 million shares				
Treasury—2003: 0.2 million shares				
—2002: 0.1 million shares				
Par value	3,675	3,583		
Paid-in capital	747	338		
Treasury, at cost	(4)	(3)		
Retained earnings	5,343	4,874		
Accumulated other comprehensive income (loss)	(113)	(82)		
Total common stockholders' equity	9,648	8,710	43.6	43.3
Total Capitalization	\$22,135	\$20,102	100.0%	100.0%

The accompanying notes are an integral part of these financial statements.

CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS' EQUITY FOR THE YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001

(in millions)	Common Stock			Retained Earnings	Accumulated Other Comprehensive Income (Loss) From		Total
	Par Value	Paid-In Capital	Treasury		Continuing Operations	Discontinued Operations	
Balance at December 31, 2000	\$3,503	\$ 3,153	\$(545)	\$ 4,672	\$ –	\$ (93)	\$10,690
Net income	–	–	–	1,262	–	–	1,262
Other comprehensive income (loss)	–	–	–	–	7	(315)	(308)
Stock issued	–	–	488	(93)	–	–	395
Mirant spin off distribution	–	(3,168)	–	(391)	–	408	(3,151)
Cash dividends	–	–	–	(922)	–	–	(922)
Other	–	29	–	(11)	–	–	18
Balance at December 31, 2001	3,503	14	(57)	4,517	7	–	7,984
Net income	–	–	–	1,318	–	–	1,318
Other comprehensive income (loss)	–	–	–	–	(89)	–	(89)
Stock issued	80	322	55	(6)	–	–	451
Cash dividends	–	–	–	(958)	–	–	(958)
Other	–	2	(1)	3	–	–	4
Balance at December 31, 2002	3,583	338	(3)	4,874	(82)	–	8,710
Net income	–	–	–	1,474	–	–	1,474
Other comprehensive income (loss)	–	–	–	–	(31)	–	(31)
Stock issued	92	408	–	–	–	–	500
Cash dividends	–	–	–	(1,004)	–	–	(1,004)
Other	–	1	(1)	(1)	–	–	(1)
Balance at December 31, 2003	\$3,675	\$ 747	\$ (4)	\$ 5,343	\$(113)	\$ –	\$ 9,648

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2003, 2002, AND 2001

(in millions)	2003	2002	2001
Consolidated Net Income	\$1,474	\$1,318	\$1,262
Other comprehensive income (loss)–continuing operations:			
Change in additional minimum pension liability, net of tax of \$(11) and \$(18), respectively	(17)	(31)	–
Changes in fair value of qualifying hedges, net of tax of \$(2), \$(45), and \$4, respectively	(17)	(60)	7
Less: Reclassification adjustment for amounts included in net income, net of tax of \$1 and \$1, respectively	3	2	–
Total other comprehensive income (loss)–continuing operations	(31)	(89)	7
Other comprehensive income (loss)–discontinued operations:			
Cumulative effect of accounting change for qualifying hedges, net of tax of \$(121)	–	–	(249)
Changes in fair value of qualifying hedges, net of tax of \$(51)	–	–	(104)
Less: Reclassification adjustment for amounts included in net income, net of tax of \$29	–	–	60
Foreign currency translation adjustments, net of tax of \$(22)	–	–	(22)
Total other comprehensive income (loss)–discontinued operations	–	–	(315)
Consolidated Comprehensive Income	\$1,443	\$1,229	\$ 954

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

NOTE ONE

Summary of Significant Accounting Policies**General**

Southern Company is the parent company of five retail operating companies, Southern Power Company (Southern Power), Southern Company Services (SCS), Southern Communications Services (Southern LINC), Southern Company Gas (Southern Company GAS), Southern Company Holdings (Southern Holdings), Southern Nuclear Operating Company (Southern Nuclear), Southern Telecom, and other direct and indirect subsidiaries. The retail operating companies—Alabama Power, Georgia Power, Gulf Power, Mississippi Power, and Savannah Electric—provide electric service in four Southeastern states. Southern Power constructs, owns, and manages Southern Company's competitive generation assets and sells electricity at market-based rates in the wholesale market. Contracts among the retail operating companies and Southern Power—related to jointly owned generating facilities, interconnecting transmission lines, or the exchange of electric power—are regulated by the Federal Energy Regulatory Commission (FERC) and/or the Securities and Exchange Commission (SEC). SCS—the system service company—provides, at cost, specialized services to Southern Company and subsidiary companies. Southern LINC provides digital wireless communications services to the retail operating companies and also markets these services to the public within the Southeast. Southern Telecom provides fiber cable services within the Southeast. Southern Company GAS is a competitive retail natural gas marketer serving customers in Georgia. Southern Holdings is an intermediate holding subsidiary for Southern Company's investments in synthetic fuels and leveraged leases and an energy services business. Southern Nuclear operates and provides services to Southern Company's nuclear power plants.

On April 2, 2001, the spin off of Mirant Corporation (Mirant) was completed. As a result of the spin off, Southern Company's financial statements and related information reflect Mirant as discontinued operations. For additional information regarding Mirant, see Note 3 under "Mirant Related Matters."

The financial statements reflect Southern Company's investments in the subsidiaries on a consolidated basis. The equity method is used for subsidiaries in which the company has significant influence but does not control. All material intercompany items have been eliminated in consolidation. Certain prior years' data presented in the consolidated financial statements have been reclassified to conform with the current year presentation.

Southern Company is registered as a holding company under the Public Utility Holding Company Act of 1935 (PUHCA). Both the company and its subsidiaries are subject to the regulatory

provisions of the PUHCA. In addition, the retail operating companies and Southern Power are subject to regulation by the FERC, and the retail operating companies are also subject to regulation by their respective state public service commissions. The companies follow accounting principles generally accepted in the United States and comply with the accounting policies and practices prescribed by their respective commissions. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates, and the actual results may differ from those estimates.

Related Party Transactions

Alabama Power and Georgia Power purchase synthetic fuel from Alabama Fuel Products, LLC (AFP), an entity in which Southern Holdings holds a 30 percent ownership interest. Total fuel purchases for 2003 and 2002 were \$301 million and \$211 million, respectively. The financial statements reflect the elimination of 30 percent of these amounts. Another subsidiary of Southern Holdings provides services to AFP. In connection with these services, revenues of approximately \$74 million and \$44 million in 2003 and 2002, respectively, have been billed to an entity that is a subsidiary of AFP's majority owner.

Revenues and Fuel Costs

Capacity revenues are generally recognized on a levelized basis over the appropriate contract periods. Energy and other revenues are recognized as services are provided. Unbilled revenues are accrued at the end of each fiscal period. Fuel costs are expensed as the fuel is used. Electric rates for the retail operating companies include provisions to adjust billings for fluctuations in fuel costs, fuel hedging, the energy component of purchased power costs, and certain other costs. Revenues are adjusted for differences between recoverable fuel costs and amounts actually recovered in current regulated rates.

Southern Company has a diversified base of customers. No single customer or industry comprises 10 percent or more of revenues. For all periods presented, uncollectible accounts continued to average less than 1 percent of revenues.

Fuel expense includes the amortization of the cost of nuclear fuel and a charge, based on nuclear generation, for the permanent disposal of spent nuclear fuel. Total charges for nuclear fuel included in fuel expense amounted to \$138 million in 2003, \$134 million in 2002, and \$133 million in 2001. Alabama Power and Georgia Power have contracts with the U.S. Department of Energy (DOE) that provide for the permanent disposal of spent nuclear fuel. The DOE failed to begin disposing of spent nuclear fuel in January 1998 as required by the contracts, and the companies are pursuing legal

NOTES (CONTINUED)

remedies against the government for breach of contract. Sufficient pool storage capacity for spent fuel is available at Plant Farley to maintain full-core discharge capability until the refueling outages scheduled for 2006 and 2008 for units 1 and 2, respectively.

Sufficient pool storage capacity for spent fuel is available at Plant Vogtle to maintain full-core discharge capability for both units into 2015. At Plant Hatch, an on-site dry storage facility became operational in 2000 and can be expanded to accommodate spent fuel through the life of the plant. Construction of an on-site dry storage facility at Plant Farley is in progress and scheduled for operation in 2005. Construction of an on-site dry storage facility at Plant Vogtle will begin in sufficient time to maintain pool full-core discharge capability.

Also, the Energy Policy Act of 1992 required the establishment of a Uranium Enrichment Decontamination and Decommissioning Fund, which is funded in part by a special assessment on utilities with nuclear plants. This assessment is being paid over a 15-year period, which began in 1993. This fund will be used by the DOE for the decontamination and decommissioning of its nuclear fuel enrichment facilities. The law provides that utilities will recover these payments in the same manner as any other fuel expense. Alabama Power and Georgia Power—based on its ownership interest—estimate their respective remaining liability at December 31, 2003, under this law to be approximately \$13 million and \$10 million.

Income Taxes

Southern Company uses the liability method of accounting for deferred income taxes and provides deferred income taxes for all significant income tax temporary differences. Investment tax credits utilized are deferred and amortized to income over the average lives of the related property.

Regulatory Assets and Liabilities

The retail operating companies are subject to the provisions of Financial Accounting Standards Board (FASB) Statement No. 71, Accounting for the Effects of Certain Types of Regulation. Regulatory assets represent probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be credited to customers through the

ratemaking process. Regulatory assets and (liabilities) reflected in the Consolidated Balance Sheets at December 31 relate to:

<i>(in millions)</i>	2003	2002	Note
Deferred income tax charges	\$ 874	\$ 898	(a)
Loss on reacquired debt	326	313	(b)
DOE assessments	26	33	(c)
Vacation pay	97	98	(d)
Building lease	54	54	(f)
Generating plant outage costs	35	38	(f)
Other assets	75	73	(f)
Asset retirement obligations	(138)	—	(a)
Other cost of removal obligations	(1,269)	(1,944)	(a)
Deferred income tax credits	(409)	(450)	(a)
Accelerated cost recovery	(115)	(229)	(e)
Plant Daniel capacity	(60)	—	(g)
Storm damage reserves	(53)	(38)	(f)
Fuel-hedging liabilities	(13)	(38)	(c)
Environmental remediation reserves	(41)	(42)	(f)
Deferred purchased power	(92)	(63)	(f)
Other liabilities	(13)	(12)	(f)
Total	\$ (716)	\$(1,309)	

Note: The recovery and amortization periods for these regulatory assets and (liabilities) are as follows:

- (a) Asset retirement and removal liabilities are recorded, deferred income tax assets are recovered, and deferred tax liabilities are amortized over the related property lives, which may range up to 50 years. Asset retirement and removal liabilities will be settled and trued up following completion of the related activities.*
- (b) Recovered over either the remaining life of the original issue or, if refinanced, over the life of the new issue, which may range up to 50 years.*
- (c) Assessments for the decontamination and decommissioning of the DOE's nuclear fuel enrichment facilities are recorded annually from 1993 through 2008. Fuel-hedging assets and liabilities are recorded over the life of the underlying hedged purchase contracts, which generally do not exceed two years. Upon final settlement, actual costs incurred are recovered through the fuel cost recovery clauses.*
- (d) Recorded as earned by employees and recovered as paid, generally within one year.*
- (e) Amortized over three-year period ending in 2004.*
- (f) Recorded and recovered or amortized as approved by the appropriate state public service commissions.*
- (g) See Note 3 under "Mississippi Power Regulatory Filing."*

NOTES (CONTINUED)

In the event that a portion of an operating company's operations is no longer subject to the provisions of FASB Statement No. 71, the company would be required to write off related regulatory assets and liabilities that are not specifically recoverable through regulated rates. In addition, the operating company would be required to determine if any impairment to other assets exists, including plant, and write down the assets, if impaired, to their fair value. All regulatory assets and liabilities are to be reflected in rates.

Depreciation and Amortization

Depreciation of the original cost of plant in service is provided primarily by using composite straight-line rates, which approximated 3.1 percent in 2003, 3.2 percent in 2002, and 3.4 percent in 2001. When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its original cost— together with the cost of removal, less salvage— is charged to accumulated depreciation. Minor items of property included in the original cost of the plant are retired when the related property unit is retired.

Under previous rate orders, Georgia Power recorded accelerated depreciation and amortization amounting to \$91 million in 2001. Effective January 2002, Georgia Power discontinued recording accelerated depreciation and amortization in accordance with a new retail rate order. Also, Georgia Power was ordered to amortize \$333 million—the cumulative balance previously expensed— equally over three years as a credit to depreciation and amortization expense beginning January 2002. Also, effective January 2002, Georgia Power was ordered by the Georgia Public Service Commission (GPSC) to recognize new certified purchased power costs in rates evenly over the three years covered by the current retail rate order. As a result of this regulatory adjustment, Georgia Power recorded in depreciation and amortization expense \$14 million and \$63 million in 2003 and 2002, respectively. Georgia Power will record a credit to amortization expense of \$77 million in 2004. See Note 3 under “Georgia Power Retail Rate Orders” for additional information.

Asset Retirement Obligations And Other Costs of Removal

In accordance with regulatory requirements, prior to January 2003, Southern Company followed the industry practice of accruing for the ultimate cost of retiring most long-lived assets over the life of the related asset as part of the annual depreciation expense provision. In accordance with SEC requirements, such amounts are reflected on the Consolidated Balance Sheet as regulatory liabilities. Effective January 1, 2003, Southern Company adopted FASB Statement No. 143, Accounting for Asset Retirement Obligations. Statement No. 143 establishes new accounting and reporting standards for legal obligations associated with the ultimate costs of retiring long-lived assets. The present value of the ultimate costs for an asset's future retirement must be recorded in the period in which the liability is incurred. The costs must be capitalized as part of the related long-lived asset and depreciated over the asset's useful life. Additionally, Statement No. 143 does not permit the continued accrual of future retirement costs for long-lived assets that the

company does not have a legal obligation to retire. However, the retail operating companies have received guidance regarding accounting for the financial statement impacts of Statement No. 143 from their respective state public service commissions and will continue to recognize the accumulated removal costs for other obligations as a regulatory liability. Therefore, the retail operating companies had no cumulative effect to net income resulting from the adoption of Statement No. 143.

