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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Southern Company's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting as required by the Sarbanes-Oxley Act of 2002 and as defined in Exchange Act Rule 13a-15(f). A control system can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Under management's supervision, an evaluation of the design and effectiveness of Southern Company's internal control over financial reporting was conducted based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management concluded that Southern Company's internal control over financial reporting was effective as of December 31, 2005.

Deloitte & Touche LLP, an independent registered public accounting firm, as auditors of Southern Company's financial statements, has issued an attestation report on management's assessment of the effectiveness of Southern Company's internal control over financial reporting as of December 31, 2005. Deloitte

& Touche LLP's report, which expresses unqualified opinions on management's assessment and on the effectiveness of Southern Company's internal control over financial reporting, is included herein.



David M. Ratcliffe
Chairman, President, and Chief Executive Officer



Thomas A. Fanning
Executive Vice President, Chief Financial Officer, and Treasurer

February 27, 2006

INTERNAL CONTROL OVER FINANCIAL REPORTING

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Southern Company

We have audited management's assessment, included in the accompanying Management Report (page 26), that Southern Company (the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in

accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2005 of the Company and our report dated February 27, 2006 expressed an unqualified opinion on those financial statements.



Atlanta, Georgia
February 27, 2006

CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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 (the "Company") as of December 31, 2005 and 2004, 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, 2005. 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 the standards of the Public Company Accounting Oversight Board (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, such consolidated financial statements (pages 49 to 81) present fairly, in all material respects, the financial position of Southern Company and Subsidiary Companies at

December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.



Atlanta, Georgia
February 27, 2006

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

OVERVIEW

Business Activities

The primary business of Southern Company (the Company) is 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 constructs, owns, and manages Southern Company's competitive generation assets and sells electricity at market-based rates in the wholesale market.

Many factors affect the opportunities, challenges, and risks of Southern Company's electricity business. 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 rising costs. These costs include those related to growing demand, increasingly stringent environmental standards, fuel prices, and storm restoration following multiple hurricanes. Since the beginning of 2004, each of the retail operating companies completed successful retail rate proceedings. These regulatory actions are expected to benefit future earnings stability and enable the recovery of substantial capital investments to facilitate the continued reliability of the transmission and distribution network and to continue environmental improvements at the generating plants. Appropriately balancing environmental expenditures with customer prices will continue to challenge the Company for the foreseeable future. In addition, Georgia Power, Gulf Power, and Mississippi Power expect further rate proceedings in 2006 as necessary to address fuel and storm damage cost recovery.

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. Southern Power continued executing its regional strategy in 2005 by signing several wholesale contracts with major utilities, as well as with cooperatives and municipal suppliers in the Southeast. However, the Company continues to face regulatory challenges related to transmission and market power issues at the national level.

Southern Company's other business activities include investments in synthetic fuel producing entities, which claim federal income tax credits that offset their operating losses, leveraged lease projects, telecommunications, and energy-related services. Management continues to evaluate the contribution of each of these activities to total shareholder return and may pursue acquisitions and dispositions accordingly. In January 2006, the sale of the Company's natural gas marketing business was completed.

Key Performance Indicators

In striving to maximize shareholder value while providing cost-effective energy to more than 4 million customers, Southern Company continues to focus on several key indicators. These indicators include

customer satisfaction, plant availability, system reliability, and earnings per share (EPS). Southern Company's financial success is directly tied to the satisfaction of its customers. Key elements of ensuring customer satisfaction include outstanding service, high reliability, and competitive prices. Management uses customer satisfaction surveys and reliability indicators to evaluate the Company's results.

Peak season equivalent forced outage rate (Peak Season EFOR) is an indicator of fossil/hydro plant availability and efficient generation fleet operations during the months when generation needs are greatest. The rate is calculated by dividing the number of hours of forced outages by total generation hours. Peak Season EFOR performance excludes the impact of hurricanes and certain outage events caused by manufacturer defects. The 2005 Peak Season EFOR performance was slightly below target (as shown in the chart below) primarily due to an outage event at a combined cycle unit. Transmission and distribution system reliability performance is measured by the frequency and duration of outages. Performance targets for reliability are set internally based on historical performance, expected weather conditions, and expected capital expenditures. The 2005 performance was above target on these reliability measures. EPS is the measure for Southern Company's efforts to increase returns to shareholders through average long-term earnings per share growth of 5 percent.

Southern Company's 2005 results compared with its targets for some of these key indicators are reflected in the following chart:

KEY PERFORMANCE INDICATOR	2005 TARGET PERFORMANCE	2005 ACTUAL PERFORMANCE
Customer Satisfaction	Top quartile in national and regional surveys	Top quartile
Peak Season EFOR	2.75% or less	2.83%
EPS	\$2.04 – \$2.09	\$2.14

See RESULTS OF OPERATIONS herein for additional information on the Company's financial performance. The strong financial performance achieved in 2005 reflects the continued emphasis that management places on these indicators as well as the commitment shown by employees in achieving or exceeding management's expectations.

Earnings

Southern Company's financial performance in 2005 remained strong, despite the challenges of rising costs and major hurricanes. Net income was \$1.59 billion in 2005, an increase of 3.8 percent over the prior year. Net income was \$1.53 billion in 2004 and \$1.47 billion in 2003, reflecting increases over the prior year of 4.0 percent and 11.8 percent, respectively. Basic EPS, including discontinued operations, was \$2.14 in 2005, \$2.07 in 2004, and \$2.03 in 2003. Diluted EPS, which factors in additional shares related to stock options, was 1 cent lower than basic EPS each year.

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

Dividends

Southern Company has paid dividends on its common stock since 1948. Dividends paid per share of common stock were \$1.475 in 2005, \$1.415 in 2004, and \$1.385 in 2003. In January 2006, Southern Company declared a quarterly dividend of 37.25 cents per share. This is the 233rd 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 to achieve and maintain a payout of approximately 70 percent of net income, excluding earnings from synthetic fuel businesses. For 2005, the actual payout ratio was 73 percent excluding synthetic fuel earnings, and 69 percent overall.

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 electricity business is as follows:

(in millions)	AMOUNT		INCREASE (DECREASE) FROM PRIOR YEAR	
	2005	2005	2004	2003
Electric operating revenues	\$13,278	\$1,813	\$718	\$541
Fuel	4,488	1,089	400	213
Purchased power	731	88	170	24
Other operation and maintenance	3,220	215	148	105
Depreciation and amortization	1,137	229	(64)	(16)
Taxes other than income taxes	676	52	40	29
Total electric operating expenses	10,252	1,673	694	355
Operating income	3,026	140	24	186
Other income, net	62	38	22	20
Interest expenses	676	62	19	10
Income taxes	899	24	30	68
Net income	\$ 1,513	\$ 92	\$ (3)	\$128

Revenues

Details of electric operating revenues are as follows:

(in millions)	2005	2004	2003
Retail—prior year	\$ 9,732	\$ 8,875	\$ 8,728
Change in—			
Base rates	236	41	75
Sales growth	184	216	104
Weather	34	48	(135)
Fuel and other cost recovery clauses	979	552	103
Retail current year	11,165	9,732	8,875
Sales—for resale	1,667	1,341	1,358
Other electric operating revenues	446	392	514
Electric operating revenues	\$13,278	\$11,465	\$10,747
Percent change	15.8%	6.7%	5.3%

Retail revenues increased \$1.4 billion in 2005, \$857 million in 2004, and \$147 million in 2003. The significant factors driving these changes are shown in the preceding table. The increase in base rates in 2005 is primarily due to approval by the Georgia Public Service Commission (PSC) of retail base rate increases at Georgia Power and Savannah Electric. Electric rates for the retail operating companies include provisions to adjust billings for fluctuations in fuel costs, including the energy component of purchased energy costs. Under these provisions, fuel revenues generally equal fuel expenses, including the fuel component of purchased energy, and do not affect net income. Certain of the retail operating companies also have clauses to recover other costs, such as environmental, storm damage, new plants, and/or purchased power agreements (PPAs).

Sales for resale revenues increased \$326 million in 2005, decreased \$17 million in 2004, and increased \$190 million in 2003. In 2005, sales for resale revenues increased primarily due to a 26.5 percent increase in the average cost of fuel per net kilowatt-hour (KWH) generated. In addition, Southern Company entered into new PPAs with 30 electric membership cooperatives (EMCs) and Flint EMC, both beginning in January 2005, and in June 2005, in connection with the acquisition of Plant Oleander, assumed two PPAs. In 2004, coal and gas prices increased, resulting in a lower marginal price differential that reduced demand. Mild summer weather throughout the Southeast also reduced demand. In 2003, Southern Company entered into several new PPAs with neighboring utilities. In addition, milder weather in Southern Company's service territory, compared with the rest of the Southeast and combined with higher gas prices, resulted in increases in both customer demand and available generation.

Southern Company's average wholesale contract now extends more than 11 years, and as a result, the Company has significantly limited its remarketing risk. Capacity revenues under unit power sales contracts, principally sales to Florida utilities, reflect the recovery of fixed costs and a return on investment, and energy is generally sold at variable cost. Unit power energy sales increased 1.7 percent, 1.9 percent, and 4.0 percent in 2005, 2004, and 2003, respectively. Fluctuations in oil and natural gas prices, which are the primary fuel sources for unit power sales customers, influence changes in these sales. However, because the energy is generally sold at variable cost, these fluctuations have a minimal effect on earnings. The capacity and energy components of the unit power contract revenues were as follows:

(in millions)	2005	2004	2003
Unit power—			
Capacity	\$201	\$ 185	\$ 182
Energy	237	213	211
Total	\$438	\$398	\$393

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Short-term opportunity energy sales are also included in sales for resale. These opportunity sales are made at market-based rates that generally provide a margin above the Company's variable cost to produce the energy. Revenues associated with opportunity sales and PPAs were as follows:

(in millions)	2005	2004	2003
Other power sales –			
Capacity and other	\$ 430	\$308	\$298
Energy	799	635	667
Total	\$1,229	\$943	\$965

In May 2003, Mississippi Power and Southern Power entered into agreements with Dynegy, Inc. (Dynegy) that terminated all capacity sales contracts with subsidiaries of Dynegy. The termination payments from Dynegy resulted in an increase in other electric revenues of \$135 million in 2003.

Energy Sales

Changes in revenues are influenced heavily by the volume of energy sold each year. KWH sales for 2005 and the percent change by year were as follows:

(billions of Kilowatt-hours)	AMOUNT		PERCENT CHANGE	
	2005	2005	2004	2003
Residential	51.1	2.8%	3.9%	(1.9)%
Commercial	51.9	3.6	3.4	0.3
Industrial	55.1	(2.2)	3.6	1.0
Other	1.0	(0.9)	0.8	(0.2)
Total retail	159.1	1.2	3.6	(0.2)
Sales for resale	37.8	7.3	(13.0)	24.5
Total	196.9	2.3	0.1	4.2

Energy sales in 2005 increased 4.5 billion KWH as a result of sustained economic growth and customer growth of 1.2 percent. Hurricane Katrina dampened customer growth from previous years and was the primary contributor to the decrease in industrial sales in 2005. In addition, in 2005, some Georgia Power industrial customers were reclassified from industrial to commercial to be consistent with the rate structure approved by the Georgia PSC resulting in higher commercial sales and lower industrial sales in 2005 when compared with 2004. Energy sales in 2004 were strong across all retail customer classes as a result of an improved economy in the Southeast and customer growth of 1.5 percent. Residential energy sales in 2003 reflected a decrease in customer demand as a result of very mild weather, partially offset by customer growth of 1.6 percent. In 2003, commercial sales continued to show steady growth while industrial sales increased somewhat over the depressed results of previous years. Energy sales to retail customers are projected to increase at a compound average annual rate of 1.9 percent during the period 2006 through 2011, assuming normal weather conditions.

Energy sales for resale increased by 2.6 billion KWH in 2005, decreased 5.3 billion KWH in 2004, and increased by 8.0 billion KWH in 2003. The increase in sales in 2005 is related primarily to the new PPAs discussed above. The decrease in 2004 as compared with 2003 is due to the increased availability of coal-fired generation in 2003 resulting from weather-related lower retail demand coupled with higher natural gas prices, which increased the wholesale market demand for opportunity sales.

Fuel and Purchased Power Expenses

Fuel costs constitute the single largest expense for the 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:

	2005	2004	2003
Total generation (billions of KWH)	196	188	189
Sources of generation (percent) –			
Coal	71	69	71
Nuclear	15	16	16
Gas	11	12	9
Hydro	3	3	4
Average cost of fuel per net KWH generated (cents)	2.39	1.89	1.67
Average cost of purchased power per net KWH (cents)	7.14	4.48	3.86

In 2005, fuel and purchased power expenses were \$5.2 billion, an increase of \$1.2 billion or 29.1 percent above the prior year costs. An additional 7.8 billion KWH were generated in 2005 at a 26.5 percent higher average cost per net KWH generated; however, this lowered requirements to purchase even more expensive electricity from non-affiliates.

Fuel and purchased power expenses were \$4.0 billion in 2004, an increase of \$570 million or 16.4 percent above 2003 costs. This increase was the result of a 13.2 percent increase in the average cost per net KWH generated and a 16.1 percent increase in the average cost per KWH purchased.

Fuel and purchased power expenses were \$3.5 billion in 2003, an increase of \$237 million or 7.3 percent above the prior year costs. This increase was primarily attributed to higher average unit fuel cost and increased customer demand.

A significant upward trend in the cost of coal and natural gas has emerged since 2003, and volatility in these markets is expected to continue. Increased coal prices have been influenced by a worldwide increase in demand as a result of rapid economic growth in China, as well as by increases in mining costs. Higher natural gas prices in the United States are the result of increased demand and slightly lower gas supplies despite increased drilling activity. Natural gas supply interruptions, such as those caused

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

by the 2004 and 2005 hurricanes result in an immediate market response; however, the long-term impact of this price volatility may be reduced by imports of natural gas and liquefied natural gas. Fuel expenses generally do not affect net income, since they are offset by fuel revenues under the retail operating companies' fuel cost recovery provisions. Likewise, Southern Power's PPAs generally provide that the purchasers are responsible for substantially all of the cost of fuel.

Other Operation and Maintenance Expenses

Other operation and maintenance expenses were \$3.2 billion, \$3.0 billion, and \$2.9 billion, increasing \$215 million, \$148 million, and \$105 million in 2005, 2004, and 2003, respectively. Other production expenses increased \$58 million and \$53 million in 2005 and 2004, respectively, and decreased \$27 million in 2003. Production expenses fluctuate from year to year due to variations in outage schedules, flexible spending projects, and normal increases in costs.