The liability recognized to retire long-lived assets primarily relates to Southern Company's nuclear facilities, which include Alabama Power's Plant Farley and Georgia Power's ownership interests in plants Hatch and Vogtle. The fair value of assets legally restricted for settling retirement obligations related to nuclear facilities as of December 31, 2003 was \$808 million. In addition, the retail operating companies have retirement obligations related to various landfill sites, ash ponds, and underground storage tanks. The retail operating companies have also identified retirement obligations related to certain transmission and distribution facilities. However, liabilities for the removal of these transmission and distribution assets have not been recorded because no reasonable estimate can be made regarding the timing of the obligations. The retail operating companies will continue to recognize in the income statement allowed removal costs in accordance with each company's respective regulatory treatment. Any difference between costs recognized under Statement No. 143 and those reflected in rates are recognized as either a regulatory asset or liability and are reflected in the Consolidated Balance Sheets. See “Nuclear Decommissioning” for further information on amounts included in rates.

Details of the asset retirement obligations included in the Consolidated Balance Sheets are as follows:

<i>(in millions)</i>	2003
Balance beginning of year	\$ —
Liabilities incurred	780
Liabilities settled	—
Accretion	55
Cash flow revisions	10
Balance end of year	\$845

If Statement No. 143 had been adopted on January 1, 2002, the pro-forma asset retirement obligations would have been \$729 million.

Nuclear Decommissioning

The Nuclear Regulatory Commission (NRC) requires all licensees operating commercial nuclear power reactors to establish a plan for providing, with reasonable assurance, funds for decommissioning. Alabama Power and Georgia Power have external trust funds to comply with the NRC's regulations. The funds set aside for decommissioning are managed and invested in accordance with applicable requirements of various regulatory bodies, including the NRC, the FERC, and state public utility commissions, as well as

NOTES (CONTINUED)

the Internal Revenue Service (IRS). Funds are invested in a tax efficient manner in a diversified mix of equity and fixed income securities. Equity securities typically range from 50 to 75 percent of the funds and fixed income securities from 25 to 50 percent. Amounts previously recorded in internal reserves are being transferred into the external trust funds over periods approved by the respective state public service commissions. The NRC's minimum external funding requirements are based on a generic estimate of the cost to decommission the radioactive portions of a nuclear unit based on the size and type of reactor. Alabama Power and Georgia Power have filed plans with the NRC to ensure that—over time—the deposits and earnings of the external trust funds will provide the minimum funding amounts prescribed by the NRC.

Site study cost is the estimate to decommission a specific facility as of the site study year. The estimated costs of decommissioning based on the most current study as of December 31, 2003, for Alabama Power's Plant Farley and Georgia Power's ownership interests in plants Hatch and Vogtle were as follows:

	Plant Farley	Plant Hatch	Plant Vogtle
Site study year	2003	2003	2003
Decommissioning periods:			
Beginning year	2017	2034	2027
Completion year	2046	2065	2048

(in millions)

Site study costs:			
Radiated structures	\$892	\$497	\$452
Non-radiated structures	63	49	58
Total	\$955	\$546	\$510

Significant assumptions:

Inflation rate	4.5%	3.1%	3.1%
Trust earning rate	7.0	6.6	6.6

The decommissioning cost estimates are based on prompt dismantlement and removal of the plant from service. The actual decommissioning costs may vary from the above estimates because of changes in the assumed date of decommissioning, changes in NRC requirements, or changes in the assumptions used in making these estimates.

Annual provisions for nuclear decommissioning are based on an annuity method as approved by the respective state public service commissions. The amount expended in 2003 and fund balances were as follows:

(in millions)	Plant Farley	Plant Hatch	Plant Vogtle
Amount expended in 2003	\$18	\$7	\$2
Accumulated provisions:			
External trust funds, at fair value	\$385	\$269	\$154
Internal reserves	31	7	4
Total	\$416	\$276	\$158

Alabama Power's decommissioning costs for ratemaking are based on the site study. Effective January 1, 2002, the GPSC decreased Georgia Power's annual decommissioning costs for ratemaking to \$9 million. This amount is based on the NRC generic estimate to decommission the radioactive portion of the facilities as of 2000. The estimates are \$383 million and \$282 million for plants Hatch and Vogtle, respectively. Assumptions used to determine these costs for ratemaking were an inflation rate of 4.5 percent and 4.7 percent for Alabama Power and Georgia Power, respectively, and a trust earning rate of 7.0 percent and 6.5 percent for Alabama Power and Georgia Power, respectively. Alabama Power and Georgia Power expect their respective state public service commissions to periodically review and adjust, if necessary, the amounts collected in rates for the anticipated cost of decommissioning.

In January 2002, Georgia Power received NRC approval for a 20-year extension of the license at Plant Hatch, which permits the operation of units 1 and 2 until 2034 and 2038, respectively. The site study decommissioning costs reflect the license extension; however, the updated costs will not be reflected in rates until the GPSC issues a new rate order, which is not expected until December 2004. Alabama Power filed an application with the NRC in September 2003 to extend the operating license for Plant Farley for an additional 20 years.

Allowance for Funds Used During Construction (AFUDC) and Interest Capitalized

In accordance with regulatory treatment, the retail operating companies record AFUDC. AFUDC represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new regulated facilities. While cash is not realized currently from such allowance, it increases the revenue requirement over the service life of the plant through a higher rate base and higher depreciation expense. Interest related to the construction of new facilities not included in the retail operating companies' regulated rates is capitalized in accordance with standard interest capitalization requirements.

Cash payments for interest totaled \$603 million, \$544 million, and \$624 million in 2003, 2002, and 2001, respectively, net of amounts capitalized of \$49 million, \$59 million, and \$57 million, respectively.

Property, Plant, and Equipment

Property, plant, and equipment is stated at original cost less regulatory disallowances and impairments. Original cost includes: materials; labor; minor items of property; appropriate administrative and general costs; payroll-related costs such as taxes, pensions, and other benefits; and the interest capitalized and/or cost of funds used during construction.

The cost of replacements of property—exclusive of minor items of property—is capitalized. The cost of maintenance, repairs, and replacement of minor items of property is charged to maintenance expense as incurred or performed with the exception of nuclear refueling costs, which are recorded in accordance with specific

NOTES (CONTINUED)

public service commission orders. Alabama Power accrues estimated refueling costs in advance of the unit's next refueling outage. Georgia Power defers and amortizes refueling costs over the unit's operating cycle before the next refueling. The refueling cycles for Alabama Power and Georgia Power range from 18 to 24 months for each unit. In accordance with retail accounting orders, both Georgia Power and Savannah Electric will defer the costs of certain significant inspection costs for the combustion turbines at Plant McIntosh and amortize such costs over 10 years, which approximates the expected maintenance cycle.

Impairment of Long-Lived Assets and Intangibles

Southern Company evaluates long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. The determination of whether an impairment has occurred is based on either a specific regulatory disallowance or an estimate of undiscounted future cash flows attributable to the assets, as compared with the carrying value of the assets. If an impairment has occurred, the amount of the impairment recognized is determined by either the amount of regulatory disallowance or by estimating the fair value of the assets and recording a loss if the carrying value is greater than the fair value. For assets identified as held for sale, the carrying value is compared to the estimated fair value less the cost to sell in order to determine if an impairment provision is required. Until the assets are disposed of, their estimated fair value is re-evaluated when circumstances or events change.

Leveraged Leases

Southern Company has several leveraged lease agreements—ranging up to 45 years—that relate to international and domestic energy generation, distribution, and transportation assets. Southern Company receives federal income tax deductions for rent or depreciation and amortization, as well as interest on long-term debt related to these investments.

Southern Company's net investment in leveraged leases consists of the following at December 31:

<i>(in millions)</i>	2003	2002
Net rentals receivable	\$1,512	\$1,531
Unearned income	(674)	(740)
Investment in leveraged leases	838	791
Deferred taxes arising from leveraged leases	(351)	(260)
Net investment in leveraged leases	\$ 487	\$ 531

A summary of the components of income from leveraged leases is as follows:

<i>(in millions)</i>	2003	2002	2001
Pretax leveraged lease income	\$66	\$58	\$59
Income tax expense	23	21	21
Net leveraged lease income	\$43	\$37	\$38

Cash and Cash Equivalents

For purposes of the consolidated financial statements, temporary cash investments are considered cash equivalents. Temporary cash investments are securities with original maturities of 90 days or less.

Materials and Supplies

Generally, materials and supplies include the average costs of transmission, distribution, and generating plant materials. Materials are charged to inventory when purchased and then expensed or capitalized to plant, as appropriate, when installed.

Stock Options

Southern Company accounts for its stock-based compensation plans in accordance with Accounting Principles Board Opinion No. 25. Accordingly, no compensation expense has been recognized because the exercise price of all options granted equaled the fair-market value on the date of grant.

Financial Instruments

Southern Company uses derivative financial instruments to limit exposure to fluctuations in interest rates, the prices of certain fuel purchases, and electricity purchases and sales. All derivative financial instruments are recognized as either assets or liabilities and are measured at fair value. Substantially all of Southern Company's bulk energy purchases and sales contracts that meet the definition of a derivative are exempt from fair value accounting requirements and are accounted for under the accrual method. Other derivative contracts qualify as cash flow hedges of anticipated transactions. This results in the deferral of related gains and losses in other comprehensive income or regulatory assets or liabilities as appropriate until the hedged transactions occur. Any ineffectiveness is recognized currently in net income. Other derivative contracts are marked to market through current period income and are recorded on a net basis in the Consolidated Statements of Income.

Southern Company is exposed to losses related to financial instruments in the event of counterparties' nonperformance. The company has established controls to determine and monitor the creditworthiness of counterparties in order to mitigate the company's exposure to counterparty credit risk.

The other Southern Company financial instruments for which the carrying amount does not equal fair value at December 31 were as follows:

<i>(in millions)</i>	Carrying Amount	Fair Value
Long-term debt:		
At December 31, 2003	\$10,759	\$10,971
At December 31, 2002	10,226	10,510
Preferred securities:		
At December 31, 2003	1,940	2,059
At December 31, 2002	2,428	2,498

The fair values were based on either closing market price or closing price of comparable instruments.

NOTES (CONTINUED)

Comprehensive Income

The objective of comprehensive income is to report a measure of all changes in common stock equity of an enterprise that result from transactions and other economic events of the period other than transactions with owners. Comprehensive income consists of net income and changes in the fair value of qualifying cash flow hedges and changes in additional minimum pension liability, less income taxes and reclassifications for amounts included in net income. Comprehensive income from discontinued operations also includes foreign currency translation adjustments, net of income taxes.

NOTE TWO**Retirement Benefits**

Southern Company has a defined benefit, trustee, pension plan covering substantially all employees. The plan is funded in accordance with Employee Retirement Income Security Act (ERISA) requirements. No contributions to the plan are expected for the year ending December 31, 2004. Southern Company also provides certain non-qualified benefit plans for a selected group of management and highly compensated employees. Benefits under these non-qualified plans are funded on a cash basis. In addition, Southern Company provides certain medical care and life insurance benefits for retired employees. The retail operating companies fund related trusts to the extent required by their respective regulatory commissions. For the year ended December 31, 2004, postretirement benefit contributions are expected to total approximately \$15 million.

The measurement date for plan assets and obligations is September 30 for each year. In 2002, Southern Company adopted several plan changes that had the effect of increasing benefits to both current and future retirees.

Pension Plans

The accumulated benefit obligation for the pension plans was \$4.2 billion in 2003 and \$3.6 billion in 2002. Changes during the year in the projected benefit obligations, accumulated benefit obligations, and fair value of plan assets were as follows:

<i>(in millions)</i>	Projected Benefit Obligations	
	2003	2002
Balance at beginning of year	\$4,094	\$3,760
Service cost	115	109
Interest cost	261	277
Benefits paid	(197)	(184)
Plan amendments	11	88
Actuarial (gain) loss	289	44
Balance at end of year	\$4,573	\$4,094

<i>(in millions)</i>	Plan Assets	
	2003	2002
Balance at beginning of year	\$4,600	\$5,109
Actual return on plan assets	735	(343)
Benefits paid	(176)	(166)
Balance at end of year	\$5,159	\$4,600

Pension plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the IRS revenue code. The company's investment policy covers a diversified mix of assets, including equity and fixed income securities, real estate, and private equity, as described in the table below. Derivative instruments are used primarily as hedging tools but may also be used to gain efficient exposure to the various asset classes. The company primarily minimizes the risk of large losses through diversification but also monitors and manages other aspects of risk.

	Plan Assets		
	Target	2003	2002
Domestic equity	37%	37%	35%
International equity	20	20	18
Global fixed income	26	24	25
Real estate	10	11	12
Private equity	7	8	10
Total	100%	100%	100%

The accrued pension costs recognized in the Consolidated Balance Sheets were as follows:

<i>(in millions)</i>	2003	2002
Funded status	\$586	\$ 506
Unrecognized transition amount	(26)	(39)
Unrecognized prior service cost	314	334
Unrecognized net (gain) loss	(70)	(115)
Prepaid pension asset, net	804	686
Portion included in benefit obligations	107	100
Total prepaid assets recognized in the Consolidated Balance Sheets	\$911	\$ 786

In 2003 and 2002, amounts recognized in the Consolidated Balance Sheets for accumulated other comprehensive income and intangible assets to record the minimum pension liability related to the non-qualified plans were \$77 million and \$49 million and \$42 million and \$35 million, respectively.

NOTES (CONTINUED)

Components of the pension plans' net periodic cost were as follows:

<i>(in millions)</i>	2003	2002	2001
Service cost	\$ 115	\$ 109	\$ 104
Interest cost	261	277	260
Expected return on plan assets	(450)	(449)	(423)
Recognized net gain	(42)	(65)	(73)
Net amortization	17	11	8
Net pension cost (income)	\$ (99)	\$(117)	\$(124)

Postretirement Benefits

Changes during the year in the accumulated benefit obligations and in the fair value of plan assets were as follows:

<i>(in millions)</i>	2003	2002
		Accumulated Benefit Obligations
Balance at beginning of year	\$1,461	\$1,239
Service cost	25	21
Interest cost	93	91
Benefits paid	(66)	(62)
Actuarial (gain) loss	142	172
Balance at end of year	\$1,655	\$1,461

<i>(in millions)</i>	2003	2002
		Plan Assets
Balance at beginning of year	\$417	\$425
Actual return on plan assets	70	(34)
Employer contributions	101	88
Benefits paid	(66)	(62)
Balance at end of year	\$522	\$417

Postretirement benefits plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the IRS revenue code. The company's investment policy covers a diversified mix of assets, including equity and fixed income securities, real estate, and private equity, as described in the table below. Derivative instruments are used primarily as hedging tools but may also be used to gain efficient exposure to the various asset classes. The company primarily minimizes the risk of large losses through diversification but also monitors and manages other aspects of risk.

	Plan Assets		
	Target	2003	2002
Domestic equity	43%	44%	38%
International equity	17	18	16
Global fixed income	33	31	37
Real estate	4	4	5
Private equity	3	3	4
Total	100%	100%	100%

The accrued postretirement costs recognized in the Consolidated Balance Sheets were as follows:

<i>(in millions)</i>	2003	2002
Funded status	\$ (1,133)	\$(1,043)
Unrecognized transition obligation	144	159
Unrecognized prior service cost	211	225
Unrecognized net loss (gain)	357	239
Fourth quarter contributions	19	51
Accrued liability recognized in the Consolidated Balance Sheets	\$ (402)	\$ (369)

Components of the postretirement plans' net periodic cost were as follows:

<i>(in millions)</i>	2003	2002	2001
Service cost	\$ 25	\$ 21	\$ 22
Interest cost	93	91	88
Expected return on plan assets	(47)	(42)	(40)
Net amortization	30	29	26
Net postretirement cost	\$101	\$ 99	\$ 96

The weighted average rates assumed in the actuarial calculations used to determine both the benefit obligations and the net periodic costs for the pension and postretirement benefit plans were as follows:

	2003	2002	2001
Discount	6.00%	6.50%	7.50%
Annual salary increase	3.75	4.00	5.00
Long-term return on plan assets	8.50	8.50	8.50

The company determined the long-term rate of return based on historical asset class returns and current market conditions, taking into account the diversification benefits of investing in multiple asset classes.

An additional assumption used in measuring the accumulated postretirement benefit obligation was a weighted average medical care cost trend rate of 8.25 percent for 2003, decreasing gradually to 5.25 percent through the year 2010 and remaining at that level thereafter. An annual increase or decrease in the assumed medical care cost trend rate of 1 percent would affect the accumulated benefit obligation and the service and interest cost components at December 31, 2003, as follows:

<i>(in millions)</i>	1 Percent Increase	1 Percent Decrease
Benefit obligation	\$140	\$124
Service and interest costs	10	8

NOTES (CONTINUED)

Employee Savings Plan

Southern Company also sponsors a 401(k) defined contribution plan covering substantially all employees. The company provides a 75 percent matching contribution up to 6 percent of an employee's base salary. Total matching contributions made to the plan for the years 2003, 2002, and 2001 were \$55 million, \$53 million, and \$51 million, respectively.

NOTE THREE**Contingencies and Regulatory Matters****General Litigation Matters**

Southern Company is subject to certain claims and legal actions arising in the ordinary course of business. In addition, Southern Company's business activities are subject to extensive governmental regulation related to public health and the environment. Litigation over environmental issues and claims of various types, including property damage, personal injury, and citizen enforcement of environmental requirements, has increased generally throughout the United States. In particular, personal injury claims for damages caused by alleged exposure to hazardous materials have become more frequent. The ultimate outcome of such litigation against Southern Company and its subsidiaries cannot be predicted at this time; however, management does not anticipate that the liabilities, if any, arising from such current proceedings would have a material adverse effect on Southern Company's financial statements.

Mirant Related Matters**Mirant Spin Off**

In April 2000, Southern Company announced an initial public offering of up to 19.9 percent of Mirant and its intention to spin off the remaining ownership of Mirant to Southern Company stockholders. On October 2, 2000, Mirant completed its initial public offering of 66.7 million shares. On April 2, 2001, the tax-free distribution of Mirant shares was completed at a ratio of approximately 0.4 for every share of Southern Company common stock held at record date.

Potential Mirant Restatement

In November 2002, Mirant first announced that it had identified accounting errors in previously issued financial statements. Mirant has restated and reduced its net income for 2001 by \$159 million. Mirant has stated that the specific quarters in 2001 to which the overstatement apply have not been determined. If any adjustments are necessary prior to April 2, 2001, before Southern Company's spin off of Mirant, then Southern Company's earnings from discontinued operations for such periods would be affected. The impact of any such adjustments cannot be determined until Mirant's 2001 revised quarterly financial statements are filed and would not affect Southern Company's 2002 or any future financial statements.

Mirant Bankruptcy

On July 14, 2003, Mirant filed for voluntary reorganization under Chapter 11 with the U.S. Bankruptcy Court. Southern Company has certain contingent liabilities associated with guarantees of contractual commitments made by Mirant's subsidiaries discussed in Note 7 under "Guarantees" and with various lawsuits related to Mirant discussed later in this note. Also, Southern Company has joint and several liability with Mirant regarding the joint consolidated federal income tax return as discussed in Note 5. Under the terms of the separation agreement, Mirant agreed to indemnify Southern Company for costs associated with these guarantees, lawsuits, and additional IRS assessments. The impact of Mirant's bankruptcy filing on Mirant's indemnity obligations, if any, cannot now be determined. If Southern Company is ultimately required to make any payments related to these potentially material obligations, Mirant's indemnification obligation to Southern Company would represent an unsecured pre-bankruptcy claim, subject to compromise pursuant to Mirant's final reorganization plan.

The Bankruptcy Code automatically stays all litigation as to Mirant. A motion filed with the bankruptcy court requesting an extension of this automatic stay to all other non-debtor defendants, including Southern Company and the named current and/or former Southern Company officers, was granted in November 2003. Although the Mirant securities litigation is stayed until further order from the bankruptcy court, Mirant is authorized to agree with parties in pending actions to allow discovery or other matters to proceed without violating the stay. Mirant and plaintiffs' counsel in the Mirant securities litigation have agreed that document discovery may proceed. On October 23, 2003, the bankruptcy court entered an order authorizing Southern Company's insurance companies to pay related defense costs.

On February 20, 2004, the Official Committee of Unsecured Creditors of Mirant informed Southern Company of its intent to examine Southern Company in accordance with federal bankruptcy rules to determine whether there is a legitimate basis to bring claims against Southern Company in connection with Mirant's initial public offering, Southern Company's spinoff of Mirant, and the related separation agreements.

The final outcome of these matters cannot now be determined.

California Electricity Markets Investigation

Southern Company received a subpoena in November 2002 to provide information to a federal grand jury in the Northern District of California. The subpoena covered a number of broad areas, including specific information regarding electricity production and sales activities in California. Mirant participated in energy marketing and trading in California during the period relevant to the subpoena. Southern Company has produced documents in response to the subpoena and has fully cooperated in the investigation.

NOTES (CONTINUED)

Mirant Securities Litigation

In November 2002, Southern Company, certain former and current senior officers of Southern Company, and 12 underwriters of Mirant's initial public offering were added as defendants in a putative class action lawsuit that several Mirant shareholders originally filed against Mirant and certain Mirant officers in May 2002. The original lawsuit was based on allegations related to alleged improper energy trading and marketing activities involving the California energy market. Several other similar lawsuits filed subsequently were consolidated into this litigation in the U.S. District Court for the Northern District of Georgia. The amended complaint is based on allegations related to alleged improper energy trading and marketing activities involving the California energy market, alleged false statements and omissions in Mirant's prospectus for its initial public offering and in subsequent public statements by Mirant, and accounting-related issues previously disclosed by Mirant. The lawsuit purports to include persons who acquired Mirant securities between September 26, 2000, and September 5, 2002.

On July 14, 2003, the court dismissed all claims based on Mirant's alleged improper energy trading and marketing activities involving the California energy market. The remaining claims are based on alleged false statements and omissions in Mirant's prospectus for its initial public offering and accounting-related issues previously disclosed by Mirant. Such claims do not allege any improper trading and marketing activity, accounting errors, or material misstatements or omissions on the part of Southern Company, but rather seek to impose liability on Southern Company based on allegations that Southern Company was a "control person" as to Mirant prior to the spin off date. Southern Company filed an answer to the consolidated amended class action complaint on September 3, 2003. Plaintiffs have also filed a motion for class certification.

Under certain circumstances, Southern Company will be obligated under its Bylaws to indemnify the four current and/or former Southern Company officers who served as directors of Mirant at the time of its initial public offering through the date of the spin off and are also named as defendants in this lawsuit. Except for limited document discovery, litigation has been stayed until further order from the bankruptcy court. The final outcome of these matters cannot now be determined.

Mirant ERISA Litigation

In April 2003, a retired employee of Mirant filed a complaint in the U.S. District Court for the Northern District of Georgia alleging violations of ERISA and naming as defendants Mirant, Southern Company, several current and former directors and officers of Mirant and/or Southern Company, and "Unknown Fiduciary Defendants 1-100." In June 2003, a substantially similar complaint was filed. Neither complaint contained any specific allegations of wrongdoing with respect to Southern Company. On September 2, 2003, the court consolidated all pending and future ERISA actions arising out of the same facts, and the plaintiffs filed

a consolidated amended ERISA complaint on September 23, 2003. The plaintiffs sought to represent a class of persons who were participants in or beneficiaries of certain Mirant employee benefit plans between September 27, 2000, and July 22, 2003. The consolidated amended complaint named as defendants Mirant, certain Mirant benefit committees, Southern Company, and several of Mirant's current and former officers, directors, and employees. The consolidated amended complaint alleged that the defendants breached their fiduciary duties and violated ERISA by failing to investigate whether Mirant stock was a prudent investment for the plans, by continuing and promoting Mirant stock as an investment alternative for participants in the plans, and by failing to disclose information about Mirant's financial condition and about its improper activities in the California energy markets.

On February 19, 2004, plaintiffs dismissed Southern Company from this action without prejudice. The plaintiffs are not barred from naming Southern Company in some future lawsuit, but management believes the possibility of having to pay damages in any such lawsuit is remote.

Mobile Energy Services' Petition for Bankruptcy

Mobile Energy Services Holdings (MESH) is the owner and operator of a facility that generates electricity, produces steam, and processes black liquor as part of a pulp and paper complex in Mobile, Alabama. In January 1999, MESH filed a petition for Chapter 11 bankruptcy with the U.S. Bankruptcy Court. In 2001, MESH filed an amended plan of reorganization, which the U.S. Bankruptcy Court confirmed in September 2003. The plan became effective in late 2003 and Southern Company's equity interest in MESH—which had been written off entirely prior to 2001—was extinguished. Southern Company will continue to have contingent liabilities to the pulp and paper complex owners associated with a guarantee of certain potential environmental obligations and with a potential obligation to fund a maintenance reserve account that expires in 2019 and 2021, respectively. The combined maximum contingent liabilities were \$19 million at December 31, 2003. MESH and Mirant have each separately agreed to indemnify Southern Company for any amounts required to be paid under such obligations. The final outcome of these matters cannot now be determined.

Georgia Power Potentially Responsible Party Status

Georgia Power has been designated as a potentially responsible party at sites governed by the Georgia Hazardous Site Response Act and/or by the federal Comprehensive Environmental Response, Compensation, and Liability Act. Georgia Power has recognized \$34 million in cumulative expenses through December 31, 2003, for the assessment and anticipated cleanup of sites on the Georgia Hazardous Sites Inventory. In addition, in 1995 the Environmental Protection Agency (EPA) designated Georgia Power and four other unrelated entities as potentially responsible parties at a site in Brunswick, Georgia, that is listed on the federal National Priorities List. Georgia Power has contributed to the removal and remedial

NOTES (CONTINUED)

investigation and feasibility study costs for the site. Additional claims for recovery of natural resource damages at the site are anticipated. As of December 31, 2003, Georgia Power had recorded approximately \$6 million in cumulative expenses associated with Georgia Power's agreed-upon share of the removal and remedial investigation and feasibility study costs for the Brunswick site.

The final outcome of each of these matters cannot now be determined. However, based on the currently known conditions at these sites and the nature and extent of Georgia Power's activities relating to these sites, management does not believe that the company's additional liability, if any, at these sites would be material to the financial statements.

New Source Review Actions

In November 1999, the EPA brought a civil action in the U.S. District Court for the Northern District of Georgia against Alabama Power, Georgia Power, and SCS. The complaint alleged violations of the New Source Review (NSR) provisions of the Clean Air Act with respect to five coal-fired generating facilities in Alabama and Georgia and violations of related state laws. The civil action requested penalties and injunctive relief, including an order requiring the installation of the best available control technology at the affected units. The EPA concurrently issued to the retail operating companies notices of violation relating to 10 generating facilities, which include the five facilities mentioned previously. In early 2000, the EPA filed a motion to amend its complaint to add the violations alleged in its notices of violation and to add Gulf Power, Mississippi Power, and Savannah Electric as defendants.