Administrative and general expenses increased \$73 million in 2005 related to a \$33 million increase in employee benefits, a \$22 million increase in shared services expenses and a \$9 million increase in property insurance. Administrative and general expenses increased \$106 million in 2004 primarily related to \$41 million, \$23 million, and \$13 million increases in employee benefits, shared services expenses, primarily nuclear security, and property insurance, respectively. In 2003, administrative and general expenses increased \$46 million, due primarily to a \$19 million increase in property insurance, a \$9 million increase in employee benefits, and \$9 million of business development costs at Southern Power.

Transmission and distribution expenses increased \$60 million in 2005, \$49 million in 2004, and \$23 million in 2003. Transmission and distribution expenses increased in 2005 primarily as a result of \$48 million of expenses recorded by Alabama Power in accordance with an accounting order approved by the Alabama PSC primarily to offset the costs of Hurricane Ivan and restore the natural disaster reserve. In accordance with the accounting order, Alabama Power also returned certain regulatory liabilities related to deferred income taxes to its retail customers; therefore, the combined effect of the accounting order had no impact on net income. See Note 3 to the financial statements under "Storm Damage Cost Recovery" for additional information. Transmission and distribution expenses also fluctuate from year to year due to variations in maintenance schedules, flexible spending projects, and normal increases in costs, and are the primary basis for the 2004 and 2003 increases.

The 2003 increase in other operation and maintenance expenses also reflects the establishment of a \$60 million regulatory liability related to Plant Daniel that was expensed in 2003.

Depreciation and Amortization Expenses

Depreciation and amortization expenses increased \$229 million in 2005 as a result of additional plant in service and from the expiration in 2004 of certain provisions in Georgia Power's retail rate plan for the three years ended December 31, 2004 (2001 Retail Rate Plan). In accordance with the 2001 Retail Rate Plan, Georgia Power

amortized an accelerated cost recovery liability as a credit to amortization expense and recognized new Georgia PSC-certified purchased power costs in rates over the three years ended December 31, 2004. See Note 3 to the financial statements under "Georgia Power Retail Regulatory Matters" for additional information.

Depreciation and amortization expenses declined by \$64 million in 2004, primarily as a result of amortization of the Plant Daniel regulatory liability and a Georgia Power regulatory liability related to the levelization of certain purchased power costs that reduced amortization expense by \$17 million and \$90 million, respectively, from the prior year. See FUTURE EARNINGS POTENTIAL—"PSC Matters—Mississippi Power" herein and Note 3 to the financial statements under "Georgia Power Retail Regulatory Matters" for more information on these regulatory adjustments. These reductions were partially offset by a higher depreciable plant base.

The \$16 million decrease in depreciation and amortization expenses in 2003 was primarily due to a \$49 million reduction in amortization of the previously discussed Georgia Power purchased power regulatory liability and was partially offset by a higher depreciable plant base.

Taxes Other Than Income Taxes

Taxes other than income taxes increased by \$52 million in 2005 primarily as a result of increases in franchise and municipal gross receipts taxes associated with increases in revenues from energy sales. In 2004, taxes other than income taxes increased \$40 million as a result of additional plant in service and a higher property tax base. Taxes other than income taxes increased \$29 million in 2003 as a result of additional generating facilities, as well as higher property tax valuations on existing facilities.

Electric Other Income and (Expense)

Total interest charges and other financing costs increased by \$62 million in 2005 associated with an additional \$863 million in debt outstanding at December 31, 2005 as compared to December 31, 2004 and an increase in average interest rates on variable rate debt. Variable rates on pollution control bonds are highly correlated with the Bond Market Association Municipal Swap Index which averaged 2.5 percent in 2005 and 1.2 percent in 2004. Variable rates on commercial paper and senior notes are highly correlated with the one-month London Interbank Offer Rate (LIBOR), which averaged 3.4 percent in 2005 and 1.5 percent in 2004. An additional \$17 million increase in 2005 was the result of a lower percentage of interest costs capitalized as construction projects reached completion. The \$19 million increase in interest charges and other financing costs in 2004 was also the result of a lower percentage of interest costs capitalized as construction projects reached completion.

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-related services, and natural gas

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

marketing. These businesses are classified in general categories and may comprise one or more of the following subsidiaries: Southern Company Holdings invests in various energy-related projects, including synthetic fuels and leveraged lease projects that receive tax benefits, which contribute significantly to the economic results of these investments; SouthernLINC Wireless 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 Gas was a retail gas marketer serving customers in the State of Georgia. On January 4, 2006, Southern Company Gas completed the sale of substantially all of its assets and is reflected in the condensed income statement below as discontinued operations. See Note 3 to the financial statements under "Southern Company Gas Sale" for additional information.

A condensed income statement for Southern Company's other business activities follows:

(in millions)	AMOUNT		INCREASE (DECREASE) FROM PRIOR YEAR	
	2005	2005	2004	2003
Operating revenues	\$ 276	\$ 12	\$ (7)	\$ 30
Operation and maintenance	297	12	28	(23)
Depreciation and amortization	39	(2)	(9)	(7)
Taxes other than income taxes	4	1	1	—
Total operating expenses	340	11	20	(30)
Operating income	(64)	1	(27)	60
Equity in losses of				
unconsolidated subsidiaries	(123)	(26)	3	(8)
Leveraged lease income	74	4	4	8
Other income, net	(12)	(5)	(15)	9
Interest expenses	101	18	(21)	6
Income taxes	(304)	(14)	(63)	23
Discontinued operations, net of tax	—	(3)	12	(12)
Net income	\$ 78	\$ (33)	\$ 61	\$ 28

Southern Company's non-electric operating revenues increased \$12 million in 2005 primarily as the result of higher production and increased fees in the synthetic fuel business. The \$7 million decrease in 2004 was primarily due to lower operating revenues in the energy-related services business, partially offset by an increase in SouthernLINC Wireless revenues as a result of increased wireless subscribers. The \$30 million increase in revenues in 2003 was primarily due to increased sales in the energy-related services business. Revenues from a subsidiary that primarily provides fuel transportation services related to synthetic fuel products were \$123 million in 2005, increasing by \$17 million, \$21 million, and \$37 million in 2005, 2004, and 2003, respectively, as a result of increased production at the synthetic fuel facilities and annual increases in rates. Most of these service revenues are ultimately included in the cost of the synthetic fuel purchased by Alabama Power and Georgia Power and, therefore, have no significant effect on Southern Company's consolidated revenues. See Note 1 to the financial statements under "Related Party Transactions" for additional information.

Operation and maintenance expenses for these other businesses increased by \$12 million in 2005 as a result of \$9 million of higher losses for property damage, \$2 million in higher network costs at SouthernLINC Wireless, and a \$11 million increase in shared services expenses, offset by the 2004 \$12.5 million bad debt reserve discussed below. Operation and maintenance expenses increased \$28 million in 2004 primarily due to a \$3 million increase in advertising, a \$5 million increase in shared services expenses, and a \$12.5 million bad debt reserve related to additional federal income taxes and interest Southern Company paid on behalf of Mirant Corporation (Mirant). See FUTURE EARNINGS POTENTIAL—"Mirant Bankruptcy Matters" herein and Note 3 to the financial statements under "Mirant Matters—Mirant Bankruptcy" for additional information. Operation and maintenance expenses decreased by \$23 million in 2003 primarily due to a \$6 million decrease in shared services expenses and a \$3 million decrease in losses for property damage at the parent company; a \$4 million decrease in bad debt expense and a \$3 million decrease in network costs at SouthernLINC Wireless; and a \$2 million decrease in salaries in the energy-related services business.

Depreciation and amortization expenses decreased \$9 million and \$7 million in 2004 and 2003, respectively. These reductions are primarily the result of \$10 million of expenses associated with the repurchase of debt at Southern Holdings recorded in 2003 and a \$16 million charge recorded in 2002 related to the impairment of assets under certain customer contracts for energy-related services.

The increases in equity in losses of unconsolidated subsidiaries in 2005 and 2003 reflect the results of additional production expenses in the synthetic fuel partnerships. These partnerships also claim federal income tax credits that offset their operating losses and make the businesses profitable. These credits totaled \$177 million in 2005, \$146 million in 2004, and \$120 million in 2003. In 2004, a \$37 million reserve related to these tax credits was reversed following the settlement of an Internal Revenue Service (IRS) audit. See FUTURE EARNINGS POTENTIAL—"Income Tax Matters" herein for additional information.

The decrease in other income in 2004 as compared with 2003 reflects a \$15 million gain for a Southern Telecom contract settlement during 2003. The gain in 2003 was partially offset by an increase of \$7 million in charitable contributions made by the parent company.

Total interest charges and other financing costs increased by \$18 million in 2005 associated with an additional \$283 million in debt outstanding and a 164 basis point increase in average interest rates on variable rate debt. Interest expense decreased \$21 million in 2004 as a result of the parent company's redemption of preferred securities in 2003. This decrease was partially offset by an increase in outstanding long-term debt in 2004.

Effects of Inflation

The retail operating companies and Southern Power are subject to rate regulation and party to long-term contracts, respectively, that are generally based on the recovery of historical costs. In addition, the income tax laws are based on historical costs. Therefore, inflation

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

creates an economic loss because Southern 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 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 retail operating companies operate as vertically integrated companies providing electricity to customers within their service areas in the southeastern United States. Prices for electricity provided to retail customers are set by state PSCs under cost-based regulatory principles. Retail rates and earnings are reviewed and may be adjusted periodically within certain limitations. Southern Company's wholesale business continues to focus on long-term capacity contracts, optimized by limited energy trading activities. The level of future earnings depends on numerous factors including the FERC's market-based rate investigation, creditworthiness of customers, total generating capacity available in the Southeast and the successful remarketing of capacity as current contracts expire. See ACCOUNTING POLICIES—"Application of Critical Accounting Policies and Estimates—Electric Utility Regulation" herein and Note 3 to the financial statements for additional information about these and other regulatory matters.

The results of 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 that affect the opportunities, challenges, and risks of Southern Company's primary business of selling electricity. These factors include the retail operating companies' ability to maintain a stable regulatory environment that continues to allow for the recovery of all prudently incurred costs. 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.

Southern Company system generating capacity increased 1,880 megawatts in 2005 with the completion of Plant McIntosh units 10 and 11 by Georgia Power and Savannah Electric and

the acquisition by Southern Power of Plant Oleander. In general, Southern Company has constructed or acquired new generating capacity only 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.

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.

Environmental Matters

New Source Review Actions

In November 1999, the Environmental Protection Agency (EPA) brought a civil action in the U.S. District Court for the Northern District of Georgia against certain Southern Company subsidiaries, including Alabama Power and Georgia Power, alleging that these subsidiaries had violated the New Source Review (NSR) provisions of the Clean Air Act and related state laws at certain coal-fired generating facilities. Through subsequent amendments and other legal procedures, the EPA added Savannah Electric as a defendant to the original action and filed a separate action against Alabama Power in the U.S. District Court for the Northern District of Alabama after it was dismissed from the original action. In these lawsuits, 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. On June 3, 2005, the U.S. District Court for the Northern District of Alabama issued a decision in favor of Alabama Power on two primary legal issues in the case; however, the decision does not resolve the case, nor does it address other legal issues associated with the EPA's allegations. In accordance with a separate court order, Alabama Power and the EPA are currently participating in mediation with respect to the EPA's claims. The action against Georgia Power and Savannah Electric has been administratively closed since the spring of 2001, and none of the parties has sought to reopen the case. See Note 3 to the financial statements under "Environmental Matters—New Source Review Actions."

Southern Company believes that the retail operating companies complied with applicable laws and the EPA regulations and interpretations in effect at the time the work in question took place. The Clean Air Act authorizes maximum civil penalties of \$25,000 to \$32,500 per

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day, per violation at each generating unit, depending on the date of the alleged violation. 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 financial condition if such costs are not recovered through regulated rates.

In December 2002 and October 2003, the EPA issued final revisions to its NSR regulations under the Clean Air Act. A coalition of states and environmental organizations filed petitions for review of these regulations. On June 24, 2005, the U.S. Court of Appeals for the District of Columbia Circuit upheld, in part, the EPA's December 2002 revisions to its NSR regulations, which included changes to the regulatory exclusions and methods of calculating emissions increases. However, the court vacated portions of those revisions, including those addressing the exclusion of certain pollution control projects. The October 2003 revisions, which clarified the scope of the existing Routine Maintenance, Repair and Replacement exclusion, have been stayed by the Court of Appeals pending its review of the rules. On October 20, 2005, the EPA also published a proposed rule clarifying the test for determining when an emissions increase subject to the NSR requirements has occurred. The impact of these revisions and proposed rules will depend on adoption of the final rules by the EPA and the individual state implementation of such rules, as well as the outcome of any additional legal challenges, and, therefore, cannot be determined at this time.

Carbon Dioxide Litigation

In July 2004, attorneys general from eight states, each outside of Southern Company's service territory, and the corporation counsel for New York City filed a complaint in the U.S. District Court for the Southern District of New York against Southern Company and four other electric power companies. A nearly identical complaint was filed by three environmental groups in the same court. The complaints allege that the companies' emissions of carbon dioxide, a greenhouse gas, contribute to global warming, which the plaintiffs assert is a public nuisance. Under common law public and private nuisance theories, the plaintiffs seek a judicial order (1) holding each defendant jointly and severally liable for creating, contributing to, and/or maintaining global warming and (2) requiring each of the defendants to cap its emissions of carbon dioxide and then reduce those emissions by a specified percentage each year for at least a decade. Plaintiffs have not, however, requested that damages be awarded in connection with their claims. Southern Company believes these claims are without merit and notes that the complaint cites no statutory or regulatory basis for the claims. In September 2005, the U.S. District Court for the Southern District of New York granted Southern Company's and the other defendants' motions to dismiss these cases. The plaintiffs filed an appeal to the U.S. Court of Appeals for the Second Circuit on October 19, 2005. The ultimate outcome of these matters cannot be determined at this time.

Plant Wansley Environmental Litigation

In December 2002, the Sierra Club, Physicians for Social Responsibility, Georgia Forestwatch, and one individual filed a civil suit in the U.S. District Court for the Northern District of 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 liability phase of the case has concluded with the court ruling in favor of Georgia Power in part and the plaintiffs in part. In March 2005, the U.S. Court of Appeals for the Eleventh Circuit accepted Georgia Power's petition for review of the district court's order, and oral arguments were held on January 24, 2006. The district court case has been administratively closed pending that appeal. If necessary, the district court will hold a separate trial, which will address civil penalties and possible injunctive relief requested by the plaintiffs.