In August 2000, the U.S. District Court in Georgia granted Alabama Power's motion to dismiss for lack of jurisdiction in Georgia and granted SCS' motion to dismiss on the grounds that it neither owned nor operated the generating units involved in the proceedings. In March 2001, the court granted the EPA's motion to add Savannah Electric as a defendant, but it denied the motion to add Gulf Power and Mississippi Power based on lack of jurisdiction in Georgia over those companies. As directed by the court, the EPA refiled its amended complaint limiting claims to those brought against Georgia Power and Savannah Electric. In addition, the EPA refiled its claims against Alabama Power in the U.S. District Court for the Northern District of Alabama. These complaints allege violations with respect to eight coal-fired generating facilities in Alabama and Georgia, and they request the same kinds of relief as was requested in the original complaint, i.e. penalties and injunctive relief, including installation of the best available control technology. The EPA has not refiled against Gulf Power, Mississippi Power, or SCS.

The actions against Alabama Power, Georgia Power, and Savannah Electric were stayed in the spring of 2001 during the appeal of a very similar NSR enforcement action against the Tennessee Valley Authority (TVA) before the U.S. Court of Appeals for the Eleventh Circuit. The TVA appeal involves many of the same

legal issues raised by the actions against Alabama Power, Georgia Power, and Savannah Electric. Because the final resolution of the TVA appeal could have a significant impact on Alabama Power and Georgia Power, both companies have been involved in that appeal. On June 24, 2003, the court of appeals issued its ruling in the TVA case. It found unconstitutional the statutory scheme set forth in the Clean Air Act that allowed the EPA to impose penalties for failing to comply with an administrative compliance order, like the one issued to TVA, without the EPA having to prove the underlying violation. Thus, the court of appeals held that the compliance order was of no legal consequence, and TVA was free to ignore it. The court did not, however, rule directly on the substantive legal issues about the proper interpretation and application of certain NSR provisions that had been raised in the TVA appeal. On September 16, 2003, the court of appeals denied the EPA's request for a rehearing of the decision. On February 13, 2004, the EPA petitioned the U.S. Supreme Court to review the decision of the court of appeals. The EPA also filed a motion to lift the stay in the action against Alabama Power. At this time, no party to the Georgia Power and Savannah Electric action, which was administratively closed two years ago, has asked the court to reopen that case.

Since the inception of the NSR proceedings against Georgia Power, Alabama Power, and Savannah Electric, the EPA has also been proceeding with similar NSR enforcement actions against other utilities, involving many of the same legal issues. In each case, the EPA alleged that the utilities failed to comply with the NSR permitting requirements when performing maintenance and construction activities at coal-burning plants, which activities the utilities considered to be routine or otherwise not subject to NSR. In 2003, district courts addressing these cases issued opinions that reached conflicting conclusions.

In October 2003, the EPA issued final revisions to its NSR regulations under the Clean Air Act clarifying the scope of the existing Routine Maintenance, Repair, and Replacement exclusion. On December 24, 2003, the U.S. Court of Appeals for the District of Columbia Circuit stayed the effectiveness of these revisions pending resolution of related litigation. In January 2004, the Bush Administration announced that it would continue to enforce the existing rules.

Southern Company believes that its retail operating companies complied with applicable laws and the EPA's regulations and interpretations in effect at the time the work in question took place. The Clean Air Act authorizes civil penalties of up to \$27,500 per day, per violation at each generating unit. Prior to January 30, 1997, the penalty was \$25,000 per day. An adverse outcome in any one of these cases could require substantial capital expenditures that cannot be determined at this time and could possibly require payment of substantial penalties. This could affect future results of operations, cash flows, and possibly financial condition if such costs are not recovered through regulated rates.

NOTES (CONTINUED)

Plant Wansley Environmental Litigation

On December 30, 2002, the Sierra Club, Physicians for Social Responsibility, Georgia ForestWatch, and one individual filed a civil suit in the U.S. District Court in Georgia against Georgia Power for alleged violations of the Clean Air Act at four of the generating units at Plant Wansley. The complaint alleges Clean Air Act violations at both the existing coal-fired units and the new combined cycle units. Specifically, the plaintiffs allege (1) opacity violations at the coal-fired units, (2) violations of a permit provision that requires the combined cycle units to operate above certain levels, (3) violation of nitrogen oxide emission offset requirements, and (4) violation of hazardous air pollutant requirements. The civil action requests injunctive and declaratory relief, civil penalties, a supplemental environmental project, and attorneys' fees. The Clean Air Act authorizes civil penalties of up to \$27,500 per day, per violation at each generating unit.

On June 19, 2003, the court granted Georgia Power's motion to dismiss the allegations regarding hazardous air pollutants and denied Georgia Power's motion to dismiss the allegations regarding emission offsets. On August 29, 2003, Georgia Power filed a motion for partial summary judgment regarding emission offsets. On January 20, 2004, Georgia Power filed a motion for summary judgment on the remaining three counts, and the plaintiffs have filed motions for partial summary judgment. The case is currently scheduled for trial during the summer of 2004. While Georgia Power believes that it has complied with applicable laws and regulations, an adverse outcome could require payment of substantial penalties. The final outcome of this matter cannot now be determined.

Race Discrimination Litigation

In July 2000, a lawsuit alleging race discrimination was filed by three Georgia Power employees against Georgia Power, Southern Company, and SCS in the Superior Court of Fulton County, Georgia. Shortly thereafter, the lawsuit was removed to the U.S. District Court for the Northern District of Georgia. The lawsuit also raised claims on behalf of a purported class. The plaintiffs seek compensatory and punitive damages in an unspecified amount, as well as injunctive relief. In August 2000, the lawsuit was amended to add four more plaintiffs. Also, an additional indirect subsidiary of Southern Company, Southern Company Energy Solutions, was named a defendant.

In October 2001, the district court denied the plaintiffs' motion for class certification. The plaintiffs filed a motion to reconsider the order denying class certification, and the court denied the plaintiffs' motion to reconsider. In December 2001, the plaintiffs filed a petition in the U.S. Court of Appeals for the Eleventh Circuit seeking permission to file an appeal of the October 2001 decision, and this petition was denied. After discovery was completed on the claims raised by the seven named plaintiffs, the defendants filed motions for summary judgment on all of the named plaintiffs' claims. On March 31, 2003, the U.S. District Court for the

Northern District of Georgia granted summary judgment in favor of the defendants on all claims raised by all seven plaintiffs. On April 23, 2003, plaintiffs filed an appeal to the U.S. Court of Appeals for the Eleventh Circuit challenging these adverse summary judgment rulings, as well as the District Court's October 2001 ruling denying class certification. Oral argument occurred on January 27, 2004, and the parties await the court's decision. The final outcome of this matter cannot now be determined.

Right of Way Litigation

Southern Company and certain of its subsidiaries, including Georgia Power, Gulf Power, Mississippi Power, and Southern Telecom (collectively, defendants), have been named as defendants in numerous lawsuits brought by landowners since 2001 regarding the installation and use of fiber optic cable over defendants' rights of way located on the landowners' property. The plaintiffs' lawsuits claim that defendants may not use or sublease to third parties some or all of the fiber optic communications lines on the rights of way that cross the plaintiffs' properties and that such actions by defendants exceed the easements or other property rights held by defendants. The plaintiffs assert claims for, among other things, trespass and unjust enrichment. The plaintiffs seek compensatory and punitive damages and injunctive relief. With respect to one such lawsuit brought by landowners regarding the installation and use of fiber optic cable over Gulf Power rights of way located on the landowners' property, on November 7, 2003, the Second Circuit Court in Gadsden County, Florida, ruled in favor of the plaintiffs on their motion for partial summary judgment concerning liability. The question of damages, if any, will be decided at a future trial. In the event of an adverse verdict on damages, Gulf Power could appeal the verdicts on both liability and damages. Management of Southern Company and its subsidiaries believe that the defendant companies in the pending right of way litigation have complied with applicable laws and that the plaintiffs' claims are without merit. An adverse outcome in these matters could result in substantial judgments; however, the final outcome of these matters cannot now be determined.

In addition, in late 2001, certain subsidiaries of Southern Company, including Alabama Power, Georgia Power, Gulf Power, Mississippi Power, Savannah Electric, and Southern Telecom (collectively, defendants), were named as defendants in a lawsuit brought by a telecommunications company that uses certain of the defendants' rights of way. This lawsuit alleges, among other things, that the defendants are contractually obligated to indemnify, defend, and hold harmless the telecommunications company from any liability that may be assessed against the telecommunications company in pending and future right of way litigation. The defendants believe that the plaintiff's claims are without merit. An adverse outcome in this matter, combined with an adverse outcome against the telecommunications company in one or more of the right of way lawsuits, could result in substantial judgments; however, the final outcome of these matters cannot now be determined.

NOTES (CONTINUED)

Income Tax Issues**Synthetic Fuel Tax Credits**

Southern Company has investments in two entities that produce synthetic fuel and receive tax credits under Section 29 of the IRS revenue code. In April 2001, Southern Company acquired a 30 percent membership interest in AFP. In 1998, Southern Company acquired a 24.975 percent limited partnership interest in Carbontronic Synfuels Investors, L.P. (Carbontronic). At December 31, 2003, Southern Company's total investment in these entities was approximately \$30 million.

On June 30, 2003, the IRS issued an announcement that suspended the issuance of new private letter rulings and indicated that it might also revoke existing private letter rulings for synthetic fuels Section 29 tax credits pending a review of the scientific validity of test procedures and results that have been presented as evidence that a significant chemical change occurred in such synthetic fuel. On October 29, 2003, the IRS announced that it has completed its review and determined that the test procedures and results used by taxpayers are scientifically valid if the procedures are applied in a consistent and unbiased manner. The IRS stated that the processes they approved do not produce the level of chemical change required by Section 29, but they will, nevertheless, resume issuing private letter rulings. The IRS will require taxpayers applying for future rulings to implement and maintain certain sampling and quality control procedures, as well as additional documentation and record retention procedures. The IRS also plans to extend these procedures to taxpayers already holding rulings on the issue of significant chemical change.

On October 30, 2003, the Senate Governmental Affairs Permanent Subcommittee on Investigations announced that it has begun a separate investigation of the synthetic fuel industry and its producers for potential abuses of these tax credits.

In January 2004, the IRS completed an audit of AFP for tax years 1999 and 2000. The IRS raised no issues related to the Section 29 tax credits for these years and issued a "no-change" audit report to AFP's tax matters partner. The IRS is currently auditing Carbontronic for tax years 2000 and 2001. From the inception of Southern Company's investment in these entities through December 31, 2003, Southern Company has recognized through income approximately \$274 million (net of approximately \$37 million reserved) in tax credits related to its share of the synthetic fuel production at these entities.

Both entities have private letter rulings from the IRS that concluded significant chemical change occurred based on the procedures and results submitted. In addition, both entities regularly use independent laboratories and experts to test for chemical change. These tests replicated significant chemical changes consistent with the procedures submitted with the private letter rulings. Southern Company has relied on these private letter rulings and believes that the test results presented in connection with such private

letter rulings are valid and that the entities have operated in compliance with their respective private letter rulings and Section 29 of the revenue code. The ultimate outcome of these matters cannot now be determined.

Leveraged Lease Transactions

Southern Company undergoes audits by the IRS for each of its tax years. The IRS has completed its audits of Southern Company's consolidated federal income tax returns for all years through 1999. As part of the audit for the 1996-1999 tax years, the IRS reviewed Southern Company's four international leveraged lease transactions. Based on its review, the IRS proposed to disallow the tax losses associated with one of these transactions, resulting in an additional tax payment of approximately \$30 million, including interest. To finalize the audit and eliminate any additional interest charges, Southern Company made this payment to the IRS in May 2003 and filed a refund claim for this amount. On January 5, 2004, the IRS proposed to disallow the refund claim. Southern Company has accounted for the payment as a deposit. Southern Company continues to believe that the transaction remains a valid lease for U.S. tax purposes and, accordingly, intends to file a petition for refund in federal court. If Southern Company is not successful in its defense of the tax treatment for this transaction, it could also affect the timing of the related revenue recognition for book purposes. A cumulative effect adjustment could be required to reduce net income based on the revised cash flows as a result of the changes in the allowed tax deductions.

The IRS did not disallow any tax losses or make any other adjustments for the 1996-1999 period with respect to any of Southern Company's other lease transactions. However, there can be no assurance that subsequent IRS audits would not raise similar disallowance issues. See Note 1 under "Leveraged Leases" for additional information on deferred taxes arising from these transactions. The ultimate outcome of these matters cannot now be determined.

Alabama Power Retail Rate Adjustment Procedures

In November 1982, the Alabama Public Service Commission (APSC) adopted rates that provide for periodic adjustments based upon Alabama Power's earned return on end-of-period retail common equity. The rates also provide for adjustments to recognize the placing of new generating facilities in retail service and for the recovery of retail costs associated with certificated purchased power agreements. Both increases and decreases have been placed into effect since the adoption of these rates. Rate adjustment procedures were revised by the APSC on March 5, 2002. The new procedures provide for periodic rate adjustments annually rather than quarterly and limit any annual adjustment to 3 percent. The return on common equity range of 13 percent to 14.5 percent remained unchanged. The ratemaking procedures will remain in effect until the APSC votes to modify or discontinue them.

NOTES (CONTINUED)

In accordance with the Rate Stabilization Equalization plan, a 2 percent increase in retail rates was effective in both April 2002 and October 2001, amounting to an annual increase of \$55 million and \$58 million, respectively. Also, to recover certificated purchased power costs, an increase of 2.6 percent in retail rates, or \$79 million annually, was effective July 2003. An additional increase of \$25 million annually is scheduled to be effective in June 2004 for new certificated purchased power costs.

Georgia Power Retail Rate Orders

In December 2001, the GPSC approved a three-year retail rate order for Georgia Power ending December 31, 2004. Retail rates were decreased by \$118 million effective January 1, 2002. Under the terms of the order, earnings are evaluated against a retail return on common equity range of 10 percent to 12.95 percent. Two-thirds of any earnings above the 12.95 percent return will be applied to rate refunds, with the remaining one-third retained by Georgia Power. Georgia Power's earnings in both 2002 and 2003 were within the common equity range.