The ultimate outcome of this matter cannot currently be determined; however, an adverse outcome could require substantial capital expenditures that cannot be determined at this time and could possibly require the payment of substantial penalties. This could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

Environmental Statutes and Regulations

General

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. Applicable statutes 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 these environmental requirements involves significant capital and operating costs, a major portion of which is expected to be recovered through existing ratemaking provisions. Through 2005, Southern Company had invested approximately \$2.4 billion in capital projects to comply with these requirements, with annual totals of \$423 million, \$300 million, and \$256 million for 2005, 2004, and 2003, respectively. Over the next decade, the Company expects that capital expenditures to assure compliance with existing and new regulations could exceed an additional \$7.5 billion, including \$0.8 billion, \$1.3 billion, and \$1.1 billion for 2006, 2007, and 2008, respectively. Because the Company's compliance strategy is impacted by changes to existing environmental laws and regulations, the cost, availability, and existing inventory of emission allowances, and the Company's fuel mix, the ultimate outcome cannot be determined at this time. Environmental costs that are known and estimable

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at this time are included in capital expenditures discussed under FINANCIAL CONDITION AND LIQUIDITY—"Capital Requirements and Contractual Obligations" herein.

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

Air Quality

Compliance with the Clean Air Act and resulting regulations has been and will continue to be a significant focus for Southern Company. Through 2005, the Company had spent approximately \$1.6 billion in reducing sulfur dioxide (SO₂) and nitrogen oxide (NO_x) emissions and in monitoring emissions pursuant to the Clean Air Act. Additional controls have been announced and are currently being installed at several plants to further reduce SO₂ and NO_x emissions, maintain compliance with existing regulations, and to meet new requirements.

Approximately \$1.3 billion of these expenditures related to reducing NO_x emissions pursuant to state and federal requirements in connection with the EPA's one-hour ozone standard and the 1998 regional NO_x reduction rules. In 2004, the regional NO_x reduction rules were implemented for the northern two-thirds of Alabama. Although the State of Georgia was originally included in the states subject to the regional NO_x rules, the EPA, in August 2005, stayed compliance with these requirements and initiated rulemakings to address issues raised in a petition for reconsideration filed by a coalition of Georgia industries. The impact of the 1998 regional NO_x reduction rules for the State of Georgia will depend on the outcome of the petition for reconsideration and/or any subsequent development and approval of its state implementation plan.

In addition, in 2005, Gulf Power substantially completed the terms of a 2002 agreement with the State of Florida to help ensure attainment of the ozone standard in the Pensacola, Florida area. The conditions of the agreement, which required installing additional controls on certain units and retiring three older units at a plant near Pensacola, will be fully implemented in 2006 at a cost of approximately \$134.4 million, of which \$4.3 million remains to be spent. Gulf Power's costs have been approved under its environmental cost recovery clause. See Note 1 to the financial statements under "Environmental Cost Recovery" for additional information.

In 2005, the EPA revoked the one-hour ozone standard and published the final set of rules for implementation of the new, more stringent eight-hour ozone standard. Areas within Southern Company's service area that have been designated as nonattainment under the eight-hour ozone standard include Birmingham (Alabama), Macon (Georgia), and a 20-county area within metropolitan Atlanta. State implementation plans, including new emission control regulations necessary to bring those areas into attainment, are required for most areas by June 2007. These state implementation plans could require further reductions in NO_x emissions from power plants.

In November 2005, the State of Alabama, through the Alabama Department of Environmental Management, submitted a request to the EPA to redesignate the Birmingham eight-hour ozone non-attainment area to attainment for the standard. On January 25, 2006, the EPA published a proposal in the Federal Register to approve the redesignation request. If ultimately approved by the EPA, the area would be designated to be in attainment. The final outcome of this matter cannot now be determined.

During 2005, the EPA's fine particulate matter nonattainment designations became effective for several areas within Southern Company's service area in Alabama and Georgia, and the EPA proposed a rule for the implementation of the fine particulate matter standard. The EPA plans to finalize the proposed implementation rule in 2006. State plans for addressing the nonattainment designations are required by April 2008 and could require further reductions in SO₂ and NO_x emissions from power plants. The EPA has also published proposed revisions to lower the levels of particulate matter currently allowed.

The EPA issued the final Clean Air Interstate Rule on March 10, 2005. This cap-and-trade rule addresses power plant SO₂ and NO_x emissions that were found to contribute to nonattainment of the eight-hour ozone and fine particulate matter standards in downwind states. Twenty-eight eastern states, including each of the states within Southern Company's service area, are subject to the requirements of the rule. The rule calls for additional reductions of NO_x and/or SO₂ to be achieved in two phases, 2009/2010 and 2015. These reductions will be accomplished by the installation of additional emission controls at Southern Company's coal-fired facilities or by the purchase of emission allowances from a cap-and-trade program.

The Clean Air Visibility Rule (formerly called the Regional Haze Rule) was finalized on July 6, 2005. The goal of this rule is to restore natural visibility conditions in certain areas (primarily national parks and wilderness areas) by 2064. The rule involves the application of Best Available Retrofit Technology (BART) requirements and a review each decade, beginning in 2018, of progress toward the goal. BART requires that sources that contribute to visibility impairment implement additional emission reductions, if necessary, to make progress toward remedying current visibility concerns. For power plants, the Clean Air Visibility Rule allows states to determine that the Clean Air Interstate Rule satisfies BART requirements for SO₂ and NO_x. However, additional requirements could be imposed. By December 17, 2007, states must submit implementation plans that contain emission reduction strategies for implementing BART requirements and for achieving sufficient and reasonable progress toward the goal.

On March 15, 2005, the EPA announced the final Clean Air Mercury Rule, a cap-and-trade program for the reduction of mercury emissions from coal-fired power plants. The rule sets caps on mercury emissions to be implemented in two phases, 2010 and 2018, and provides for an emission allowance trading market. The Company anticipates that emission controls installed to achieve compliance with the Clean Air Interstate Rule and the eight-hour ozone and fine-particulate standards will also result in mercury emission reductions. However, the long-term capability of emission control equipment to

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reduce mercury emissions is still being evaluated, and the installation of additional control technologies may be required.

The impacts of the eight-hour ozone standard, the fine particulate matter nonattainment designations, the Clean Air Interstate Rule, the Clean Air Visibility Rule, and the Clean Air Mercury Rule on the Company will depend on the development and implementation of rules at the state level. States implementing the Clean Air Mercury Rule and the Clean Air Interstate Rule, in particular, have the option not to participate in the national cap-and-trade programs and could require reductions greater than those mandated by the federal rules. Such impacts will also depend on resolution of pending legal challenges to the Clean Air Interstate Rule, the Clean Air Mercury Rule and a related petition from the State of North Carolina under Section 126 of the Clean Air Act, also related to the interstate transport of air pollutants. Therefore, the full impacts of these regulations on the Company cannot be determined at this time. The Company has developed and continually updates a comprehensive environmental compliance strategy to comply with the continuing and new environmental requirements discussed above. As part of this strategy, the Company plans to install additional SO₂, NO_x, and mercury emission controls within the next several years to assure continued compliance with applicable air quality requirements.

Water Quality

In July 2004, the EPA published final rules under the Clean Water Act for the purpose of reducing impingement and entrainment of fish and fish larvae at power plants' cooling water intake structures. The new rules require baseline biological information and, perhaps, installation of fish protection technology near some intake structures at existing power plants.

Georgia Power is installing cooling towers at additional facilities under the Clean Water Act to cool water prior to discharge. Near Atlanta, a cooling tower for one plant was completed in 2004 and two others are scheduled for completion in 2008. The total estimated cost of these projects is \$173 million, with \$85 million remaining to be spent. Georgia Power is also conducting a study of the aquatic environment at another facility to determine if further thermal controls are necessary at that plant.

The full impact of these new rules will depend on the results of studies and analyses performed as part of the rules' implementation and the actual requirements established by state regulatory agencies, and therefore, cannot now be determined.

Environmental Remediation

Southern Company must comply with other environmental laws and regulations that cover the handling and disposal of waste and release of hazardous substances. Under these various laws and regulations, the retail operating companies could incur substantial costs to clean up properties. The retail operating companies 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 retail operating companies 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 "Environmental Matters—Environmental Remediation" for additional information.

Global Climate Issues

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 constraints on the emissions of greenhouse gases for a group of industrialized countries. The Bush Administration has not supported U.S. ratification of the Kyoto Protocol or other mandatory carbon dioxide reduction legislation; however, in 2002, it did announce a goal to reduce the greenhouse gas intensity of the U.S., the ratio of greenhouse gas emissions to the value of U.S. economic output, by 18 percent by 2012. A year later, the Department of Energy (DOE) announced the Climate VISION program to support this goal. Energy-intensive industries, including electricity generation, are the initial focus of this program. Southern Company is involved in the development of a voluntary electric utility sector climate change initiative in partnership with the government. In a memorandum of understanding signed in December 2004 with the DOE under Climate VISION, the utility sector pledged to reduce its greenhouse gas emissions rate by 3 percent to 5 percent by 2010-2012. The Company is continuing to evaluate future energy and emission profiles relative to the Climate VISION program and is analyzing voluntary programs to support the industry initiative.

FERC Matters

Market-Based Rate Authority

Each of the retail operating companies and Southern Power has authorization from the Federal Energy Regulatory Commission (FERC) to sell power to non-affiliates at market-based prices. The retail operating companies and Southern Power 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 December 2004, the FERC initiated a proceeding to assess Southern Company's generation dominance within its retail service territory. The ability to charge market-based rates in other markets is not an issue in that proceeding. In February 2005, Southern Company submitted responsive information. In February 2006, the FERC suspended the proceedings to allow the parties to conduct settlement discussions. Any new market-based rate transactions in its retail service territory entered into after February 27, 2005 are subject to refund to the level of the default cost-based rates, pending the outcome of the proceeding. The impact of such sales through December 31, 2005 is not expected to exceed \$16 million. The refund period covers 15 months. In the event that the FERC's default mitigation measures for entities that are found to have market power are ultimately applied, the retail operating companies and Southern Power may be required to charge cost-based rates for certain whole-

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sale sales in the Southern Company retail service territory, which may be lower than negotiated market-based rates. The final outcome of this matter will depend on the form in which the final methodology for assessing generation market power and mitigation rules may be ultimately adopted and cannot be determined at this time.

In addition, in May 2005, the FERC started an investigation to determine whether Southern Company satisfies the other three parts of the FERC's market-based rate analysis: transmission market power, barriers to entry, and affiliate abuse or reciprocal dealing. The FERC established a new refund period related to this expanded investigation. Any and all new market-based rate transactions both inside and outside Southern Company's retail service territory involving any Southern Company subsidiary will be subject to refund to the extent the FERC orders lower rates as a result of this new investigation, with the 15-month refund period beginning July 19, 2005. The impact of such sales through December 31, 2005 is not expected to exceed \$31 million, of which \$11 million relates to sales inside the retail service territory discussed above. The FERC also directed that this expanded proceeding be held in abeyance pending the outcome of the proceeding on the Intercompany Interchange Contract (IIC) discussed below.

Southern Company and its subsidiaries believe that there is no meritorious basis for this proceeding and are vigorously defending themselves in this matter. However, the final outcome of this matter, including any remedies to be applied in the event of an adverse ruling in this proceeding, cannot now be determined.

Intercompany Interchange Contract

The Company's generation fleet in its retail service territory is operated under the IIC, as approved by the FERC. In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among Alabama Power, Georgia Power, Gulf Power, Mississippi Power, Savannah Electric, Southern Power, and SCS, as agent, under the terms of which the power pool of Southern Company is operated, and, in particular, the propriety of the continued inclusion of Southern Power as a party to the IIC, (2) whether any parties to the IIC have violated the FERC's standards of conduct applicable to utility companies that are transmission providers, and (3) whether Southern Company's code of conduct defining Southern Power as a "system company" rather than a "marketing affiliate" is just and reasonable. In connection with the formation of Southern Power, the FERC authorized Southern Power's inclusion in the IIC in 2000. The FERC also previously approved Southern Company's code of conduct. The FERC order directs that the administrative law judge who presided over a proceeding involving approval of PPAs between Southern Power and Georgia Power and Savannah Electric be assigned to preside over the hearing in this proceeding and that the testimony and exhibits presented in that proceeding be preserved to the extent appropriate. Hearings are scheduled for September 2006. Effective July 19, 2005, revenues from transactions under the IIC involving any Southern Company subsidiaries are subject to refund to the extent the FERC orders any changes to the IIC.

Southern Company and its subsidiaries believe that there is no meritorious basis for this proceeding and are vigorously defending themselves in this matter. However, the final outcome of this matter, including any remedies to be applied in the event of an adverse ruling in this proceeding, cannot now be determined.

Generation Interconnection Agreements

In July 2003, the FERC issued its final rule on the standardization of generation interconnection agreements and procedures (Order 2003). Order 2003 shifts much of the financial burden of new transmission investment from the generator to the transmission provider. The FERC has indicated that Order 2003, which was effective January 20, 2004, is to be applied prospectively to interconnection agreements. Subsidiaries of Tenaska, Inc., as counterparties to three previously executed interconnection agreements with subsidiaries of Southern Company, have filed complaints at the FERC requesting that the FERC modify the agreements and that Southern Company refund a total of \$19 million previously paid for interconnection facilities, with interest. These proceedings are still pending at the FERC. Southern Company has also received similar requests from other entities totaling approximately \$14 million. Southern Company has opposed all such requests. The impact of Order 2003 and its subsequent rehearings on Southern Company and the final results of these matters cannot be determined at this time.

Transmission

In December 1999, the FERC issued its final rule on Regional Transmission Organizations (RTOs). Since that time, there have been a number of additional proceedings at the FERC designed to encourage further voluntary formation of RTOs or to mandate their formation. However, at the current time, there are no active proceedings that would require Southern Company to participate in an RTO. Current FERC efforts that may potentially change the regulatory and/or operational structure of transmission include rules related to the standardization of generation interconnection, as well as an inquiry into, among other things, market power by vertically integrated utilities. See "Market-Based Rate Authority" and "Generation Interconnection Agreements" above for additional information. The final outcome of these proceedings cannot now be determined. However, Southern Company's financial condition, results of operations, and cash flows could be adversely affected by future changes in the federal regulatory or operational structure of transmission.

PSC Matters

Alabama Power

In October 2004, the Alabama PSC approved a specific rate mechanism for the recovery of Alabama Power's retail costs associated with environmental laws, regulations, or other such mandates. The rate mechanism began operation in January 2005 and provides for the recovery of these costs pursuant to a factor that will be calculated annually. Environmental costs to be recovered

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include operation and maintenance expenses, depreciation, and a return on invested capital. Retail rates increased approximately 1 percent in both January 2005 and 2006. In conjunction with the Alabama PSC's approval of this rate mechanism, Alabama Power agreed to a moratorium until 2007 on any retail rate increase under its previously approved Rate Stabilization and Equalization Plan (Rate RSE).

On October 4, 2005, the Alabama PSC approved a revision to Rate RSE requested by Alabama Power. Effective January 2007, Rate RSE adjustments will be based on forward-looking information for the applicable upcoming calendar year. Rate adjustments for any two-year period, when averaged together, cannot exceed 4 percent per year and any annual adjustment is limited to 5 percent. Rates will remain unchanged if the return on equity (ROE) is between 13 percent and 14.5 percent. If Alabama Power's actual retail ROE is above the allowed equity return range, customer refunds will be required; however, there is no provision for additional customer billings should the actual retail return on common equity fall below the allowed equity return range. Alabama Power will make its initial submission of projected data for calendar year 2007 by December 1, 2006.

See Note 3 to the financial statements under "Alabama Power Retail Regulatory Matters" for further information.

Georgia Power

In December 2004, the Georgia PSC approved the December 2004 three-year retail rate plan ending December 31, 2007 (2004 Retail Rate Plan) for Georgia Power. Under the terms of the 2004 Retail Rate Plan, earnings will be evaluated against a retail ROE range of 10.25 percent to 12.25 percent. Two-thirds of any earnings above 12.25 percent will be applied to rate refunds, with the remaining one-third retained by Georgia Power. Retail rates and customer fees were increased by approximately \$203 million in January 2005 to cover the higher costs of purchased power, operation and maintenance expenses, environmental compliance, and continued investment in new generation, transmission, and distribution facilities to support growth and ensure reliability.

Georgia Power is required to file a general rate case on or about July 1, 2007, in response to which the Georgia PSC would be expected to determine whether the 2004 Retail Rate Plan should be continued, modified, or discontinued. Until then, Georgia Power may not file for a general base rate increase unless its projected retail return on common equity falls below 10.25 percent. See Note 3 to the financial statements under "Georgia Power Retail Regulatory Matters" for additional information.

On December 13, 2005, Georgia Power and Savannah Electric entered into a merger agreement. Savannah Electric will merge into Georgia Power, with Georgia Power continuing as the surviving corporation. Pending regulatory approvals, the merger is expected to occur by July 2006. See "Fuel Cost Recovery" herein and Note 3 to the financial statements under "Merger of Georgia Power and Savannah Electric" for additional information.

Mississippi Power

On December 1, 2005, Mississippi Power submitted its annual Performance Evaluation Plan (PEP) filing to the Mississippi PSC. Ordinarily, PEP limits annual rate increases to 4 percent; however, Mississippi Power has requested that the Mississippi PSC approve a temporary change to allow it to exceed this cap as a result of the ongoing effects of Hurricane Katrina. Mississippi Power has requested a 5 percent or \$32 million retail base rate increase to become effective in April 2006 if approved. Hearings are scheduled for March 2, 2006.

In May 2004, the Mississippi PSC approved Mississippi Power's request to reclassify to jurisdictional cost of service the 266 megawatts of Plant Daniel unit 3 and 4 capacity, effective January 1, 2004. The Mississippi PSC authorized Mississippi Power to include the related costs and revenue credits in jurisdictional rate base, cost of service, and revenue requirement calculations for purposes of retail rate recovery. Mississippi Power is amortizing the regulatory liability established pursuant to the Mississippi PSC's interim December 2003 order, as approved in May 2004, to earnings as follows: \$16.5 million in 2004, \$25.1 million in 2005, \$13.0 million in 2006, and \$5.7 million in 2007, resulting in expense reductions in each of those years.

Fuel Cost Recovery

The retail operating companies each have established fuel cost recovery rates approved by their respective state PSCs. Over the past year, the retail operating companies have continued to experience higher than expected fuel costs for coal and natural gas. These higher fuel costs have increased the under recovered fuel costs included in the balance sheets. The retail operating companies continuously monitor the under recovered fuel cost balance in light of these higher fuel costs. Each of the retail operating companies received approval in 2005 to increase their fuel cost recovery factors to recover existing under recovered amounts as well as projected future costs.

Alabama Power fuel costs are recovered under Rate ECR (Energy Cost Recovery), which provides for the addition of a fuel and energy cost factor to base rates. In December 2005, the Alabama PSC approved an increase that allows for the recovery of approximately \$227 million in existing under recovered fuel costs over a two-year period.

In May 2005, the Georgia PSC approved Georgia Power's request to increase customer fuel rates by approximately 9.5 percent to recover under recovered fuel costs of approximately \$508 million existing as of May 31, 2005 over a four-year period that began June 1, 2005. Under recovered fuel amounts for the period subsequent to June 1, 2005 totaled \$327.5 million through December 31, 2005. The Georgia PSC's order instructs that such amounts be reviewed semi-annually beginning February 2006. If the amount under or over recovered exceeds \$50 million at the evaluation date, Georgia Power would be required to file for a temporary fuel rate change. In addition, Savannah Electric's under recovered fuel costs totaled \$77.7 million at December 31, 2005. In accordance with a Georgia PSC order, Savannah Electric was scheduled to file an additional request for a fuel cost recovery increase in January 2006.

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In connection with the proposed merger, Georgia Power has agreed with a Georgia PSC staff recommendation to forego the temporary fuel rate process, and Savannah Electric has postponed its scheduled filing. Instead, Georgia Power and Savannah Electric will file a combined request in March 2006 to increase its fuel cost recovery rate.

The case will seek approval of a fuel cost recovery rate based upon future fuel cost projections for the combined Georgia Power and Savannah Electric generating fleet as well as the under recovered balances existing at June 30, 2006. The new fuel cost recovery rate would be billed beginning in July 2006 to all Georgia Power customers, including the existing Savannah Electric customers. Under recovered amounts as of the date of the merger will be paid by the appropriate customer groups.

In August 2005, the Georgia PSC initiated an investigation of Savannah Electric's fuel practices. In February 2006, an investigation of Georgia Power's fuel practices was initiated. Georgia Power and Savannah Electric are responding to data requests and cooperating in the investigations. The final outcome of these matters cannot now be determined.

Fuel cost recovery revenues as recorded on the financial statements are adjusted for differences in actual recoverable costs and amounts billed in current regulated rates. Accordingly, any increase in the billing factor would have no significant effect on the Company's revenues or net income, but would increase annual cash flow. Based on their respective state PSC orders, a portion of the under recovered regulatory clause revenues for Alabama Power, Georgia Power, and Savannah Electric was reclassified from current assets to deferred charges and other assets in the balance sheet. See Note 1 to the financial statements under "Revenues" and Note 3 to the financial statements under "Alabama Power Retail Regulatory Matters" and "Georgia Power Retail Regulatory Matters" for additional information.

Storm Damage Cost Recovery

Each retail operating company maintains a reserve for property damage to cover the cost of damages from major storms to its transmission and distribution facilities and the cost of uninsured damages to its generation facilities and other property. In September 2004, Hurricane Ivan hit the Gulf Coast of Florida and Alabama and continued north through Southern Company's service territory causing substantial damage.

At Gulf Power, the related costs charged to its property damage reserve as of December 31, 2004 were \$93.5 million. Prior to Hurricane Ivan, Gulf Power's reserve balance was approximately \$28 million. Gulf Power's current annual accrual to the property damage reserve, as approved by the Florida PSC, is \$3.5 million. The Florida PSC has also approved additional accrual amounts at Gulf Power's discretion; Gulf Power accrued an additional \$6 million and \$15 million in 2005 and 2004, respectively. In February 2005, Gulf Power, the Office of Public Counsel for the State of Florida, and the Florida Industrial Power Users Group filed a Stipulation and Settlement with the Florida PSC, which the Florida PSC subse-

quently approved, allowing Gulf Power to recover the retail portion of \$51.7 million of these costs, plus interest and revenue taxes, from customers over a 24-month period that began in April 2005. In connection with the stipulation, Gulf Power has agreed that it will not seek any additional increase in its base rates and charges to become effective on or before March 1, 2007.

At Alabama Power, operation and maintenance expenses associated with repairing the damage to its facilities and restoring service to customers as a result of Hurricane Ivan were \$57.8 million for 2004. The balance in Alabama Power's natural disaster reserve prior to the storm was \$14.6 million. In October 2004, Alabama Power received approval from the Alabama PSC to defer the negative balance for recovery in future periods. Alabama Power is allowed to accrue \$250,000 per month until a maximum accumulated provision of \$32 million is attained. Higher accruals to restore the reserve to its authorized level are allowed whenever the balance in the reserve declines below \$22.4 million. During 2004, Alabama Power accrued an additional \$6.9 million.

In February and December 2005, Alabama Power requested and received Alabama PSC approval of accounting orders that allowed Alabama Power to immediately return certain regulatory liabilities to the retail customers. These orders also allowed Alabama Power to simultaneously recover from customers accruals of approximately \$48 million primarily to offset the costs of Hurricane Ivan and restore a positive balance in the natural disaster reserve. The combined effect of these orders had no impact on net income in 2005.

In July and August 2005, Hurricanes Dennis and Katrina, respectively, hit the Gulf Coast of the United States and caused significant damage within Southern Company's service area, including portions of the service areas of Alabama Power, Gulf Power, and Mississippi Power. The total incremental cost of repairing the damages to Mississippi Power's facilities and restoring service to customers is currently estimated to be approximately \$277 million net of approximately \$68 million of insurance proceeds. Prior to Hurricane Katrina, Mississippi Power had a balance of approximately \$3 million in its property reserve. Incremental costs incurred through December 31, 2005 were \$210 million net of insurance proceeds of \$68 million, of which \$8 million has been received. These costs include approximately \$149 million of capital additions and \$133 million of operation and maintenance expenditures. Restoration efforts following Hurricane Katrina are ongoing for approximately 19,200 Mississippi Power customers who remain unable to receive power, as well as to make permanent improvements in areas where temporary emergency repairs were necessary. In addition, business and governmental authorities are still reviewing redevelopment plans for portions of the most severely damaged areas along the Mississippi shoreline. Until such plans are complete, Mississippi Power cannot determine the related electric power needs or associated cost estimates. The ultimate impact of redevelopment plans in these areas on the cost estimates cannot now be determined.

Each of the affected retail operating companies has been authorized by their respective state PSCs to defer the portion of the Hurricane Dennis and Katrina restoration costs that exceeded the

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balance in their storm damage reserve accounts. As of December 31, 2005, the deficit balance in Southern Company's storm damage reserve accounts totaled approximately \$366 million, of which approximately \$70 million and \$296 million, respectively, is included in the balance sheets herein under Other Current Assets and Other Regulatory Assets. The recovery of these deferred costs is subject to the approval of the respective state PSCs.

In December 2005, the Alabama PSC approved a separate rate rider to recover Alabama Power's \$51 million of deferred Hurricane Dennis and Katrina operation and maintenance costs over a two-year period and to replenish its reserve to a target balance of \$75 million over a five-year period.

In October 2005, the Mississippi PSC issued an Interim Accounting Order requiring Mississippi Power to recognize a regulatory asset in an amount equal to the retail portion of the recorded Hurricane Katrina restoration costs, including both operation and maintenance expenditures and capital additions. In December 2005, Mississippi Power filed with the Mississippi PSC a detailed review of all Hurricane Katrina restoration costs as required in the Interim Accounting Order. Mississippi Power is currently working with the Mississippi PSC to establish a method to recover all such prudently incurred costs upon resolution of uncertainties related to federal grant assistance and proposed state legislation to allow securitized financing.

In 2005, the Florida Legislature authorized securitized financing for hurricane costs. On February 22, 2006, Gulf Power filed a petition with the Florida PSC under this legislative authority requesting permission to issue \$87.2 million in securitized storm-recovery bonds. The bonds would be repaid over 8 years from revenues to be received from storm-recovery charges implemented under the securitization plan and billed to customers. If approved as proposed, the plan would resolve Gulf Power's remaining deferred costs, by refinancing, net of taxes, the remaining balance of storm damage costs currently being recovered from customers related to Hurricane Ivan and financing, net of taxes, restoration costs associated with Hurricanes Dennis and Katrina of approximately \$54 million. It would also replenish Gulf Power's property damage reserve with an additional \$70 million. A decision on the plan is expected prior to the end of the second quarter of 2006. Since Gulf Power will recognize expenses equal to the revenues billed to customers, the securitization plan would have no impact on net income, but would increase cash flow.

See Notes 1 and 3 to the financial statements under "Storm Damage Reserves" and "Storm Damage Cost Recovery," respectively, for additional information on these reserves. The final outcome of these matters cannot now be determined.

Mirant Bankruptcy Matters

Mirant is an energy company with businesses that include independent power projects and energy trading and risk management companies in the U.S. and selected other countries. It was a wholly-owned subsidiary of Southern Company until its initial public offering in October 2000. In April 2001, Southern Company completed a spin-off to its shareholders of its remaining ownership and Mirant became an independent corporate entity.

In July 2003, Mirant filed for voluntary reorganization under Chapter 11 of the Bankruptcy Code. In January 2006, Mirant's plan of reorganization became effective, and Mirant emerged from bankruptcy. As part of the plan, Mirant transferred substantially all of its assets and its restructured debt to a new corporation that adopted the name Mirant Corporation (Reorganized Mirant). 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."

In December 2004, as a result of concluding an IRS audit for the tax years 2000 and 2001, Southern Company paid \$39 million in additional tax and interest for issues related to Mirant tax items. Under the terms of the separation agreements entered into in connection with the spin-off, Mirant agreed to indemnify Southern Company for costs associated with these tax items and additional IRS assessments. However, as a result of Mirant's bankruptcy, Southern Company sought reimbursement as an unsecured creditor in the Chapter 11 proceeding. Based on management's assessment of the collectibility of this receivable, Southern Company has reserved approximately \$12.5 million. If Southern Company is ultimately required to make any additional payments, Mirant's indemnification obligation to Southern Company for these additional payments would constitute unsecured claims against Mirant, entitled to stock in Reorganized Mirant, the value of which is uncertain. See Note 3 to the financial statements under "Mirant Matters—Mirant Bankruptcy."