Under a previous three-year order ending December 2001, Georgia Power's earnings were evaluated against a retail return on common equity range of 10 percent to 12.5 percent. The order further provided for \$85 million in each year, plus up to \$50 million of any earnings above the 12.5 percent return during the second and third years, to be applied to accelerated amortization or depreciation of assets. Two-thirds of additional earnings above the 12.5 percent return were applied to rate refunds, with the remaining one-third retained by Georgia Power. Pursuant to the order, Georgia Power recorded \$333 million of accelerated amortization and interest thereon, which was credited to a regulatory liability account as mandated by the GPSC.

Under the 2001 rate order, Georgia Power discontinued recording accelerated depreciation and amortization and began amortizing the accumulated balance equally over three years as a credit to expense beginning in 2002. Also, the rate order required Georgia Power to recognize capacity and operating and maintenance costs related to certified purchase power contracts evenly into rates over a three-year period ending December 31, 2004.

Georgia Power is required to file a general rate case on July 1, 2004, in response to which the GPSC would be expected to determine whether the rate order should be continued, modified, or discontinued.

Uncontracted Generating Capacity

On May 21, 2003, Mississippi Power and Southern Power entered into agreements with Dynegy, Inc. (Dynegy) to resolve all outstanding matters related to capacity sales contracts with subsidiaries of Dynegy. Under the terms of the agreements, Dynegy made a cash payment of \$75 million to Mississippi Power and \$80 million to Southern Power. The contracts between Southern Power and Dynegy were terminated in May 2003, and the Mississippi Power contract was terminated effective October 31, 2003.

The termination payments from Dynegy resulted in a one-time gain to Southern Company of approximately \$88 million after tax (\$38 million for Mississippi Power and \$50 million for Southern Power).

As a result of these contract terminations, Southern Power is completing limited construction activities on Plant Franklin Unit 3 to preserve the long-term viability of the project but has deferred final completion until the 2008-2011 period. The length of the deferral period will depend on forecasted capacity needs and other wholesale market opportunities. As of December 31, 2003, Southern Power's investment in Unit 3 of Plant Franklin was \$156 million. Southern Power is continuing to explore alternatives for its existing capacity. The final outcome of these matters cannot now be determined.

Mississippi Power Regulatory Filing

On December 5, 2003, Mississippi Power filed a request with the Mississippi Public Service Commission (MPSC) to modify certain portions of its Performance Evaluation Plan (PEP) and to include 266 megawatts of Plant Daniel units 3 and 4 generating capacity not currently included in jurisdictional cost of service.

As part of Mississippi Power's proposal to include the additional Plant Daniel capacity in retail rates, the MPSC issued an interim accounting order in December 2003 directing Mississippi Power to expense and record in 2003 a regulatory liability in the amount of approximately \$60 million while the MPSC fully considers the entire request. However, if the MPSC ultimately denies Mississippi Power's request, the regulatory liability will be required to be reversed.

In the second quarter of 2004, Mississippi Power expects the MPSC to render a final order on the inclusion of the additional Plant Daniel capacity in rates, the amortization period for the regulatory liability, and the requested changes to PEP.

FERC Matters

Southern Power currently has general authorization from the FERC to sell power to nonaffiliates at market-based prices. In addition, each of the retail operating companies has obtained FERC approval to sell power to nonaffiliates at market-based prices under specific contracts. Southern Power and the retail operating companies also have FERC authority to make short-term opportunity sales at market rates. Specific FERC approval must be obtained with respect to a market-based contract with an affiliate. In November 2001, the FERC modified the test it uses to consider utilities' applications to charge market-based rates and adopted a new test called the Supply Margin Assessment (SMA). The FERC applied the SMA to several utilities, including Southern Company, and found Southern Company and others to be "pivotal suppliers" in their service areas and ordered the implementation of several mitigation measures. Southern Company and others sought rehearing of the FERC order, and the FERC delayed the implementation of certain mitigation measures. Southern Company and others submitted comments to the FERC in 2002 regarding these issues. In December 2003, the FERC issued a staff

NOTES (CONTINUED)

paper discussing alternatives and held a technical conference in January 2004. Southern Company anticipates that the FERC will address the requests for rehearing in the near future. The final outcome of this matter will depend on the form in which the SMA test and mitigation measures rules may be ultimately adopted and cannot be determined at this time.

Purchased Power Agreements (PPAs) by Georgia Power and Savannah Electric for Southern Power's Plant McIntosh capacity were certified by the GPSC in December 2002 after a competitive bidding process. In April 2003, Southern Power applied for FERC approval of these PPAs. Interveners opposed the FERC's acceptance of the PPAs, alleging that the PPAs do not meet the applicable standards for market-based rates between affiliates. In July 2003, the FERC accepted the PPAs to become effective as scheduled on June 1, 2005, subject to refund, and ordered that hearings be held to determine: (a) whether, in the design and implementation of the GPSC competitive bidding process, Georgia Power and Savannah Electric unduly preferred Southern Power; (b) whether the analysis of the competitive bids unduly favored Southern Power, particularly with respect to evaluation of non-price factors; (c) whether Georgia Power and Savannah Electric selected their affiliate, Southern Power, based upon a reasonable combination of price and non-price factors; (d) whether Southern Power received an undue preference or competitive advantage in the competitive bidding process as a result of access to its affiliate's transmission system; (e) whether and to what extent the PPAs impact wholesale competition; and (f) whether the PPAs are just and reasonable and not unduly discriminatory. Hearings are scheduled to begin in March 2004. Management believes that the PPAs should be approved by the FERC; however, the ultimate outcome of this matter cannot now be determined.

NOTE FOUR**Joint Ownership Agreements**

Alabama Power owns an undivided interest in units 1 and 2 of Plant Miller and related facilities jointly with Alabama Electric Cooperative, Inc.

Georgia Power owns undivided interests in plants Vogtle, Hatch, Scherer, and Wansley in varying amounts jointly with Oglethorpe Power Corporation (OPC), the Municipal Electric Authority of Georgia, the city of Dalton, Georgia, Florida Power & Light Company, and Jacksonville Electric Authority. In addition, Georgia Power has joint ownership agreements with OPC for the Rocky Mountain facilities and with Florida Power Corporation for a combustion turbine unit at Intercession City, Florida.

Southern Power owns an undivided interest in Stanton Unit A and related facilities jointly with the Orlando Utilities Commission, Kissimmee Utility Authority, and Florida Municipal Power Agency.

At December 31, 2003, Alabama Power's, Georgia Power's, and Southern Power's ownership and investment (exclusive of nuclear fuel) in jointly owned facilities with the above entities were as follows:

<i>(in millions)</i>	Jointly Owned Facilities		
	Amount of Investment	Accumulated Depreciation	Percent Ownership
Plant Vogtle (nuclear)	\$3,307	\$1,706	45.7%
Plant Hatch (nuclear)	908	469	50.1
Plant Miller (coal)			
Units 1 and 2	767	355	91.8
Plant Scherer (coal)			
Units 1 and 2	115	52	8.4
Plant Wansley (coal)	390	160	53.5
Rocky Mountain (pumped storage)	169	85	25.4
Intercession City (combustion turbine)	12	1	33.3
Plant Stanton (combined cycle)			
Unit A	155	1	65.0

Alabama Power, Georgia Power, and Southern Power have contracted to operate and maintain the jointly owned facilities—except for the Rocky Mountain project and Intercession City—as agents for their respective co-owners. The companies' proportionate share of their plant operating expenses is included in the corresponding operating expenses in the Consolidated Statements of Income.

NOTE FIVE**Income Taxes**

Southern Company files a consolidated federal income tax return. In 2002, Southern Company began filing a combined state of Georgia income tax return. Under a joint consolidated income tax agreement, each subsidiary's current and deferred tax expense is computed on a stand-alone basis. In accordance with IRS regulations, each company is jointly and severally liable for the tax liability.

Mirant was included in the consolidated federal tax return through April 2, 2001. Under the terms of the separation agreement, Mirant will indemnify Southern Company for subsequent assessment of any additional taxes related to its transactions prior to the spin off. The IRS is currently auditing the consolidated tax returns for 2001 and 2000. For additional tax-related information, see Note 3 under "Mirant Bankruptcy" and "Income Tax Issues."

At December 31, 2003, the tax-related regulatory assets and liabilities were \$874 million and \$409 million, respectively. These assets are attributable to tax benefits flowed through to customers in prior years and to taxes applicable to capitalized interest. These liabilities are attributable to deferred taxes previously recognized at rates higher than the current enacted tax law and to unamortized investment tax credits.

NOTES (CONTINUED)

Details of income tax provisions are as follows:

<i>(in millions)</i>	2003	2002	2001
Total provision for income taxes:			
Federal –			
Current	\$130	\$284	\$477
Deferred	404	167	(10)
	534	451	467
State –			
Current	42	64	103
Deferred	36	13	(12)
	78	77	91
Total	\$612	\$528	\$558

Net cash payments for income taxes related to continuing operations in 2003, 2002, and 2001 were \$188 million, \$374 million, and \$558 million, respectively.

The tax effects of temporary differences between the carrying amounts of assets and liabilities in the financial statements and their respective tax bases, which give rise to deferred tax assets and liabilities, are as follows:

<i>(in millions)</i>	2003	2002
Deferred tax liabilities:		
Accelerated depreciation	\$3,737	\$3,364
Property basis differences	970	1,011
Other	985	840
Total	5,692	5,215
Deferred tax assets:		
Federal effect of state deferred taxes	119	111
Other property basis differences	171	185
Deferred costs	128	188
Pension and other benefits	160	146
Other	483	428
Total	1,061	1,058
Total deferred tax liabilities, net	4,631	4,157
Portion included in prepaid expenses		
(accrued income taxes), net	(55)	33
Deferred state tax assets	10	13
Accumulated deferred income taxes		
in the Consolidated Balance Sheets	\$4,586	\$4,203

At December 31, 2003, Southern Company also had available state of Georgia net operating loss carryforward deductions totaling \$1.0 billion, which could result in net state income tax benefits of \$60 million, if utilized. Less than \$27 million of such deductions will expire by 2008; the remainder will expire between 2009 and

2021. During 2003, Southern Company realized \$19 million in such state income tax benefits. Beginning in 2002, the state of Georgia allows the filing of a combined return, which should substantially reduce any additional net operating loss carryforwards.

In accordance with regulatory requirements, deferred investment tax credits are amortized over the lives of the related property with such amortization normally applied as a credit to reduce depreciation in the Consolidated Statements of Income. Credits amortized in this manner amounted to \$29 million in 2003, \$27 million in 2002, and \$30 million in 2001. At December 31, 2003, all investment tax credits available to reduce federal income taxes payable had been utilized.

The provision for income taxes differs from the amount of income taxes determined by applying the applicable U.S. federal statutory rate to earnings before income taxes and preferred dividends of subsidiaries, as a result of the following:

	2003	2002	2001
Federal statutory rate	35.0%	35.0%	35.0%
State income tax, net of federal deduction	2.4	2.7	3.7
Synthetic fuel tax credits	(5.7)	(5.8)	(4.2)
Employee stock plans dividend deduction	(1.5)	(2.9)	–
Non-deductible book depreciation	1.1	1.3	1.7
Difference in prior years'			
deferred and current tax rate	(0.7)	(1.0)	(1.1)
Other	(1.5)	(0.9)	(2.2)
Effective income tax rate	29.1%	28.4%	32.9%

NOTE SIX

Financing

Mandatorily Redeemable Preferred Securities

Southern Company and the retail operating companies have each formed certain wholly owned trust subsidiaries for the purpose of issuing preferred securities. The proceeds of the related equity investments and preferred security sales were loaned back to Southern Company and the retail operating companies through the issuance of junior subordinated notes totaling \$2.0 billion, which constitute substantially all assets of these trusts. Southern Company and the retail operating companies each considers that the mechanisms and obligations relating to the preferred securities issued for its benefit, taken together, constitute a full and unconditional guarantee by it of the respective trusts' payment obligations with respect to these securities. At December 31, 2003, preferred securities of \$1.9 billion were outstanding and recognized as liabilities in the Consolidated Balance Sheets. Southern Company guarantees the notes related to \$555 million of these securities issued on its behalf.

NOTES (CONTINUED)

Long-Term Debt Due Within One Year

A summary of scheduled maturities and redemptions of long-term debt due within one year at December 31 is as follows:

<i>(in millions)</i>	2003	2002
First mortgage bond maturities and redemptions	\$ -	\$ 33
Pollution control bonds	-	1
Capitalized leases	11	11
Senior notes	655	1,552
Other long-term debt	35	42
Total	\$701	\$1,639

Debt redemptions and/or serial maturities through 2008 applicable to total long-term debt are as follows: \$701 million in 2004; \$891 million in 2005; \$951 million in 2006; \$975 million in 2007; and \$473 million in 2008.

Assets Subject to Lien

Each of Southern Company's subsidiaries is organized as a legal entity, separate and apart from Southern Company and its other subsidiaries. The subsidiary companies' mortgages, which secure the first mortgage bonds issued by the retail operating companies, constitute a direct first lien on substantially all of the retail operating companies' respective fixed property and franchises. Georgia Power discharged its mortgage in 2002 and the lien was removed. There are no agreements or other arrangements among the subsidiary companies under which the assets of one company have been pledged or otherwise made available to satisfy obligations of Southern Company or any of its other subsidiaries.

Bank Credit Arrangements

At the beginning of 2004, unused credit arrangements with banks totaled \$3.5 billion, of which \$2.8 billion expires during 2004 and \$670 million expires during 2005 and beyond. The following table outlines the credit arrangements by company:

<i>(in millions)</i>	Amount of Credit			
	Total	Unused	Expires	
			2004	2005 & beyond
COMPANY				
Alabama Power	\$ 865	\$ 865	\$ 865	\$ -
Georgia Power	725	725	725	-
Gulf Power	56	56	56	-
Mississippi Power	100	100	100	-
Savannah Electric	80	60	40	20
Southern Company	1,000	1,000	1,000	-
Southern Power	650	650	-	650
Other	20	20	20	-
Total	\$3,496	\$3,476	\$2,806	\$670

Approximately \$2.25 billion of the credit facilities expiring in 2004 allow the execution of term loans for an additional two-year period, and \$265 million allow execution of one-year term loans. Most of these agreements include stated borrowing rates but also allow for competitive bid loans.