In June 2005, Mirant, as a debtor in possession, and The Official Committee of Unsecured Creditors of Mirant Corporation filed a complaint against Southern Company in the U.S. Bankruptcy Court for the Northern District of Texas, which was amended in July 2005 and February 2006. The complaint alleges that Southern Company caused Mirant to engage in certain fraudulent transfers and to pay illegal dividends to Southern Company prior to the spin-off. The complaint also seeks to recharacterize certain advances from Southern Company to Mirant for investments in energy facilities from debt to equity. The complaint further alleges that Southern Company is liable to Mirant's creditors for the full amount of Mirant's liability and that Southern Company caused Mirant to breach its fiduciary duties to creditors. The complaint seeks monetary damages in excess of \$2 billion plus interest, punitive damages, attorneys' fees, and costs. Finally, Mirant objects to Southern Company's claims against Mirant in the Bankruptcy Court (which relate to reimbursement under the separation agreements of payments such as income taxes, interest, legal fees, and other guarantees described in Note 7 to the financial statements) and seeks equitable subordination of Southern Company's claims to the claims of all other creditors. Southern Company served an answer to the second amended complaint in February 2006. Also in February 2006, the Company's motion to transfer the case to the U.S. District Court for the Northern District of Georgia was granted. Southern Company believes there is no meritorious basis for the claims in the complaint and is vigorously defending itself in this action. See Note 3 to the financial statements under

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"Mirant Matters–Mirant Bankruptcy Litigation" for additional information. The ultimate outcome of these matters cannot be determined at this time.

Income Tax Matters

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 2001. Southern Company participates in four international leveraged lease transactions and receives federal income tax deductions for depreciation and amortization, as well as interest on related debt. The IRS proposed to disallow the tax losses for one of these leases (a lease-in-lease-out, or LILO) in connection with its audit of 1996 through 2001. In October 2004, Southern Company submitted the issue to the IRS appeals division and in February 2005 reached a negotiated settlement with the IRS, which is subject to final approval.

In connection with its audit of 2000 and 2001, the IRS also challenged Southern Company's deductions related to three other international lease (sale-in-lease-out, or SILO) transactions. If the IRS is ultimately successful in disallowing the tax deductions related to these three transactions, beginning with the 2000 tax year, Southern Company would be subject to additional interest charges of up to \$34 million. The IRS has also proposed a penalty of approximately \$16 million. Southern Company believes these transactions are valid leases for U.S. tax purposes, the related deductions are allowable, and the assessment of a penalty is inappropriate. Southern Company is continuing to pursue resolution of these matters with the IRS and expects to litigate the issue if necessary. Although the payment of the tax liability, exclusive of interest, would not affect Southern Company's results of operations under current accounting standards, it could have a material impact on cash flow. Through December 31, 2005, Southern Company has claimed \$241 million in tax benefits related to these SILO transactions challenged by the IRS. See Note 1 to the financial statements under "Leveraged Leases" for additional information.

Under current accounting rules, the settlement of the LILO transaction will not have a material impact on Southern Company's financial statements; however, the Financial Accounting Standards Board (FASB) has proposed changes to the accounting for leveraged leases that are expected to become effective in 2006. If approved as proposed, these changes could require Southern Company to reflect the tax deductions that the IRS is challenging as currently payable in the balance sheet and to change the timing of income recognized for the leases, including a cumulative effect upon adoption of the change. For the LILO transaction settled with the IRS in February 2005, Southern Company estimates such cumulative effect would reduce Southern Company's net income by up to \$16 million. The impact of these proposed changes related to the SILO transactions would be dependent on the resolution of these matters with the IRS but could be significant, and potentially material, to Southern Company's net income. The ultimate outcome of these matters cannot now be determined.

Synthetic Fuel Tax Credits

Southern Company has investments in two entities that produce synthetic fuel and receive tax credits under Section 45K (formerly Section 29) of the Internal Revenue Code of 1986, as amended (Internal Revenue Code). In accordance with Section 45K of the Internal Revenue Code, these tax credits are subject to limitation as the annual average price of oil (as determined by the DOE) increases over a specified, inflation-adjusted dollar amount published in the spring of the subsequent year. Southern Company, along with its partners in these investments, will continue to monitor oil prices. Any indicated potential limitation on these credits could affect either the timing or the amount of the credit recognition and could also result in an impairment of these investments, which total approximately \$19.5 million at December 31, 2005, by Southern Company.

Construction Projects

Integrated Coal Gasification Combined Cycle

In December 2005, Southern Power and the Orlando Utilities Commission (OUC) executed definitive agreements for development of an integrated coal gasification combined cycle (IGCC) 283-megawatt project in Orlando, Florida. The definitive agreements provide that Southern Power will own at least 65 percent of the gasifier portion of the IGCC project. OUC will own the remainder of the gasifier portion and 100 percent of the combined cycle portion of the IGCC project. OUC will purchase all of the gasifier capacity from Southern Power once the plant is in commercial operation. Southern Power will construct the project and manage its operation after construction is completed. In February 2006, Southern Power signed a cooperative agreement with the DOE that provides up to \$235 million in grant funding for the gasification portion of this project. The IGCC project is subject to National Environmental Policy Act review as well as state environmental review, requires certain regulatory approvals, and is expected to begin commercial operation in 2010. Southern Power's total cost related to the IGCC project is estimated at approximately \$121 million.

Plant Franklin Unit 3

In August 2004, Southern Power completed limited construction activities on Plant Franklin Unit 3 to preserve the long-term viability of the project. Final completion is not anticipated until the 2008-2011 period. See Note 3 to the financial statements under "Plant Franklin Construction Project" for additional information. The final outcome of this matter cannot now be determined.

Nuclear

As part of a potential expansion of Plant Vogtle, Georgia Power and Southern Nuclear have notified the Nuclear Regulatory Commission (NRC) of their intent to apply for an early site permit (ESP) this year and a combined construction and operating license (COL) in 2008. In addition, a reactor design from Westinghouse Electric Company has been selected and a purchase agreement is being negotiated. Participation agreements have been reached with each of the existing Plant Vogtle co-owners. See Note 4

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to the financial statements for additional information on these co-owners. At this point, no final decision has been made regarding actual construction. The NRC's streamlined licensing process for new nuclear units allows utilities to seek regulatory approval at various stages. These stages include design certification, which is obtained by the reactor vendor, and the ESP and COL, which are each obtained by the owner-operators of the units. An ESP indicates site approval is obtained before a company decides to build and the COL provides regulatory approval for building and operating the plant. In addition, any new Georgia Power generation must be certified by the Georgia PSC.

Southern Company also is participating in NuStart Energy Development, LLC (NuStart Energy), a broad-based nuclear industry consortium formed to share the cost of developing a COL and the related NRC review. NuStart Energy plans to complete detailed engineering design work and to prepare COL applications for two advanced reactor designs, then to choose one of the applications and file it for NRC review and approval. The COL ultimately is expected to be transferred to one or more of the consortium companies; however, at this time, none of them have committed to build a new nuclear plant.

Southern Company is also exploring other possibilities relating to nuclear power projects, both on its own or in partnership with other utilities.

Other Matters

In accordance with FASB Statement No. 87, Employers' Accounting for Pensions, Southern Company recorded non-cash pre-tax pension income/(expense) of approximately \$(2) million, \$44 million, and \$99 million in 2005, 2004, and 2003, respectively. Postretirement benefit costs for Southern Company were \$118 million, \$106 million, and \$101 million in 2005, 2004, and 2003, respectively. Both pension and postretirement costs are expected to continue to trend upward. Such amounts are dependent on several factors including trust earnings and changes to the plans. A portion of pension and postretirement benefit costs is capitalized based on construction-related labor charges. For the retail operating companies, pension 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.

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

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 poli-

cies, 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 88 percent of Southern Company's total earnings for 2005, are subject to retail regulation by their respective state PSCs 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 (Statement No. 71), which requires the financial statements to reflect the effects of rate 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 postretirement 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 and accounting principles generally accepted in the United States. However, adverse legislative, 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 herein and Note 3 to the financial statements for more information regarding certain of these contingencies. Southern Company periodically evaluates its exposure to such risks and records reserves for those matters where a loss is considered probable and reasonably estimable in accordance with generally accepted accounting

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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. 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.

Unbilled Revenues

Revenues related to the sale of electricity are recorded when electricity is delivered to customers. However, the determination of KWH sales to individual customers is based on the reading of their meters, which is performed on a systematic basis throughout the month. At the end of each month, amounts of electricity delivered to customers, but not yet metered and billed, are estimated. Components of the unbilled revenue estimates include total KWH territorial supply, total KWH billed, estimated total electricity lost in delivery, and customer usage. These components can fluctuate as a result of a number of factors including weather, generation patterns, and power delivery volume and other operational constraints. These factors can be unpredictable and can vary from historical trends. As a result, the overall estimate of unbilled revenues could be significantly affected, which could have a material impact on the Company's results of operations.

New Accounting Standards

Income Taxes

In December 2004, the FASB issued FASB Staff Position 109-1, Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities provided by the American Jobs Creation Act of 2004 (FSP 109-1), which requires that the generation deduction be accounted for as a special tax deduction rather than as a tax rate reduction. Southern Company adopted FSP 109-1 in the first quarter of 2005 with no material impact on its financial statements.

Conditional Asset Retirement Obligations

Effective December 31, 2005, Southern Company adopted the provision of FASB Interpretation No. 47 (FIN 47), Conditional Asset Retirement Obligations, which requires that an asset retirement obligation be recorded even though the timing and/or method of

settlement are conditional on future events. Prior to December 2005, Southern Company did not recognize asset retirement obligations for asbestos removal and disposal of polychlorinated biphenyls in certain transformers because the timing of their retirements was dependent on future events. For additional information, see Note 1 to the financial statements under "Asset Retirement Obligations and Other Costs of Removal." At December 31, 2005, Southern Company recorded additional asset retirement obligations (and assets) of approximately \$153 million. The adoption of FIN 47 did not have any effect on Southern Company's income statement.

Stock Options

On January 1, 2006, Southern Company adopted FASB Statement No. 123R, Share-Based Payment, on a modified prospective basis. This statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. Although the compensation expense required under the revised statement differs slightly, the impacts on the Company's financial statements are similar to the pro forma disclosures included in Note 1 to the financial statements under "Stock Options."

FINANCIAL CONDITION AND LIQUIDITY

Overview

Southern Company's financial condition continued to be stable at December 31, 2005. Net cash flow from operating activities totaled \$2.5 billion, \$2.7 billion, and \$3.1 billion for 2005, 2004, and 2003, respectively. The \$165 million decrease for 2005 resulted primarily from higher fuel costs at the retail operating companies, partially offset by increases in base rates and fuel recovery rates. The \$376 million decrease from 2003 to 2004 also resulted primarily from higher fuel costs at the retail operating companies. Fuel costs are recoverable in future periods and are reflected in the balance sheets as under recovered regulatory clause revenues. See FUTURE EARNINGS POTENTIAL—"PSC Matters—Fuel Cost Recovery" herein for additional information.

Significant balance sheet changes include a \$0.4 billion increase in long-term debt and preferred stock for 2005 due to an increase of \$1.1 billion in property, plant, and equipment. The majority of funds needed for property additions were provided from operating activities.

At the close of 2005, the closing price of Southern Company's common stock was \$34.53 per share, compared with book value of \$14.42 per share. The market-to-book value ratio was 240 percent at the end of 2005, compared with 242 percent at year-end 2004.

Each of the retail operating companies, Southern Power, and SCS have received investment grade ratings from the major rating agencies.

Sources of Capital

Southern Company intends to meet its future capital needs through internal cash flow and external security issuances. Equity capital can

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be provided from any combination of the Company's stock plans, private placements, or public offerings. The amount and timing of additional equity capital to be raised in 2006, 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 2006 outside of its existing stock option plan.

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, security issuances, and term loan and short-term borrowings. Gulf Power and Mississippi Power are considering other financing options for storm recovery costs. However, the type and timing of any financings, if needed, will depend upon prevailing market conditions, regulatory approval, and other factors. The issuance of securities by the retail operating companies is generally subject to the approval of the applicable state PSC. In addition, the issuance of all securities by Mississippi Power and Southern Power and short-term securities by Georgia Power and Savannah Electric is generally subject to regulatory approval by the FERC following the repeal of the Public Utility Holding Company Act of 1935, as amended (PUHCA), on February 8, 2006. Additionally, with respect to the public offering of securities, Southern Company and certain of its subsidiaries file registration statements with the Securities and Exchange Commission under the Securities Act of 1933, as amended (1933 Act). The amounts of securities authorized by the appropriate regulatory authorities, as well as the amounts registered under the 1933 Act, are continuously monitored and appropriate filings are made to ensure flexibility in the capital markets.

Southern Power plans to use operating cash flows, external funds, and equity capital from Southern Company to finance its capital expenditures. External funds are expected to be obtained from the issuance of unsecured senior debt and commercial paper or through credit arrangements from banks.

Southern Company and each retail operating company obtains financing separately without credit support from any affiliate. 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.

Southern Company's current liabilities frequently 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 sources of liquidity. 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.

At December 31, 2005, Southern Company and its subsidiaries had approximately \$202 million of cash and cash equivalents and \$3.3 billion of unused credit arrangements with banks, of which \$810 million expire in 2006 and \$2.5 billion expire in 2007 and beyond. Approximately \$228 million of the credit facilities expiring in 2006 allow for the execution of term loans for an additional two-

year period, and \$311 million allow for the execution of one-year term loans. Most of these arrangements contain covenants that limit debt levels and typically contain cross default provisions that are restricted only to the indebtedness of the individual company. Southern Company and its subsidiaries are currently in compliance with all such covenants. See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information.

Financing Activities

During 2005, Southern Company and its subsidiaries issued \$1.6 billion of long-term debt and \$55 million of preference stock. The security issuances were used to redeem \$1.3 billion of long-term debt, fund Southern Company's ongoing construction program, and for general corporate purposes. In addition, Southern Company issued 10.1 million new shares of common stock through the Company's stock plans and realized proceeds of \$213 million. In a program designed primarily to offset these issuances, Southern Company also repurchased 10.1 million shares of common stock at a total cost of \$352 million. The repurchase program was discontinued in early January 2006.

Subsequent to December 31, 2005, Alabama Power issued \$600 million of long-term senior notes to reduce short-term debt and for other general corporate purposes. In conjunction with these transactions, Alabama Power terminated \$600 million notional amount of interest rate swaps at a gain of \$18 million. The gain will be amortized to interest expense over a 10-year period. In addition, Southern Company redeemed \$72 million in long-term debt payable to affiliated trusts following the repurchase of the underlying capital securities.

Off-Balance Sheet Financing Arrangements

In 2001, Mississippi Power began the initial 10-year term of a lease agreement for a combined cycle generating facility built at Plant Daniel for 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. 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 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 assets. See Note 7 to the financial statements under "Operating Leases" for additional information.

Credit Rating Risk

Southern Company does not have any credit arrangements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. There are certain contracts that could require collateral, but not accelerated payment, in the event of a

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credit rating change to BBB- or Baa3 or below. These contracts are primarily for physical electricity purchases and sales. At December 31, 2005, the maximum potential collateral requirements at a BBB- or Baa3 rating were approximately \$196.4 million. The maximum potential collateral requirements at a rating below BBB- or Baa3 were approximately \$602.3 million. Generally, collateral may be provided by a Southern Company guaranty, letter of credit, or cash. Southern Company is also party to certain derivative agreements that could require collateral and/or accelerated payment in the event of a credit rating change to below investment grade. These agreements are primarily for natural gas price risk management activities. At December 31, 2005, Southern Company and its subsidiaries had no material exposure under these contracts.

Subsequent to December 31, 2005, the Company has entered into additional physical electricity purchases and sales contracts adding \$9 million to the maximum potential collateral requirements at a credit rating of BBB and Baa2 and \$17 million at BBB- or Baa3 and below.

Market Price Risk

Southern Company is exposed to market risks, primarily commodity price risk and interest rate risk. 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 risk management practices. Company policy is that derivatives are to be used primarily for hedging purposes and mandates strict adherence to all applicable risk management policies. Derivative positions are monitored using techniques including, but not limited to, market valuation, value at risk, stress testing, and sensitivity analysis.

To mitigate future exposure to change in interest rates, the Company has entered into forward starting interest rate swaps that have been designated as hedges. These swaps have a notional amount of \$930 million and are related to anticipated debt issuances over the next two years. The weighted average interest rate on \$1.5 billion of long-term variable interest rate exposure that has not been hedged at January 1, 2006 was 4.37 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 \$15.4 million at January 1, 2006. 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 whole-

sale electricity market and, to a lesser extent, into similar contracts for natural gas purchases. The retail operating companies have implemented fuel-hedging programs at the instruction of their respective state PSCs. Southern Company Gas also utilized a risk management program to substantially mitigate its exposure to price volatility for its natural gas purchases.

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

(in millions)	CHANGES IN FAIR VALUE	
	2005	2004
Contracts beginning of year	\$ 10.5	\$ 15.8
Contracts realized or settled	(106.1)	(58.7)
New contracts at inception	—	—
Changes in valuation techniques	—	—
Current period changes ^(a)	196.1	53.4
Contracts end of year	\$ 100.5	\$ 10.5

(a) Current period changes also include the changes in fair value of new contracts entered into during the period.

(in millions)	SOURCE OF 2005 YEAR-END VALUATION PRICES		
	TOTAL FAIR VALUE	MATURITY	
		2006	2007-2008
Actively quoted	\$101.6	\$67.6	\$34.0
External sources	(1.1)	(1.1)	—
Models and other	—	—	—
Contracts end of year	\$100.5	\$66.5	\$34.0

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 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, 2005, the fair value of derivative energy contracts was reflected in the financial statements as follows:

(in millions)	AMOUNTS
Regulatory liabilities, net	\$103.4
Other comprehensive income	(0.3)
Net income	(2.6)
Total fair value	\$100.5

Unrealized pre-tax gains and losses recognized in income were not material for any year presented.

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

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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."

Capital Requirements and Contractual Obligations

The construction program of Southern Company is currently estimated to be \$2.8 billion for 2006, \$3.6 billion for 2007, and \$3.1 billion for 2008. Environmental expenditures included in these amounts are \$0.8 billion, \$1.3 billion, and \$1.1 billion for 2006, 2007, and 2008, 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 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.

As a result of NRC requirements, Alabama Power and Georgia Power have external trust funds for nuclear decommissioning costs; however, Alabama Power currently has no additional funding requirements. For additional information, see Note 1 to the financial statements under "Nuclear Decommissioning." Also, as discussed in Note 1 to the financial statements under "Nuclear Fuel Disposal 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. The final installment is scheduled to occur in 2006.

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, derivative obligations, preferred and preference stock dividends, leases, and other purchase commitments are as follows. See Notes 1, 6, and 7 to the financial statements for additional information.

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

Contractual Obligations

(in millions)	2006	2007-2008	2009-2010	After 2010	Total
Long-term debt ^(a) –					
Principal	\$ 901	\$ 1,966	\$ 834	\$10,065	\$13,766
Interest	688	1,246	1,108	9,752	12,794
Other derivative obligations ^(b) –					
Commodity	32	–	–	–	32
Preferred and preference stock dividends ^(c)	33	65	65	–	163
Operating leases	123	205	156	259	743
Purchase commitments ^(d) –					
Capital ^(e)	2,772	6,673	–	–	9,445
Coal	3,129	3,959	1,558	364	9,010
Nuclear fuel	63	62	34	89	248
Natural gas ^(f)	1,495	1,286	740	3,046	6,567
Purchased power	175	356	305	541	1,377
Long-term service agreements	71	175	180	1,334	1,760
Trusts –					
Nuclear decommissioning	7	14	14	117	152
Postretirement benefits ^(g)	45	88	–	–	133
DOE	9	–	–	–	9
Total	\$9,543	\$16,095	\$4,994	\$25,567	\$56,199

(a) All amounts are reflected based on final maturity dates. Southern Company and its subsidiaries plan to 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, 2006, as reflected in the statements of capitalization. Fixed rates include, where applicable, the effects of interest rate derivatives employed to manage interest rate risk.

(b) For additional information, see Notes 1 and 6 to the financial statements.

(c) Preferred and preference stock do not mature; therefore, amounts are provided for the next five years only.

(d) Southern Company generally does not enter into non-cancelable commitments for other operation and maintenance expenditures. Total other operation and maintenance expenses for 2005, 2004, and 2003 were \$3.5 billion, \$3.3 billion, and \$3.2 billion, respectively.

(e) 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, 2005, significant purchase commitments were outstanding in connection with the construction program.

(f) 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 Exchange future prices at December 31, 2005.

(g) 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 and postretirement plans, including estimated benefit payments. Certain benefit payments will be made through the related trusts. Other benefit payments will be made from Southern Company's corporate assets.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Southern Company's 2005 Annual Report contains forward-looking statements. Forward-looking statements include, among other things, statements concerning the strategic goals for Southern Company's wholesale business, retail sales growth, storm damage cost recovery and repairs, environmental regulations and expenditures, earnings growth, dividend payout ratios, the Company's projections for postretirement benefit trust contributions, financing activities, access to sources of capital, the proposed merger of Savannah Electric and Georgia Power, impacts of the adoption of new accounting rules, completion of construction projects, and estimated construction and other expenditures. 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 similar terminology. There are various factors that could cause actual results to differ materially from those suggested by 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, implementation of the Energy Policy Act of 2005, 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, FERC matters, IRS audits, and Mirant matters;
- the effects, extent, and timing of the entry of additional competition in the markets in which Southern Company's subsidiaries operate;
- variations in demand for electricity and gas, including those relating to weather, the general economy and population, and business growth (and declines);
- 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 the impact of pending and future rate cases and negotiations, including rate cases relating to fuel cost recovery;
- the performance of projects undertaken by the non-utility businesses 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 effect on Southern Company's business resulting from terrorist incidents and the threat of terrorist incidents;
- interest rate fluctuations and 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;
- catastrophic events such as fires, earthquakes, explosions, floods, hurricanes, or other similar occurrences;
- the direct or indirect effects on Southern Company's business resulting from incidents similar to the August 2003 power outage in the Northeast;
- 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 by Southern Company from time to time with the Securities and Exchange Commission.

Southern Company expressly disclaims any obligation to update any forward-looking statements.

CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

(in millions)	2005	2004	2003
OPERATING REVENUES:			
Retail sales	\$ 11,165	\$ 9,732	\$ 8,875
Sales for resale	1,667	1,341	1,358
Other electric revenues	446	392	514
Other revenues	276	264	271
Total operating revenues	13,554	11,729	11,018
OPERATING EXPENSES:			
Fuel	4,495	3,399	2,999
Purchased power	731	643	473
Other operations	2,394	2,263	2,177
Maintenance	1,116	1,027	937
Depreciation and amortization	1,176	949	1,022
Taxes other than income taxes	680	627	586
Total operating expenses	10,592	8,908	8,194
OPERATING INCOME	2,962	2,821	2,824
OTHER INCOME AND (EXPENSE):			
Allowance for equity funds used during construction	51	47	25
Interest income	36	27	36
Equity in losses of unconsolidated subsidiaries	(119)	(95)	(99)
Leveraged lease income	74	70	66
Interest expense, net of amounts capitalized	(619)	(540)	(527)
Interest expense to affiliate trusts	(128)	(100)	-
Distributions on mandatorily redeemable preferred securities	-	(27)	(151)
Preferred dividends of subsidiaries	(30)	(30)	(21)
Other income (expense), net	(41)	(59)	(52)
Total other income and (expense)	(776)	(707)	(723)
EARNINGS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	2,186	2,114	2,101
Income taxes	595	585	618
EARNINGS FROM CONTINUING OPERATIONS	1,591	1,529	1,483
Earnings from discontinued operations, net of income taxes of \$ -, \$2, and \$(6) for 2005, 2004, and 2003, respectively	-	3	(9)
CONSOLIDATED NET INCOME	\$ 1,591	\$ 1,532	\$ 1,474
COMMON STOCK DATA:			
Earnings per share from continuing operations-			
Basic	\$ 2.14	\$ 2.07	\$ 2.04
Diluted	2.13	2.06	2.03
Earnings per share including discontinued operations-			
Basic	\$ 2.14	\$ 2.07	\$ 2.03
Diluted	2.13	2.06	2.02
Average number of shares of common stock outstanding-(in millions)			
Basic	744	739	727
Diluted	749	743	732
Cash dividends paid per share of common stock	\$ 1.475	\$ 1.415	\$ 1.385

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

CONSOLIDATED BALANCE SHEETS

AT DECEMBER 31, 2005 AND 2004

ASSETS (in millions)	2005	2004
CURRENT ASSETS:		
Cash and cash equivalents	\$ 202	\$ 368
Receivables—		
Customer accounts receivable	868	697
Unbilled revenues	304	304
Under recovered regulatory clause revenues	770	532
Other accounts and notes receivable	410	310
Accumulated provision for uncollectible accounts	(38)	(33)
Fossil fuel stock, at average cost	398	308
Vacation pay	109	105
Materials and supplies, at average cost	671	602
Assets from risk management activities	125	38
Prepaid expenses	130	126
Other	256	134
Total current assets	4,205	3,491
PROPERTY, PLANT, AND EQUIPMENT:		
In service	43,578	41,425
Less accumulated depreciation	15,727	14,947
	27,851	26,478
Nuclear fuel, at amortized cost	262	218
Construction work in progress	1,367	1,662
Total property, plant, and equipment	29,480	28,358
OTHER PROPERTY AND INVESTMENTS:		
Nuclear decommissioning trusts, at fair value	954	905
Leveraged leases	1,082	976
Other	337	366
Total other property and investments	2,373	2,247
DEFERRED CHARGES AND OTHER ASSETS:		
Deferred charges related to income taxes	937	864
Prepaid pension costs	1,022	986
Unamortized debt issuance expense	162	153
Unamortized loss on reacquired debt	309	323
Deferred under recovered regulatory clause revenues	531	—
Other regulatory assets	525	253
Other	333	280
Total deferred charges and other assets	3,819	2,859
TOTAL ASSETS	\$39,877	\$36,955

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

CONSOLIDATED BALANCE SHEETS CONTINUED
AT DECEMBER 31, 2005 AND 2004

LIABILITIES AND STOCKHOLDERS' EQUITY (in millions)	2005	2004
CURRENT LIABILITIES:		
Securities due within one year	\$ 901	\$ 983
Notes payable	1,258	426
Accounts payable	1,229	877
Customer deposits	220	199
Accrued taxes—		
Income taxes	104	47
Other	319	242
Accrued interest	204	179
Accrued vacation pay	144	137
Accrued compensation	459	424
Other	402	284
Total current liabilities	5,240	3,798
LONG-TERM DEBT (See accompanying statements)	10,958	10,488
LONG-TERM DEBT PAYABLE TO AFFILIATED TRUSTS (See accompanying statements)	1,888	1,961
DEFERRED CREDITS AND OTHER LIABILITIES:		
Accumulated deferred income taxes	5,736	5,243
Deferred credits related to income taxes	311	373
Accumulated deferred investment tax credits	527	552
Employee benefit obligations	930	864
Asset retirement obligations	1,117	903
Other cost of removal obligations	1,295	1,296
Other regulatory liabilities	323	328
Other	267	310
Total deferred credits and other liabilities	10,506	9,869
TOTAL LIABILITIES	28,592	26,116
PREFERRED AND PREFERENCE STOCK OF SUBSIDIARIES (See accompanying statements)	596	561
COMMON STOCKHOLDERS' EQUITY (See accompanying statements)	10,689	10,278
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 39,877	\$ 36,955
COMMITMENTS AND CONTINGENT MATTERS (See notes)		

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

(in millions)	2005	2004	2003
OPERATING ACTIVITIES:			
Consolidated net income	\$ 1,591	\$ 1,532	\$ 1,474
Adjustments to reconcile consolidated net income to net cash provided from operating activities–			
Depreciation and amortization	1,398	1,161	1,281
Deferred income taxes and investment tax credits	499	559	427
Storm damage accounting order	48	–	–
Allowance for equity funds used during construction	(51)	(47)	(25)
Equity in losses of unconsolidated subsidiaries	119	95	99
Leveraged lease income	(74)	(70)	(66)
Pension, postretirement, and other employee benefits	(6)	(22)	(40)
Tax benefit of stock options	50	31	30
Hedge settlements	(19)	(10)	(116)
Other, net	(22)	37	32
Changes in certain current assets and liabilities–			
Receivables	(1,045)	(392)	(11)
Fossil fuel stock	(110)	(8)	(17)
Materials and supplies	(78)	(31)	(12)
Other current assets	(1)	9	26
Accounts payable	71	29	(88)
Accrued taxes	28	(109)	19
Accrued compensation	13	(23)	(11)
Other current liabilities	119	(46)	69
Net cash provided from operating activities	2,530	2,695	3,071
INVESTING ACTIVITIES:			
Property additions	(2,370)	(2,022)	(1,964)
Nuclear decommissioning trust fund purchases	(606)	(810)	(1,007)
Nuclear decommissioning trust fund sales	596	781	978
Investment in unconsolidated subsidiaries	(115)	(97)	(94)
Cost of removal net of salvage	(128)	(75)	(80)
Other	(6)	(35)	(27)
Net cash used for investing activities	(2,629)	(2,258)	(2,194)
FINANCING ACTIVITIES:			
Increase (decrease) in notes payable, net	831	(141)	(366)
Proceeds–			
Long-term debt	1,608	1,861	3,494
Mandatorily redeemable preferred securities	–	200	–
Preferred and preference stock	55	175	125
Common stock	213	124	470
Redemptions–			
Long-term debt	(1,285)	(1,246)	(3,009)
Mandatorily redeemable preferred securities	–	(240)	(480)
Preferred and preference stock	(4)	(28)	–
Common stock repurchased	(352)	–	–
Payment of common stock dividends	(1,098)	(1,045)	(1,004)
Other	(35)	(40)	(69)
Net cash (used for) provided from financing activities	(67)	(380)	(839)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(166)	57	38
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	368	311	273
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 202	\$ 368	\$ 311