All of the credit arrangements require payment of commitment fees based on the unused portion of the commitments or the maintenance of compensating balances with the banks. Commitment fees are less than 1/8 of 1 percent for Southern Company and the retail operating companies and less than 3/8 of 1 percent for Southern Power. Compensating balances are not legally restricted from withdrawal. Included in the total \$3.5 billion of unused credit arrangements is \$2.8 billion of syndicated credit arrangements that require the payment of agent fees.

Most of Southern Company's, Southern Power's, and the retail operating companies' credit arrangements with banks have covenants that limit debt levels to 65 percent of total capitalization, as defined in the agreements. Exceeding these debt levels would result in a default under the credit arrangements. At December 31, 2003, Southern Company, Southern Power, and the retail operating companies were in compliance with their respective debt limit covenants. In addition, the credit arrangements typically contain cross default provisions that would be triggered if the borrower defaulted on other indebtedness above a specified threshold. Under the credit arrangements for Southern Company and the retail operating companies, the cross default provisions are restricted only to the indebtedness, including any guarantee obligations, of the company that has the credit arrangement with the bank. For Southern Power's bank credit arrangements, there is a cross default to Southern Company's indebtedness, which if triggered would require prepayment of debt related to projects financed under the credit arrangement that are not complete. Southern Company has committed to fund at least 35 percent on Southern Power's construction project financing and to pay for construction overruns to the extent that Southern Power's cash flow is insufficient. Southern Company and its subsidiaries are currently in compliance with all such covenants. Borrowings under certain retail operating companies' unused credit arrangements totaling \$50 million would be prohibited if the borrower experiences a material adverse change, as defined in such agreements. Initial borrowings for new projects under Southern Power's credit facility would be prohibited if Southern Power or Southern Company experiences a material adverse change, as defined in that credit facility.

A portion of the \$3.5 billion unused credit with banks is allocated to provide liquidity support to the companies' variable rate pollution control bonds. The amount of variable rate pollution control bonds requiring liquidity support as of December 31, 2003, was \$659 million.

Southern Company, the retail operating companies, and Southern Power borrow through commercial paper programs that have the liquidity support of committed bank credit arrangements.

NOTES (CONTINUED)

In addition, Southern Company and the retail operating companies from time to time borrow through extendible commercial note programs. As of December 31, 2003, no extendible commercial notes were outstanding. The amount of commercial paper outstanding at December 31, 2003, and December 31, 2002, was \$568 million and \$858 million, respectively. During 2003, the peak amount outstanding for commercial paper was \$1.66 billion, and the average amount outstanding was \$900 million. The average annual interest rate on commercial paper was 1.3 percent in 2003. Commercial paper is included in notes payable on the Consolidated Balance Sheets.

Financial Instruments

The retail operating companies, Southern Power, and Southern Company GAS enter into energy-related derivatives to hedge exposures to electricity, gas, and other fuel price changes. However, due to cost-based rate regulations, the retail operating companies have limited exposure to market volatility in commodity fuel prices and prices of electricity. In addition, Southern Power's exposure to market volatility in commodity fuel prices and prices of electricity is limited because its long-term sales contracts shift substantially all fuel cost responsibility to the purchaser. Each of the retail operating companies has implemented fuel-hedging programs at the instruction of their respective public service commissions. Together with Southern Power, the retail operating companies may enter into hedges of forward electricity sales. Southern Company GAS has gas-hedging programs to substantially mitigate its exposure to price volatility for its gas purchases.

At December 31, 2003, the fair value of derivative energy contracts was reflected in the financial statements as follows:

<i>(in millions)</i>	Amounts
Regulatory liabilities, net	\$14.9
Other comprehensive income	1.5
Net income	(0.6)
Total fair value	\$15.8

The fair value gains or losses for cash flow hedges that are recoverable through the regulatory fuel clauses are recorded as regulatory assets and liabilities and are recognized in earnings at the same time the hedged items affect earnings. For Southern Power and Southern Company GAS, the fair value gains or losses for cash flow hedges are recorded in other comprehensive income and are reclassified into earnings at the same time the hedged items affect earnings. For the year 2003, approximately \$22 million of pre-tax gains were reclassified from other comprehensive income to fuel expense. For the year 2004, approximately \$5 million of pre-tax gains are expected to be reclassified from other comprehensive income to fuel expense.

Southern Company and certain subsidiaries also enter into derivatives to hedge exposure to interest rate changes. Derivatives related to fixed rate securities are accounted for as fair value hedges. Derivatives related to variable rate securities or forecasted transactions are accounted for as cash flow hedges. The derivatives are generally structured to match the critical terms of the hedged debt instruments; therefore, no material ineffectiveness has been recorded in earnings.

At December 31, 2003, Southern Company had \$3.0 billion notional amount of interest rate swaps outstanding with net fair value gains of \$33 million as follows:

Fair Value Hedges

<i>(in millions)</i>	Maturity	Variable Rate Paid	Notional Amount	Fair Value Gain
COMPANY				
Southern Company	2007	6-month LIBOR -0.10%	\$400	\$30.9
	2009	6-month LIBOR + 2.92%	40	0.8

Cash Flow Hedges

<i>(in millions)</i>	Maturity	Weighted Average Fixed Rate Paid	Notional Amount	Fair Value Gain/(Loss)
COMPANY				
Southern Company	2004	3.20%	\$200	\$(2.0)
Alabama Power	2004	1.63*	486	(0.2)
	2006	1.89	195	1.5
	2007	1.99*	486	4.4
Georgia Power	2004	1.39*	873	(0.8)
	2005	1.56	50	-
	2005	1.96	250	(1.1)
Savannah Electric	2004	2.06	20	(0.1)

*Hedged using the Bond Market Association Municipal Swap Index.

For fair value hedges where the hedged item is an asset, liability, or firm commitment, the changes in the fair value of the hedging derivatives are recorded in earnings and are offset by the changes in the fair value of the hedged item.

The fair value gain or loss for cash flow hedges is recorded in other comprehensive income and is reclassified into earnings at the same time the hedged items affect earnings. In 2003 and 2002, the company recognized losses of \$116 million and \$14 million, respectively, upon termination of certain interest derivatives at the same time it issued debt. These losses have been deferred in other comprehensive income and will be amortized to interest expense over the life of the related debt. For 2003, approximately \$26 million of pre-tax losses were reclassified from other comprehensive income to interest expense. For 2004, pre-tax losses of approximately \$22 million are expected to be reclassified from other comprehensive income to interest expense.

NOTES (CONTINUED)

NOTE SEVEN

Commitments**Construction Program**

Southern Company is engaged in continuous construction programs, currently estimated to total \$2.2 billion in 2004, \$2.2 billion in 2005, and \$2.6 billion in 2006. These amounts include \$41 million, \$31 million, and \$27 million in 2004, 2005, and 2006, respectively, for construction expenditures related to contractual purchase commitments for uranium and nuclear fuel conversion, enrichment, and fabrication services included in this note under "Fuel and Purchased Power Commitments." The construction programs are subject to periodic review and revision, and actual construction costs may vary from the above estimates because of numerous factors. These factors include: changes in business conditions; acquisition of additional generating assets; revised load growth estimates; changes in environmental regulations; changes in existing nuclear plants to meet new regulatory requirements; changes in FERC rules and transmission regulations; increasing costs of labor, equipment, and materials; and cost of capital. At December 31, 2003, significant purchase commitments were outstanding in connection with the construction program. Southern Company has approximately 1,200 megawatts of additional generating capacity scheduled to be placed in service by 2005. In addition, capital improvements to generation, transmission, and distribution facilities—including those to meet environmental standards—will continue.

Long-Term Service Agreements

The retail operating companies and Southern Power have entered into several Long-Term Service Agreements (LTSAs) with General Electric (GE) for the purpose of securing maintenance support for the combined cycle and combustion turbine generating facilities owned by the subsidiaries. In summary, the LTSAs stipulate that GE will perform all planned inspections on the covered equipment, which includes the cost of all labor and materials. GE is also obligated to cover the costs of unplanned maintenance on the covered equipment subject to a limit specified in each contract.

In general, except for Southern Power's Plant Dahlberg, these LTSAs are in effect through two major inspection cycles per unit. The Dahlberg agreement is in effect through the first major inspection of each unit. Scheduled payments to GE are made at various intervals based on actual operating hours of the respective units. Total payments to GE under these agreements for facilities owned are currently estimated at \$1.3 billion over the remaining life of the agreements, which may range up to 30 years. However, the LTSAs contain various cancellation provisions at the option of the purchasers.

Payments made to GE prior to the performance of any planned inspections are recorded as a prepayment in the Consolidated Balance Sheets. Inspection costs are capitalized or charged to expense based on the nature of the work performed.

Fuel and Purchased Power Commitments

To supply a portion of the fuel requirements of the generating plants, Southern Company has entered into various long-term commitments for the procurement of fossil and nuclear fuel. In most cases, these contracts contain provisions for price escalations, minimum purchase levels, and other financial commitments. Natural gas purchase commitments contain given volumes with prices based on various indices at the time of delivery. Amounts included in the chart below represent estimates based on New York Mercantile future prices at December 31, 2003. Also, Southern Company has entered into various long-term commitments for the purchase of electricity. Total estimated minimum long-term obligations at December 31, 2003 were as follows:

<i>(in millions)</i>	Natural Gas	Coal and Nuclear Fuel	Purchased Power
YEAR			
2004	\$ 814	\$2,409	\$ 139
2005	538	1,723	174
2006	491	1,475	181
2007	350	1,131	183
2008	269	544	184
2009 and thereafter	2,763	182	918
Total commitments	\$5,225	\$7,464	\$1,779

Operating Leases

In May 2001, Mississippi Power began the initial 10-year term of a lease agreement signed in 1999 for a combined cycle generating facility built at Plant Daniel. The facility cost approximately \$370 million. In 2003, the generating facility was acquired by Juniper Capital L.P. (Juniper), whose partners are unaffiliated with Mississippi Power. Simultaneously, Juniper entered into a restructured lease agreement with Mississippi Power. Juniper has also entered into leases with other parties unrelated to Mississippi Power. The assets leased by Mississippi Power comprise less than 50 percent of Juniper's assets. In accordance with FASB Interpretation No. 46, Mississippi Power is not required to consolidate the leased assets and related liabilities, and the lease with Juniper is considered an operating lease under FASB Statement No. 13. The initial lease term ends in 2011, and the lease includes a purchase and renewal option based on the cost of the facility at the inception of the lease, which was \$369 million. Mississippi Power is required to amortize approximately four percent of the

NOTES (CONTINUED)

initial acquisition cost over the initial lease term. Eighteen months prior to the end of the initial lease, Mississippi Power may elect to renew for 10 years. If the lease is renewed, the agreement calls for Mississippi Power to amortize an additional 17 percent of the initial completion cost over the renewal period. Upon termination of the lease, at Mississippi Power's option, it may either exercise its purchase option or the facility can be sold to a third party.

The lease provides for a residual value guarantee—approximately 73 percent of the acquisition cost—by Mississippi Power that is due upon termination of the lease in the event that Mississippi Power does not renew the lease or purchase the assets and that the fair market value is less than the unamortized cost of the asset. Mississippi Power has recognized in the balance sheet a liability of approximately \$15 million for the fair market value of this residual value guarantee. In 2003, approximately \$11 million in lease termination costs were included in operation expenses and \$26 million in lease expense. The amount of future minimum operating lease payments will be approximately \$29 million annually during the initial term.

Southern Company has other operating lease agreements with various terms and expiration dates. Total operating lease expenses were \$156 million, \$171 million, and \$64 million for 2003, 2002, and 2001, respectively. At December 31, 2003, estimated minimum rental commitments for noncancelable operating leases were as follows:

<i>(in millions)</i>	Rail Cars	Other	Total
YEAR			
2004	\$ 36	\$ 92	\$128
2005	33	80	113
2006	28	67	95
2007	19	57	76
2008	19	48	67
2009 and thereafter	106	156	262
Total minimum payments	\$241	\$500	\$741

For the retail operating companies, the rail car lease expenses are recoverable through fuel cost recovery provisions. In addition to the above rental commitments, Alabama Power and Georgia Power have obligations upon expiration of certain rail car leases with respect to the residual value of the leased property. These leases expire in 2004, 2006, and 2010, and the maximum obligations are \$39 million, \$66 million, and \$40 million, respectively. At the termination of the leases, the lessee may either exercise its purchase option, or the property can be sold to a third party. Alabama Power and Georgia Power expect that the fair market value of the leased property would substantially reduce or eliminate the payments under the residual value obligations.

Guarantees

Southern Company has made separate guarantees to certain counterparties regarding performance of contractual commitments by Mirant's trading and marketing subsidiaries. At December 31, 2003, the total notional amount of guarantees outstanding was less than \$30 million, all of which will expire by 2009. Under the terms of the separation agreement, Mirant may not enter into any new commitments under these guarantees after the spin off date and must use reasonable efforts to release Southern Company from all such support arrangements and indemnify Southern Company for any obligations incurred. Subsequent to the spin off, Mirant began paying Southern Company a fee of 1 percent annually on the average aggregate maximum principal amount of all guarantees outstanding until they are replaced or expire. However, in December 2003, Mirant notified Southern Company that the Bankruptcy Code provides relief from paying this fee.

Southern Company has executed a keep-well agreement with a subsidiary of Southern Holdings to make capital contributions in the event of any shortfall in payments due under a participation agreement with an entity in which the subsidiary holds a 30 percent investment. The maximum aggregate amount of Southern Company's liability under this keep-well agreement is \$50 million.