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

CONSOLIDATED STATEMENTS OF CAPITALIZATION

AT DECEMBER 31, 2005 AND 2004

(in millions)	PERCENT OF TOTAL			
	2005	2004	2005	2004
LONG-TERM DEBT OF SUBSIDIARIES:				
First mortgage bonds—				
Maturity	Interest Rates			
2006	6.50% to 6.90%	\$ 45	\$ 45	
2025 through 2026	6.88% to 7.45%	—	60	
Total first mortgage bonds		45	105	
Long-Term senior notes and debt—				
Maturity	Interest Rates			
2005	5.49% to 5.50%	—	379	
2006	2.65% to 6.20%	674	674	
2007	3.50% to 7.13%	1,207	1,220	
2008	2.54% to 6.55%	461	462	
2009	4.10% to 7.00%	128	169	
2010	4.70%	102	102	
2011 through 2044	4.00% to 8.12%	5,637	4,433	
Adjustable rates (at 1/1/06):				
2005	1.66% to 3.63%	—	563	
2006	2.11%	27	195	
2007	2.11% to 5.755%	265	90	
2009	4.53% to 4.64%	440	440	
2010	5.41%	154	—	
Total long-term senior notes and debt		9,095	8,727	
Other long-term debt—				
Pollution control revenue bonds—				
Maturity	Interest Rates			
Collateralized:				
2006	5.25%	12	12	
2024	5.50%	3	24	
Variable rates (at 1/1/06):				
2015 through 2017	2.01% to 2.16%	90	90	
Non-collateralized:				
2012 through 2034	2.83% to 5.45%	850	850	
Variable rates (at 1/1/06):				
2011 through 2038	2.01% to 3.87%	1,586	1,565	
Total other long-term debt		2,541	2,541	
Capitalized lease obligations		110	115	
Unamortized debt (discount), net		(19)	(17)	
Total long-term debt (annual interest requirement—\$ 561 million)		11,772	11,471	
Less amount due within one year		814	983	
Long-term debt excluding amount due within one year		10,958	10,488	45.4%
				45.1%

CONSOLIDATED STATEMENTS OF CAPITALIZATION CONTINUED

AT DECEMBER 31, 2005 AND 2004

(in millions)	PERCENT OF TOTAL			
	2005	2004	2005	2004
LONG-TERM DEBT PAYABLE TO AFFILIATED TRUSTS:				
Maturity				
Interest Rates				
2027 through 2044				
(annual interest requirement—\$128 million)	1,960	1,961		
Less amount due within one year	72	—		
Total long-term debt payable to affiliated trusts excluding amount due within one year	1,888	1,961	7.8	8.4
PREFERRED AND PREFERENCE STOCK OF SUBSIDIARIES:				
<u>Cumulative preferred stock</u>				
\$100 par or stated value—4.20% to 5.44%				
Authorized—20 million shares				
Outstanding—1 million shares	96	100		
\$1 par value—4.95% to 5.83%				
Authorized—28 million shares				
Outstanding—12 million shares: \$25 stated value	294	294		
Outstanding—1,250 shares: \$100,000 stated value	123	123		
<u>Non-cumulative preferred stock</u>				
\$25 par or stated value—6.00%				
Authorized—4 million shares				
Outstanding—2 million shares	44	44		
<u>Non-cumulative preference stock</u>				
\$100 par or stated value—6.00%				
Authorized—10 million shares				
Outstanding—1 million shares	54	—		
Total preferred and preference stock of subsidiaries (annual dividend requirement—\$33 million)	611	561		
Less amount due within one year	15	—		
Preferred and preference stock of subsidiaries excluding amount due within one year	596	561	2.5	2.4
COMMON STOCKHOLDERS' EQUITY:				
Common stock, par value \$5 per share —	3,759	3,709		
Authorized —1 billion shares				
Issued				
—2005: 752 million shares				
—2004: 742 million shares				
Treasury				
—2005: 10.4 million shares				
—2004: 0.2 million shares				
Paid-in capital	1,085	869		
Treasury, at cost	(359)	(6)		
Retained earnings	6,332	5,839		
Accumulated other comprehensive income (loss)	(128)	(133)		
Total common stockholders' equity	10,689	10,278	44.3	44.1
TOTAL CAPITALIZATION	\$24,131	\$23,288	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, 2005, 2004, AND 2003

(in millions)	COMMON STOCK			RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		TOTAL
	PAR VALUE	PAID-IN CAPITAL	TREASURY		CONTINUING OPERATIONS	DISCONTINUED OPERATIONS	
BALANCE AT DECEMBER 31, 2002	\$ 3,583	\$ 338	\$ (3)	\$ 4,874	\$ (95)	\$ 13	\$ 8,710
Net income	–	–	–	1,474	–	–	1,474
Other comprehensive income (loss)	–	–	–	–	(20)	(11)	(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	(115)	2	9,648
Net income	–	–	–	1,532	–	–	1,532
Other comprehensive income (loss)	–	–	–	–	(16)	(4)	(20)
Stock issued	34	122	–	–	–	–	156
Cash dividends	–	–	–	(1,044)	–	–	(1,044)
Other	–	–	(2)	8	–	–	6
BALANCE AT DECEMBER 31, 2004	3,709	869	(6)	5,839	(131)	(2)	10,278
Net income	–	–	–	1,591	–	–	1,591
Other comprehensive income (loss)	–	–	–	–	3	2	5
Stock issued	50	216	–	–	–	–	266
Stock repurchased, at cost	–	–	(352)	–	–	–	(352)
Cash dividends	–	–	–	(1,098)	–	–	(1,098)
Other	–	–	(1)	–	–	–	(1)
BALANCE AT DECEMBER 31, 2005	\$3,759	\$1,085	\$ (359)	\$ 6,332	\$ (128)	\$ –	\$ 10,689

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2005, 2004, AND 2003

(in millions)	2005	2004	2003
CONSOLIDATED NET INCOME	\$1,591	\$1,532	\$1,474
Other comprehensive income (loss)–continuing operations:			
Change in additional minimum pension liability, net of tax of \$(6), \$(11), and \$(11), respectively	(11)	(20)	(17)
Change in fair value of marketable securities, net of tax of \$(2) and \$4, respectively	(4)	6	–
Changes in fair value of qualifying hedges, net of tax of \$7, \$(11), and \$(12), respectively	12	(16)	(20)
Less: Reclassification adjustment for amounts included in net income, net of tax of \$4, \$8, and \$9, respectively	6	14	17
Total other comprehensive income (loss)–continuing operations	3	(16)	(20)
Other comprehensive income (loss)–discontinued operations:			
Changes in fair value of qualifying hedges, net of tax of \$4, \$(1), and \$10, respectively	6	(2)	3
Less: Reclassification adjustment for amounts included in net income, net of tax of \$(3), \$(1), and \$(8), respectively	(4)	(2)	(14)
Total other comprehensive income (loss)–discontinued operations	2	(4)	(11)
CONSOLIDATED COMPREHENSIVE INCOME	\$1,596	\$1,512	\$1,443

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

NOTES TO FINANCIAL STATEMENTS

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Southern Company (the Company) is the parent company of five retail operating companies, Southern Power Company (Southern Power), Southern Company Services (SCS), Southern Communications Services (SouthernLINC Wireless), 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). SCS, the system service company, provides, at cost, specialized services to Southern Company and the subsidiary companies. SouthernLINC Wireless 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 Holdings is an intermediate holding subsidiary for Southern Company's investments in synthetic fuels and leveraged leases and various other energy-related businesses. Southern Nuclear operates and provides services to Southern Company's nuclear power plants.

On January 4, 2006, Southern Company completed the sale of substantially all the assets of Southern Company Gas, its competitive retail natural gas marketing subsidiary, including natural gas inventory, accounts receivable, and customer list, to Gas South, LLC, an affiliate of Cobb Electric Membership Corporation. As a result of the sale, Southern Company's financial statements and related information reflect Southern Company Gas as discontinued operations. For additional information, see Note 3 under "Southern Company Gas Sale."

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 and for variable interest entities where the Company is not the primary beneficiary. All material intercompany items have been eliminated in consolidation. Certain prior years' data presented in the financial statements have been reclassified to conform with the current year presentation.

Southern Company was registered as a holding company under the Public Utility Holding Company Act of 1935, as amended (PUHCA), until its repeal on February 8, 2006, and the Company and its subsidiaries were subject to the regulatory provisions of the PUHCA. The retail operating companies, Southern Power, and certain of their subsidiaries are subject to regulation by the FERC and the retail operating companies are also subject to regulation by their respective state public service commissions (PSC). 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 2005, 2004, and 2003 were \$507 million, \$409 million, and \$312 million, respectively. Synfuel Services, Inc. (SSI), another subsidiary of Southern Holdings, provides fuel transportation services to AFP that are ultimately reflected in the cost of the synthetic fuel billed to Alabama Power and Georgia Power. In connection with these services, the related revenues of approximately \$83 million, \$82 million, and \$65 million in 2005, 2004, and 2003, respectively, have been eliminated against fuel expense in the financial statements. SSI also provides additional services to AFP, as well as to a related party of AFP. Revenues from these transactions totaled approximately \$40 million, \$24 million, and \$20 million in 2005, 2004, and 2003, respectively.

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 rate-

NOTES TO FINANCIAL STATEMENTS

making process. Regulatory assets and (liabilities) reflected in the balance sheets at December 31 relate to:

(in millions)	2005	2004	NOTE
Deferred income tax charges	\$ 937	\$ 865	(a)
Asset retirement obligations-asset	81	7	(a)
Asset retirement obligations-liab.	(139)	(180)	(a)
Other cost of removal obligations	(1,295)	(1,296)	(a)
Deferred income tax credits	(313)	(374)	(a)
Loss on reacquired debt	309	323	(b)
Vacation pay	109	105	(c)
Building lease	52	53	(d)
Generating plant outage costs-asset	54	49	(d)
Storm damage-asset	366	97	(d)
Fuel hedging	(116)	(27)	(d)
Other assets	139	115	(d)
Environmental remediation-asset	58	59	(d)
Environmental remediation-liab.	(36)	(47)	(d)
Deferred purchased power	(52)	(19)	(d)
Other liabilities	(32)	(26)	(d)
Plant Daniel capacity	(19)	(44)	(e)
Total	\$ 103	\$ (340)	

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 60 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) Recorded as earned by employees and recovered as paid, generally within one year.
- (d) Recorded and recovered or amortized as approved by the appropriate state PSCs.
- (e) Amortized over four-year period ending in 2007.

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

Revenues

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. 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 these actual costs and amounts billed in current regulated rates. Under or over recovered regulatory clause revenues are recorded in the balance sheets and are recovered or returned to customers through adjustments to the billing factors.

Retail fuel costs recovery mechanisms vary by each retail operating company, but in general, the process requires periodic

filings with the appropriate state PSC. Alabama Power continuously monitors the under/over recovered balance and files for a revised fuel rate when management deems appropriate. The Georgia PSC requires that such amounts be reviewed semi-annually. If the amount under or over recovered exceeds \$50 million at the evaluation date, Georgia Power is required to file for a temporary fuel rate change. If the over or under recovery exceeds 10 percent of the projected fuel costs for the period, Gulf Power is required to notify the Florida PSC to determine if an adjustment to the fuel cost recovery factor is necessary. Mississippi Power is required to file for an adjustment to the fuel cost recovery factor annually. See "Alabama Power Retail Regulatory Matters" and "Georgia Power Retail Regulatory Matters" in Note 3 for additional information.

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 averaged less than 1 percent of revenues despite an increase in customer bankruptcies.

Fuel Costs

Fuel costs are expensed as the fuel is used. Fuel expense generally includes the cost of purchased emission allowances as they are used. Fuel expense also 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 \$134 million in 2005, \$134 million in 2004, and \$138 million in 2003.

Nuclear Fuel Disposal Costs

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 1998 as required by the contracts, and Alabama Power and Georgia Power are pursuing legal remedies against the government for breach of contract. Sufficient pool storage capacity for spent fuel is available at Plant Vogtle to maintain full-core discharge capability for both units into 2015. Construction of an on-site dry storage facility at Plant Vogtle is scheduled to begin in sufficient time to maintain pool full-core discharge capability. At Plants Hatch and Farley, on-site dry storage facilities are operational and can be expanded to accommodate spent fuel through the life of each plant.

Also, the Energy Policy Act of 1992 established a Uranium Enrichment Decontamination and Decommissioning Fund, which is funded in part by a special assessment on utilities with nuclear plants. This assessment has been paid over a 15-year period; the final installment is scheduled to occur in 2006. 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, 2005 under this law to be approximately \$5 million and \$4 million.

NOTES TO FINANCIAL STATEMENTS

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.

Southern Company's property, plant, and equipment consisted of the following at December 31 (in millions):

	2005	2004
Generation	\$22,490	\$21,262
Transmission	6,031	5,770
Distribution	11,894	11,368
General	2,393	2,268
Plant acquisition adjustment	41	42
Utility plant in service	42,849	40,710
IT equipment and software	211	214
Communications equipment	431	404
Other	87	97
Other plant in service	729	715
Total plant in service	\$43,578	\$41,425

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 state PSC 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 a Georgia PSC order, Georgia Power also defers the costs of certain significant inspection costs for the combustion turbines at Plant McIntosh and amortizes such costs over 10 years, which approximates the expected maintenance cycle.

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 life of the related property.

Depreciation and Amortization

Depreciation of the original cost of utility plant in service is provided primarily by using composite straight-line rates, which approximated 2.9 percent in 2005, 3.0 percent in 2004, and 3.1 percent in 2003. Depreciation studies are conducted periodically to update the composite rates. These studies are filed with the respective state PSC for

the retail operating companies. Accumulated depreciation for utility plant in service totaled \$15.3 billion and \$14.6 billion at December 31, 2005 and 2004, respectively. When property subject to composite 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. For other property dispositions, the applicable cost and accumulated depreciation is removed from the balance sheet accounts and a gain or loss is recognized. Minor items of property included in the original cost of the plant are retired when the related property unit is retired.