As discussed earlier in this note under "Operating Leases," Alabama Power, Georgia Power, and Mississippi Power have entered into certain residual value guarantees. Also, Southern Company has certain contingent liabilities as discussed in Note 3 under "Mobile Energy Services' Petition for Bankruptcy."

NOTE EIGHT**Common Stock****Stock Issued**

Southern Company raised \$470 million or 18 million shares in 2003 and \$378 million or 16 million shares in 2002 from the issuance of new common shares under the company's various stock plans. Southern Company issued 2 million and 17 million treasury shares of common stock in 2002 and 2001, respectively, through various company stock plans. Proceeds from the issuance of treasury stock were \$56 million in 2002 and \$395 million in 2001.

Shares Reserved

At December 31, 2003, a total of 60 million shares was reserved for issuance pursuant to the Southern Investment Plan, the Employee Savings Plan, the Outside Directors Stock Plan, and the Omnibus Incentive Compensation Plan (stock option plan).

NOTES (CONTINUED)

Stock Option Plan

Southern Company provides non-qualified stock options to a large segment of its employees ranging from line management to executives. As of December 31, 2003, 6,202 current and former employees participated in the stock option plan. The maximum number of shares of common stock that may be issued under this plan may not exceed 55 million. The prices of options granted to date have been at the fair market value of the shares on the dates of grant. Options granted to date become exercisable pro rata over a maximum period of three years from the date of grant. Options outstanding will expire no later than 10 years after the date of grant, unless terminated earlier by the Southern Company Board of Directors in accordance with the plan. Stock option data for the plan has been adjusted to reflect the Mirant spin off. Activity from 2001 to 2003 for the plan is summarized below:

	Shares Subject To Option	Average Option Price Per Share
Balance at December 31, 2000	22,566,627	\$14.92
Options granted	13,623,210	20.31
Options canceled	(3,397,152)	15.39
Options exercised	(3,161,800)	13.83
Balance at December 31, 2001	29,630,885	17.46
Options granted	8,040,495	25.28
Options canceled	(104,212)	19.64
Options exercised	(4,892,354)	15.16
Balance at December 31, 2002	32,674,814	19.72
Options granted	7,165,452	27.98
Options canceled	(183,038)	24.35
Options exercised	(5,725,336)	16.56
Balance at December 31, 2003	33,931,892	\$21.97
Shares reserved for future grants:		
At December 31, 2001	54,795,653	
At December 31, 2002	46,788,994	
At December 31, 2003	39,752,039	
Options exercisable:		
At December 31, 2001	11,965,858	
At December 31, 2002	15,463,414	
At December 31, 2003	18,872,769	

The following table summarizes information about options outstanding at December 31, 2003:

	Dollar Price Range of Options		
	13-19	19-25	25-30
Outstanding:			
Shares (in thousands)	7,428	11,719	14,785
Average remaining life (in years)	4.7	6.2	8.3
Average exercise price	\$15.32	\$20.39	\$26.57
Exercisable:			
Shares (in thousands)	7,428	8,303	3,142
Average exercise price	\$15.32	\$20.40	\$25.49

The estimated fair values of stock options granted in 2003, 2002, and 2001 were derived using the Black-Scholes stock option pricing model. The following table shows the assumptions and the weighted average fair values of stock options:

	2003	2002	2001
Interest rate	2.7%	2.8%	4.8%
Average expected life of stock options (in years)	4.3	4.3	4.3
Expected volatility of common stock	23.6%	26.3%	25.4%
Expected annual dividends on common stock	\$1.37	\$1.34	\$1.34
Weighted average fair value of stock options granted	\$3.59	\$3.37	\$2.82

The pro forma impact of fair-value accounting for options granted on earnings from continuing operations is as follows:

	As Reported	Pro Forma
YEAR		
2003		
Net income (in millions)	\$1,474	\$1,456
Earnings per share (dollars):		
Basic	\$2.03	\$2.00
Diluted	\$2.02	\$1.99
2002		
Net income (in millions)	\$1,318	\$1,299
Earnings per share (dollars):		
Basic	\$1.86	\$1.83
Diluted	\$1.85	\$1.82
2001		
Net income (in millions)	\$1,119	\$1,102
Earnings per share (dollars):		
Basic	\$1.62	\$1.60
Diluted	\$1.61	\$1.59

Diluted Earnings Per Share

For Southern Company, the only difference in computing basic and diluted earnings per share is attributable to outstanding options under the stock option plan. The effect of the stock options was determined using the treasury stock method. Shares used to compute diluted earnings per share are as follows:

(in thousands)	Average Common Stock Shares		
	2003	2002	2001
As reported shares	726,702	708,161	689,352
Effect of options	5,202	5,409	4,191
Diluted shares	731,904	713,570	693,543

NOTES (CONTINUED)

Common Stock Dividend Restrictions

The income of Southern Company is derived primarily from equity in earnings of its subsidiaries. At December 31, 2003, consolidated retained earnings included \$3.9 billion of undistributed retained earnings of the subsidiaries. Of this amount, \$313 million was restricted against the payment by the subsidiary companies of cash dividends on common stock under terms of bond indentures.

In accordance with the PUHCA, the subsidiaries are also restricted from paying common dividends from paid-in capital without SEC approval.

NOTE NINE**Nuclear Insurance**

Under the Price-Anderson Amendments Act of 1988, Alabama Power and Georgia Power maintain agreements of indemnity with the NRC that, together with private insurance, cover third-party liability arising from any nuclear incident occurring at the companies' nuclear power plants. The act provides funds up to \$10.9 billion for public liability claims that could arise from a single nuclear incident. Each nuclear plant is insured against this liability to a maximum of \$300 million by American Nuclear Insurers (ANI), with the remaining coverage provided by a mandatory program of deferred premiums that could be assessed, after a nuclear incident, against all owners of nuclear reactors. A company could be assessed up to \$101 million per incident for each licensed reactor it operates but not more than an aggregate of \$10 million per incident to be paid in a calendar year for each reactor. Such maximum assessment, excluding any applicable state premium taxes, for Alabama Power and Georgia Power—based on its ownership and buyback interests—is \$201 million and \$203 million, respectively, per incident, but not more than an aggregate of \$20 million per company to be paid for each incident in any one year. The Price-Anderson Amendments Act expired in August 2002; however, the indemnity provisions of the act remain in place for commercial nuclear reactors.

Alabama Power and Georgia Power are members of Nuclear Electric Insurance Limited (NEIL), a mutual insurer established to provide property damage insurance in an amount up to \$500 million for members' nuclear generating facilities.

Additionally, both companies have policies that currently provide decontamination, excess property insurance, and premature decommissioning coverage up to \$2.25 billion for losses in excess of the \$500 million primary coverage. This excess insurance is also provided by NEIL.

NEIL also covers the additional costs that would be incurred in obtaining replacement power during a prolonged accidental outage at a member's nuclear plant. Members can purchase this coverage, subject to a deductible waiting period of up to 26 weeks, with a maximum per occurrence per unit limit of \$490 million. After this deductible period, weekly indemnity payments would be received until either the unit is operational or until the limit is exhausted in approximately three years. Alabama Power and Georgia Power each purchase the maximum limit allowed by NEIL subject to ownership limitations. Each facility has elected a 12 week waiting period.

Under each of the NEIL policies, members are subject to assessments if losses each year exceed the accumulated funds available to the insurer under that policy. The current maximum annual assessments for Alabama Power and Georgia Power under the NEIL policies would be \$36 million and \$40 million, respectively.

Following the terrorist attacks of September 2001, both ANI and NEIL confirmed that terrorist acts against commercial nuclear power plants would be covered under their insurance. Both companies, however, revised their policy terms on a prospective basis to include an industry aggregate for all "non-certified" terrorist acts, i.e., acts that are not certified acts of terrorism pursuant to the Terrorism Risk Insurance Act of 2002 (TRIA). The NEIL aggregate—applies to non-certified claims stemming from terrorism within a 12-month duration—is \$3.24 billion plus any amounts available through reinsurance or indemnity from an outside source. The non-certified ANI cap is a \$300 million shared industry aggregate. Any act of terrorism that is certified pursuant to the TRIA will not be subject to the foregoing NEIL and ANI limitations but will be subject to the TRIA annual aggregate limitation of \$100 billion of insured losses arising from certified acts of terrorism. The TRIA will expire on December 31, 2005.

For all on-site property damage insurance policies for commercial nuclear power plants, the NRC requires that the proceeds of such policies shall be dedicated first for the sole purpose of placing the reactor in a safe and stable condition after an accident. Any remaining proceeds are to be applied next toward the costs of decontamination and debris removal operations ordered by the NRC, and any further remaining proceeds are to be paid either to the company or to its bond trustees as may be appropriate under the policies and applicable trust indentures.

All retrospective assessments—whether generated for liability, property, or replacement power—may be subject to applicable state premium taxes.

NOTES (CONTINUED)

NOTE TEN

Segment and Related Information

Southern Company's reportable business segment is the sale of electricity in the Southeast by the five retail operating companies and Southern Power. Net income and total assets for discontinued operations are included in the reconciling eliminations column. The all other column includes parent Southern Company, which does not allocate operating expenses to business segments. Also,

this category includes segments below the quantitative threshold for separate disclosure. These segments include investments in synthetic fuels and leveraged lease projects, telecommunications, energy-related services, and natural gas marketing. Intersegment revenues are not material. Financial data for business segments and products and services are as follows:

Business Segments

(in millions)	Electric Utilities			Total	All Other	Eliminations	Consolidated
	Retail Operating Companies	Southern Power	Eliminations				
YEAR							
2003							
Operating revenues	\$10,502	\$ 682	\$(437)	\$10,747	\$ 526	\$ (22)	\$11,251
Depreciation and amortization	933	39	—	972	55	—	1,027
Interest income	33	—	—	33	6	(3)	36
Interest expense	542	32	—	574	107	(3)	678
Income taxes	760	85	—	845	(233)	—	612
Segment net income (loss)	1,269	155	—	1,424	50	—	1,474
Total assets	31,412	2,409	(122)	33,699	1,671	(325)	35,045
Gross property additions	1,625	344	—	1,969	33	—	2,002

(in millions)	Electric Utilities			Total	All Other	Eliminations	Consolidated
	Retail Operating Companies	Southern Power	Eliminations				
YEAR							
2002							
Operating revenues	\$10,109	\$ 299	\$(202)	\$10,206	\$ 365	\$ (22)	\$10,549
Depreciation and amortization	970	18	—	988	59	—	1,047
Interest income	19	—	—	19	10	(7)	22
Interest expense	559	9	—	568	105	(6)	667
Income taxes	749	28	—	777	(249)	—	528
Segment net income (loss)	1,242	54	—	1,296	23	(1)	1,318
Total assets	30,367	2,086	(78)	32,375	1,881	(535)	33,721
Gross property additions	1,773	1,215	(390)	2,598	119	—	2,717

(in millions)	Electric Utilities			Total	All Other	Eliminations	Consolidated
	Retail Operating Companies	Southern Power	Eliminations				
YEAR							
2001							
Operating revenues	\$ 9,883	\$ 29	\$ (6)	\$ 9,906	\$ 267	\$ (18)	\$10,155
Depreciation and amortization	1,141	3	—	1,144	29	—	1,173
Interest income	21	—	—	21	8	(2)	27
Interest expense	590	1	—	591	137	(2)	726
Income taxes	700	2	—	702	(144)	—	558
Segment net income (loss)	1,141	8	—	1,149	(30)	143	1,262
Gross property additions	2,444	751	(630)	2,565	52	—	2,617

NOTES (CONTINUED)

Products and Services

(in millions)	Electric Utilities Revenues			
	Retail	Wholesale	Other	Total
YEAR				
2003	\$8,875	\$1,358	\$514	\$10,747
2002	8,728	1,168	310	10,206
2001	8,440	1,174	292	9,906

NOTE ELEVEN

Quarterly Financial Information (Unaudited)

Summarized quarterly financial data for 2003 and 2002 are as follows:

(in millions)	Operating Revenues	Operating Income	Consolidated Net Income	Per Common Share (Note)			
				Basic Earnings	Dividends	Price Range	
						High	Low
QUARTER ENDED							
March 2003	\$2,548	\$ 605	\$298	\$0.41	\$0.3425	\$30.81	\$27.71
June 2003	2,845	806	432	0.60	0.3425	31.81	27.94
September 2003	3,318	1,118	619	0.85	0.3500	30.53	27.76
December 2003	2,540	366	125	0.17	0.3500	30.40	28.65
March 2002	\$2,214	\$ 526	\$224	\$0.32	\$0.3350	\$26.78	\$24.49
June 2002	2,630	676	332	0.47	0.3350	28.39	25.65
September 2002	3,248	1,089	595	0.84	0.3425	29.02	23.89
December 2002	2,457	355	167	0.23	0.3425	30.85	25.17

Southern Company's business is influenced by seasonal weather conditions.

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA 1999-2003

	2003	2002	2001	2000	1999
Operating Revenues (in millions)	\$11,251	\$10,549	\$10,155	\$10,066	\$9,317
Total Assets (in millions)	\$35,045	\$33,721	\$31,856	\$33,282	\$31,102
Gross Property Additions (in millions)	\$2,002	\$2,717	\$2,617	\$2,225	\$1,881
Return on Average Common Equity (percent)	16.05	15.79	13.51	13.20	13.43
Cash Dividends Paid Per Share of Common Stock	\$1.385	\$1.355	\$1.34	\$1.34	\$1.34
Consolidated Net Income (in millions):					
Continuing operations	\$1,474	\$1,318	\$1,120	\$ 994	\$ 915
Discontinued operations	—	—	142	319	361
Total	\$1,474	\$1,318	\$1,262	\$1,313	\$1,276
Earnings Per Share From Continuing Operations—					
Basic	\$2.03	\$1.86	\$1.62	\$1.52	\$1.33
Diluted	2.02	1.85	1.61	1.52	1.33
Earnings Per Share Including Discontinued Operations—					
Basic	\$2.03	\$1.86	\$1.83	\$2.01	\$1.86
Diluted	2.02	1.85	1.82	2.01	1.86
Capitalization (in millions):					
Common stock equity	\$ 9,648	\$ 8,710	\$ 7,984	\$10,690	\$ 9,204
Preferred stock	423	298	368	368	369
Long-term debt	12,064	11,094	10,573	10,089	9,497
Total excluding amounts due within one year	\$22,135	\$20,102	\$18,925	\$21,147	\$19,070
Capitalization Ratios (percent):					
Common stock equity	43.6	43.3	42.2	50.6	48.3
Preferred stock	1.9	1.5	1.9	1.7	1.9
Long-term debt	54.5	55.2	55.9	47.7	49.8
Total excluding amounts due within one year	100.0	100.0	100.0	100.0	100.0
Other Common Stock Data (Note):					
Book value per share (year-end)	\$13.13	\$12.16	\$11.43	\$15.69	\$13.82
Market price per share (dollars):					
High	\$31.810	\$30.850	\$26.000	\$35.000	\$29.625
Low	27.710	23.890	16.152	20.375	22.063
Close	30.250	28.390	25.350	33.250	23.500
Market-to-book ratio (year-end) (percent)	230.4	233.5	221.8	211.9	170.0
Price-earnings ratio (year-end) (times)	14.9	15.3	15.6	16.5	12.6
Dividends paid (in millions)	\$1,004	\$958	\$922	\$873	\$921
Dividend yield (year-end) (percent)	4.6	4.8	5.3	4.0	5.7
Dividend payout ratio (percent)	68.1	72.8	82.4	66.5	72.2
Shares outstanding (in thousands):					
Average	726,702	708,161	689,352	653,087	685,163
Year-end	734,829	716,402	698,344	681,158	665,796
Stockholders of record (year-end)	134,068	141,784	150,242	160,116	174,179
Customers (year-end) (in thousands):					
Residential	3,552	3,496	3,441	3,398	3,339
Commercial	564	553	539	527	513
Industrial	14	14	14	14	15
Other	6	5	4	5	4
Total	4,136	4,068	3,998	3,944	3,871
Employees (year-end)	25,762	26,178	26,122	26,021	26,269

Note: Common stock data in 2001 declined as a result of the Mirant spin off.

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA 1999-2003 (CONTINUED)

	2003	2002	2001	2000	1999
Operating Revenues (in millions):					
Residential	\$ 3,565	\$ 3,556	\$ 3,247	\$ 3,361	\$3,107
Commercial	3,075	3,007	2,966	2,918	2,745
Industrial	2,146	2,078	2,144	2,289	2,238
Other	89	87	83	32	—
Total retail	8,875	8,728	8,440	8,600	8,090
Sales for resale within service area	403	393	338	377	350
Sales for resale outside service area	955	775	836	600	473
Total revenues from sales of electricity	10,233	9,896	9,614	9,577	8,913
Other revenues	1,018	653	541	489	404
Total	\$11,251	\$10,549	\$10,155	\$10,066	\$9,317
Kilowatt-Hour Sales (in millions):					
Residential	47,833	48,784	44,538	46,213	43,402
Commercial	48,372	48,250	46,939	46,249	43,387
Industrial	54,415	53,851	52,891	56,746	56,210
Other	998	1,000	977	970	945
Total retail	151,618	151,885	145,345	150,178	143,944
Sales for resale within service area	10,610	10,597	9,388	9,579	9,440
Sales for resale outside service area	29,910	21,954	21,380	17,190	12,929
Total	192,138	184,436	176,113	176,947	166,313
Average Revenue Per Kilowatt-Hour (cents):					
Residential	7.45	7.29	7.29	7.27	7.16
Commercial	6.36	6.23	6.32	6.31	6.33
Industrial	3.94	3.86	4.05	4.03	3.98
Total retail	5.85	5.75	5.81	5.73	5.62
Sales for resale	3.35	3.59	3.82	3.65	3.68
Total sales	5.33	5.37	5.46	5.41	5.36
Average Annual Kilowatt-Hour Use Per Residential Customer	13,562	14,036	13,014	13,702	13,107
Average Annual Revenue Per Residential Customer	\$1,010.82	\$1,023.18	\$948.83	\$996.44	\$938.39
Plant Nameplate Capacity Owned (year-end) (megawatts)	38,679	36,353	34,579	32,807	31,425
Maximum Peak-Hour Demand (megawatts):					
Winter	31,318	25,939	26,272	26,370	25,203
Summer	32,949	32,355	29,700	31,359	30,578
System Reserve Margin (at peak) (percent)	21.4	13.3	19.3	8.1	8.5
Annual Load Factor (percent)	62.0	51.1	62.0	60.2	59.2
Plant Availability (percent):					
Fossil-steam	87.7	84.8	88.1	86.8	83.3
Nuclear	94.4	90.3	90.8	90.5	89.9
Source of Energy Supply (percent):					
Coal	66.4	65.7	67.5	72.3	73.1
Nuclear	14.8	14.7	15.2	15.1	15.7
Hydro	3.8	2.6	2.6	1.5	2.3
Gas	8.8	11.4	8.4	4.0	2.8
Purchased power	6.2	5.6	6.3	7.1	6.1
Total	100.0	100.0	100.0	100.0	100.0

BOARD OF DIRECTORS



Daniel P. Amos
*Chairman and
 Chief Executive Officer*
 AFLAC Incorporated
 (insurance)
 Columbus, Georgia
 Age 52; elected 2000
 Other corporate directorships:
 AFLAC Incorporated,
 Synovus Financial Corporation



Dorrit J. Bern
*Chairman, President, and
 Chief Executive Officer*
 Charming Shoppes Inc.
 (retail)
 Bensalem, Pennsylvania
 Age 53; elected 1999
 Other corporate directorships:
 Charming Shoppes Inc.,
 Brunswick Corporation



Thomas F. Chapman
*Chairman and
 Chief Executive Officer*
 Equifax Inc.
 (information services and
 transaction processing)
 Atlanta, Georgia
 Age 60; elected 1999
 Other corporate directorships:
 Equifax Inc.



Allen Franklin
*Chairman, President, and
 Chief Executive Officer**
 Southern Company
 Atlanta, Georgia
 Age 59; elected 1988
 Other corporate directorships:
 SouthTrust Corporation,
 Vulcan Materials Company
 *retirement planned
 in July 2004



Bruce S. Gordon
*Retired President-Retail
 Markets Group*
 Verizon Communications
 (telecommunications)
 New York, New York
 Age 58; elected 1994
 Other corporate directorships:
 Bartech Personnel Services,
 Advertising Council Inc.,
 Tyco International Ltd.

**Donald M. James**

*Chairman and
Chief Executive Officer*
Vulcan Materials Company
(construction materials,
industrial chemicals)
Birmingham, Alabama
Age 55; elected 1999
Other corporate directorships:
Vulcan Materials Company,
Protective Life Corporation,
SouthTrust Corporation

Zack T. Pate

Chairman Emeritus
World Association of
Nuclear Operators
(nuclear power industry)
Atlanta, Georgia
Age 67; elected 1998
Other corporate directorships:
Michon Inc.

J. Neal Purcell

*Retired Vice Chair-Audit
Operations*
KPMG
(audit and accounting)
Duluth, Georgia
Age 62; elected 2003
Other corporate directorships:
Kaiser Permanente, Kaiser
Permanente-Georgia Regional
Advisory Board, Synovus
Financial Corporation,
Synovus Financial Services-
Advisory Board

David M. Ratcliffe

Chief Executive Officer
Georgia Power
*President-Elect**
Southern Company
Atlanta, Georgia
Age 55; elected 2003
Other corporate directorships:
CSX Transportation

**to become chairman and
chief executive officer, upon
retirement of Allen Franklin*

Jerry St. Pe'

Former President
Ingalls Shipbuilding
Retired Executive
Vice President
Litton Industries
(shipbuilding)
Pascagoula, Mississippi
Age 64; elected 1995
Other corporate directorships:
Signal International,
Delta Health Group,
Mac Land Disposal Centers,
Merchants and Marine Bank

2003 COMMITTEES OF THE BOARD

Audit Committee

J. Neal Purcell, Chairman
Dorrit J. Bern
Donald M. James
Zack T. Pate

Compensation and

Management
Succession Committee
Jerry St. Pe', Chairman
Daniel P. Amos
Thomas F. Chapman

Governance Committee

Bruce S. Gordon, Chairman
Dorrit J. Bern
Thomas F. Chapman
Jerry St. Pe'

Finance Committee

Donald M. James, Chairman
Daniel P. Amos
Bruce S. Gordon

Nuclear Oversight Committee

Zack T. Pate, Chairman

SHAREOWNER INFORMATION

Transfer Agent

SCS Stockholder Services is Southern Company's transfer agent, dividend-paying agent, investment plan administrator, and registrar. If you have questions concerning your Southern Company stockholder account, please contact:

By mail

SCS Stockholder Services
P.O. Box 54250
Atlanta, GA 30308-0250

By courier

SCS Stockholder Services
270 Peachtree St. N.W.—16th Floor
Bin 962
Atlanta, GA 30303

By phone

9 a.m. to 5 p.m. ET
Monday through Friday
(800) 554-7626

By e-mail

stockholders@southernco.com

Stockholder Services Internet Site

<http://investor.southerncompany.com/stockholder/overview.cfm> provides transfer instructions, service request forms, and answers to frequently asked questions. Registered stockholders may also access their account information on the Internet.

Stockholders can securely view detailed account information—including share balance, market value, and dividend payment details—as well as change their account mailing address.

Southern Investment Plan

Southern Investment Plan provides a convenient way to purchase common stock and reinvest dividends. Access <http://investor.southerncompany.com> to review the Prospectus and enrollment forms.

Direct Registration

Southern Company common stock can be issued in direct registration (book entry or uncertified) form. The stock is Direct Registration System eligible.

Dividend Payments

The entire amount of dividends for 2003 is paid out of earnings and profits, and therefore is taxable.

The board of directors sets the record and payment dates for quarterly dividends. A dividend of 35 cents per share was paid in March 2004.

For the remainder of 2004, projected record dates are May 3, Aug. 2, and Nov. 1. Projected payment dates for dividends declared during the remainder of 2004 are June 5, Sept. 6, and Dec. 6.

Annual Meeting

The 2004 Annual Meeting of Stockholders will be held Wednesday, May 26, at 10 a.m. ET at The Southern Pine at Callaway in Pine Mountain, Georgia.

Auditors

Deloitte & Touche LLP
Suite 1500, 191 Peachtree St. N.E.
Atlanta, GA 30303

Investor Information Line

For recorded information about earnings and dividends, stock quotes, and current news releases, call toll-free (866) 762-6411.

Institutional Investor Inquiries

Southern Company maintains an investor relations office in Atlanta, (404) 506-5195, to meet the information needs of institutional investors and securities analysts.

Eliminate Duplicate Mailings

If you are a stockholder of record and receive multiple copies of the annual report and proxy statement, or wish to access these electronically in the future, you may authorize Southern Company to suspend future mailings of these documents to a specific account. To do so, consent when you vote your proxy or check the box on the dividend check stub or account statement and mail it to SCS Stockholder Services.

Environmental Information

Southern Company's 2003 Environmental Progress Report is available in print or online. The report and other information about what the company is doing to improve the environment are available at www.southerncompany.com/planetpower/. To request printed copies of the Progress Report or other environmental information, write to:

Dr. Charles H. Goodman
Senior Vice President, Research and Environmental Affairs
600 North 18th St.
P.O. Box 2641
Birmingham, AL 35203-2206

GLOSSARY

Book value—a company's common stockholders' equity as it appears on the balance sheet, divided by the number of common stock shares outstanding.

Competitive generation business—our wholesale market-based electricity supply business that, primarily through long-term contracts, serves customers who can choose their suppliers based on price, reliability, capacity, and other market needs.

Distribution lines—power lines, like those in neighborhoods, which carry moderate-voltage electricity to customer service areas.

Dividend yield—the annual dividend income per share received from a company divided by its current stock price.

Earnings per share—net income divided by the average number of shares of common stock outstanding.

Federal Energy Regulatory Commission (FERC)—an independent agency within the U.S. Department of Energy that, among other things, regulates wholesale sales of electricity and transmission in interstate commerce.

Generating capacity—the amount of energy that can be produced using all of our power generation facilities.

Kilowatt-Hour—the basic unit of electric energy, which equals one kilowatt of power taken from an electric circuit steadily for one hour. A 100-watt light bulb burning for 10 hours uses one kilowatt-hour of electricity.

Market value—what investors believe a company is worth, calculated by multiplying the number of common stock shares outstanding by the current market price of the company's shares.

Payout ratio—the percentage of earnings that is paid to shareholders in the form of dividends.

Regulated business—the part of our business that generates, transmits, and distributes electricity to commercial, industrial, and residential customers in most of Alabama and Georgia, the Florida panhandle, and southeastern Mississippi.

Retail markets—markets in which energy is sold and delivered directly to the ultimate end-users of that energy.

Super Southeast—the vibrant region and energy market that includes the four states of our traditional service territory as well as surrounding Southeastern states. The geographic focus of our business.

Total shareholder return—return on investment, including stock price appreciation plus reinvested dividends. The distribution of shares of Mirant Corporation stock to Southern Company shareholders in 2001 is treated as a special dividend for purposes of calculating Southern Company shareholder return.

Transmission lines—circuits carrying power at a high voltage. They generally carry the power from the source of generation to the point where the voltage is reduced and distributed to customers.

Wholesale customers—energy marketers, electric and gas utilities, municipal utilities, rural electric cooperatives, and other entities that buy power for resale to retail customers.

Southern Company

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