Under its 2001 rate order, the Georgia PSC ordered Georgia Power to amortize \$333 million, the cumulative balance of accelerated depreciation and amortization previously expensed, equally over three years as a credit to depreciation and amortization expense beginning January 2002. Georgia Power was also ordered to recognize new certified purchased power costs in rates evenly over the three-year period by the 2001 rate order. As a result of this regulatory adjustment, Georgia Power recorded depreciation and amortization expense of \$(77) million and \$14 million in 2004 and 2003, respectively. See Note 3 under "Georgia Power Retail Regulatory Matters" for additional information.

In May 2004, the Mississippi PSC approved Mississippi Power's request to reclassify 266 megawatts of Plant Daniel units 3 and 4 capacity to jurisdictional cost of service effective January 1, 2004 and authorized Mississippi Power to include the related costs and revenue credits in jurisdictional rate base, cost of service, and revenue requirement calculations for purposes of retail rate recovery. Mississippi Power is amortizing the related regulatory liability pursuant to the Mississippi PSC's order as follows: \$16.5 million in 2004, \$25.1 million in 2005, \$13.0 million in 2006, and \$5.7 million in 2007, resulting in increases to earnings in each of those years.

Depreciation of the original cost of other plant in service is provided primarily on a straight-line basis over estimated useful lives ranging from 3 to 25 years. Accumulated depreciation for other plant in service totaled \$378 million and \$345 million at December 31, 2005 and 2004, respectively.

Asset Retirement Obligations and Other Costs of Removal

Effective January 1, 2003, Southern Company adopted FASB Statement No. 143, Accounting for Asset Retirement Obligations, which established 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 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. In addition, effective December 31, 2005, Southern Company adopted the provisions of FASB Interpretation No. 47, Conditional Asset Retirement Obligations, which requires that an asset retirement obligation be recorded even though the timing and/or method of settlement are conditional on future events. Prior to December 2005, the Company did not

NOTES TO FINANCIAL STATEMENTS

recognize asset retirement obligations for asbestos removal and disposal of polychlorinated biphenyls in certain transformers because the timing of their retirements was dependent on future events. The Company has received accounting guidance from the various state PSCs allowing the continued accrual of other future retirement costs for long-lived assets that the Company does not have a legal obligation to retire. Accordingly, the accumulated removal costs for these obligations will continue to be reflected in the balance sheets as a regulatory liability. Therefore, the Company had no cumulative effect to net income resulting from the adoption of Statement No. 143 or Interpretation No. 47.

The liability recognized to retire long-lived assets primarily relates to the Company's nuclear facilities, Plants Farley, Hatch, and Vogtle. The fair value of assets legally restricted for settling retirement obligations related to nuclear facilities as of December 31, 2005 was \$954 million. In addition, the Company has retirement obligations related to various landfill sites and underground storage tanks. In connection with the adoption of Interpretation No. 47, Southern Company also recorded additional asset retirement obligations (and assets) of approximately \$153 million, primarily related to asbestos removal and disposal of polychlorinated biphenyls in certain transformers. The Company has also identified retirement obligations related to certain transmission and distribution facilities, co-generation facilities, certain wireless communication towers, and certain structures authorized by the United States Army Corps of Engineers. However, liabilities for the removal of these assets have not been recorded because the range of time over which the Company may settle these obligations is unknown and cannot be reasonably estimated. The Company will continue to recognize in the statements of income allowed removal costs in accordance with its regulatory treatment. Any difference between costs recognized under Statement No. 143 and Interpretation No. 47 and those reflected in rates are recognized as either a regulatory asset or liability, as ordered by the various state PSCs, and are reflected in the balance sheets. See "Nuclear Decommissioning" herein for further information on amounts included in rates.

Details of the asset retirement obligations included in the balance sheets are as follows:

(in millions)	2005	2004
Balance beginning of year	\$ 903	\$845
Liabilities incurred	155	-
Liabilities settled	(2)	(3)
Accretion	61	57
Cash flow revisions	-	4
Balance end of year	\$1,117	\$903

If Interpretation No. 47 had been adopted as of December 31, 2004, the pro forma asset retirement obligations would have been \$1.0 billion.

Nuclear Decommissioning

The Nuclear Regulatory Commission (NRC) requires licensees of commercial nuclear power reactors to establish a plan for providing reasonable assurance of funds for future decommissioning. Alabama Power and Georgia Power have external trust funds to comply with the NRC's regulations. Use of the funds is restricted to nuclear decommissioning activities and the funds are managed and invested in accordance with applicable requirements of various regulatory bodies, including the NRC, the FERC, and state PSCs, as well as the Internal Revenue Service (IRS). The trust funds are invested in a tax-efficient manner in a diversified mix of equity and fixed income securities and are classified as available-for-sale. The trust funds are included in the balance sheets at fair value, as obtained from quoted market prices for the same or similar investments. Details of the securities held in these trusts at December 31 are as follows:

(in millions)	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
2005			
Equity	\$155.6	\$(14.0)	\$600.8
Debt	4.1	(2.4)	241.4
Other	17.0	-	111.4
Total	\$176.7	\$(16.4)	\$953.6

(in millions)	UNREALIZED GAINS	UNREALIZED LOSSES	FAIR VALUE
2004			
Equity	\$140.0	\$(8.3)	\$566.3
Debt	8.5	(0.7)	233.5
Other	13.6	(0.2)	105.0
Total	\$162.1	\$(9.2)	\$904.8

The contractual maturities of debt securities at December 31, 2005 are as follows: \$17.3 million in 2006; \$90.1 million in 2007-2010; \$59.5 million in 2011-2015; and \$65.5 million thereafter.

Sales of the securities held in the trust funds resulted in proceeds of \$596.3 million, \$781.3 million, and \$978.1 million in 2005, 2004, and 2003, respectively, all of which were re-invested. Net realized gains (losses) were \$22.5 million, \$21.6 million and \$19.6 million in 2005, 2004, and 2003, respectively. Realized gains and losses are determined on a specific identification basis. In accordance with regulatory guidance, all realized and unrealized gains and losses are included in the regulatory liability for Asset Retirement Obligations in the balance sheets and are not included in net income or other comprehensive income. Unrealized gains and losses are considered non-cash transactions for purposes of the statements of cash flow. Unrealized losses were not material in any period presented and did not require the recognition of any impairment related to the underlying investments.

NOTES TO FINANCIAL STATEMENTS

Amounts previously recorded in internal reserves are being transferred into the external trust funds over periods approved by the respective state PSCs. The NRC's minimum external funding requirements are based on a generic estimate of the cost to decommission only 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 designed to ensure that, over time, the deposits and earnings of the external trust funds will provide the minimum funding amounts prescribed by the NRC. At December 31, 2005, the accumulated provisions for decommissioning were as follows:

(in millions)	PLANT FARLEY	PLANT HATCH	PLANT VOGTLE
External trust funds, at fair value	\$467	\$313	\$174
Internal reserves	28	–	1
Total	\$495	\$313	\$175

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 studies, which were performed in 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
Decommissioning periods:			
Beginning year	2017	2034	2027
Completion year	2046	2065	2048

(in millions)	PLANT FARLEY	PLANT HATCH	PLANT VOGTLE
Site study costs:			
Radiated structures	\$892	\$497	\$452
Non-radiated structures	63	49	58
Total	\$955	\$546	\$510

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.

For ratemaking purposes, Alabama Power's decommissioning costs are based on the site study and Georgia Power's decommissioning costs are based on the NRC generic estimate to decommission the radioactive portion of the facilities as of 2003, \$421 million and \$326 million for Plants Hatch and Vogtle, respectively. Amounts expensed in 2005, 2004, and 2003 totaled \$7 million, \$27 million, and \$27 million, respectively. Significant assumptions used to determine these costs for ratemaking were an inflation rate of 4.5 percent and 3.1 percent for Alabama Power and Georgia Power, respectively, and a trust earnings rate of 7.0 percent and 5.1 percent for Alabama Power and Georgia Power, respectively. Another significant assumption used was the change in the operating licenses for Plants Farley and

Hatch. In January 2002, the NRC granted Georgia Power a 20-year extension of the licenses for both units at Plant Hatch, which permits the operation of units 1 and 2 until 2034 and 2038, respectively.

In May 2005, the NRC granted Alabama Power a similar 20-year extension of the operating license for both units at Plant Farley. As a result of the Farley license extension, amounts previously contributed to the external trust fund are currently projected to be adequate to meet the decommissioning obligations. Therefore, in June 2005, the Alabama PSC approved Alabama Power's request to suspend, effective January 1, 2005, the inclusion in its annual cost of service of \$18 million in decommissioning costs and to also suspend the associated obligation to make semi-annual contributions to the external trust fund. Alabama Power will continue to provide site specific estimates of the decommissioning costs and related projections of trust funds to the Alabama PSC and, if necessary, would seek the Alabama PSC's approval to address any changes in a manner consistent with NRC and other applicable requirements. The approved suspension would not affect the transfer of internal reserves (less than \$1 million annually) to the external trust over the remaining life of the licenses.

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 \$661 million, \$551 million, and \$603 million in 2005, 2004, and 2003, respectively, net of amounts capitalized of \$21 million, \$36 million, and \$49 million, respectively.

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.

NOTES TO FINANCIAL STATEMENTS

Storm Damage Reserves

Each retail operating company maintains a reserve for property damage to cover the cost of uninsured damages from major storms to transmission and distribution facilities and to generation facilities and other property. In accordance with their respective state PSC orders, the retail operating companies accrued \$15 million in 2005 that is recoverable through base rates. Alabama Power, Gulf Power, and Mississippi Power also have discretionary authority from their state PSCs to accrue certain additional amounts as circumstances warrant. In 2005, 2004, and 2003, such additional accruals totaled \$6 million, \$25 million, and \$8 million, respectively. See Note 3 under "Storm Damage Recovery" for additional information regarding the depletion of these reserves following Hurricanes Ivan, Dennis, and Katrina and the deferral of additional costs, as well as additional rate riders or other cost recovery mechanisms which may be approved by the respective state PSCs to replenish these reserves.

Environmental Cost Recovery

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 may also incur substantial costs to clean up properties. Alabama Power, Gulf Power, and Mississippi Power have each received authority from their respective state PSCs to recover approved environmental compliance costs through specific retail rate clauses. Within limits approved by the state PSCs, these rates are adjusted annually.

Georgia Power continues to recover environmental costs through its base rates. Beginning in 2005, such rates include an annual accrual of \$5.4 million. Environmental remediation expenditures will be charged against the reserve as they are incurred. The annual accrual amount will be reviewed and adjusted in future regulatory proceedings. Under Georgia PSC ratemaking provisions, \$22 million had previously been deferred in a regulatory liability account for use in meeting future environmental remediation costs of Georgia Power and is being amortized over a three-year period that began in January 2005.

In September 2004, Gulf Power increased its liability for the estimated costs of environmental remediation projects by approximately \$47 million. This increase related to new regulations and more stringent site closure criteria by the Florida Department of Environmental Protection (FDEP) for impacts to soil and groundwater from herbicide applications at Gulf Power substations. The schedule for completion of the remediation projects will be subject to FDEP approval. The projects have been approved by the Florida PSC for recovery, as expended, through Gulf Power's environmental cost recovery clause; therefore, there was no impact on net income as a result of these revised estimates.

For Southern Company, the environmental remediation liabilities balances as of December 31, 2005 and 2004 totaled \$62 million and \$63 million, respectively.

Leveraged Leases

Southern Company has several leveraged lease agreements, ranging up to 45 years, which 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 domestic leveraged leases consists of the following at December 31:

(in millions)	2005	2004
Net rentals receivable	\$ 509	\$ 457
Unearned income	(280)	(283)
Investment in leveraged leases	229	174
Deferred taxes arising from leveraged leases	(59)	(32)
Net investment in leveraged leases	\$ 170	\$ 142

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

(in millions)	2005	2004	2003
Pretax leveraged lease income	\$ 23	\$ 17	\$ 11
Income tax expense	(11)	(8)	(4)
Net leveraged lease income	\$ 12	\$ 9	\$ 7

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

(in millions)	2005	2004
Net rentals receivable	\$ 1,298	\$ 1,298
Unearned income	(445)	(496)
Investment in leveraged leases	853	802
Deferred taxes arising from leveraged leases	(351)	(360)
Net investment in leveraged leases	\$ 502	\$ 442

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

(in millions)	2005	2004	2003
Pretax leveraged lease income	\$ 51	\$ 53	\$ 55
Income tax expense	(18)	(19)	(19)
Net leveraged lease income	\$ 33	\$ 34	\$ 36

NOTES TO FINANCIAL STATEMENTS

Cash and Cash Equivalents

For purposes of the 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.

Fuel Inventory

Fuel inventory includes the average costs of oil, coal, natural gas, and emission allowances. Fuel is charged to inventory when purchased and then expensed as used. Emission allowances granted by the Environmental Protection Agency (EPA) are included in inventory at zero cost.

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.

For pro forma purposes, Southern Company generally recognizes stock option expense on a straight-line basis over the vesting period. Stock options granted to employees who are eligible for retirement are expensed at the grant date. The pro forma impact of fair-value accounting for options granted on earnings from continuing operations is as follows:

	AS REPORTED	OPTIONS IMPACT	PRO FORMA
2005			
Net income (in millions)	\$1,591	\$ (17)	\$1,574
Earnings per share (dollars):			
Basic	\$ 2.14	\$(0.02)	\$ 2.12
Diluted	\$ 2.13	\$(0.03)	\$ 2.10
2004			
Net income (in millions)	\$1,529	\$ (16)	\$1,513
Earnings per share (dollars):			
Basic	\$ 2.07	\$(0.02)	\$ 2.05
Diluted	\$ 2.06	\$(0.02)	\$ 2.04
2003			
Net income (in millions)	\$1,483	\$ (17)	\$1,466
Earnings per share (dollars):			
Basic	\$ 2.04	\$(0.02)	\$ 2.02
Diluted	\$ 2.03	\$(0.03)	\$ 2.00

The estimated fair values of stock options granted in 2005, 2004, and 2003 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:

	2005	2004	2003
Interest rate	3.9%	3.1%	2.7%
Average expected life of stock options (in years)	5.0	5.0	4.3
Expected volatility of common stock	17.9%	19.6%	23.6%
Expected annual dividends on common stock	\$1.43	\$1.40	\$1.37
Weighted average fair value of stock options granted	\$3.90	\$3.29	\$3.59

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 or are recoverable through the retail operating companies' fuel hedging programs. This results in the deferral of related gains and losses in other comprehensive income or regulatory assets and liabilities, respectively, until the hedged transactions occur. Any ineffectiveness arising from cash flow hedges 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 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:

(in millions)	CARRYING AMOUNT	FAIR VALUE
Long-term debt:		
2005	\$13,623	\$13,633
2004	13,317	13,560

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

NOTES TO FINANCIAL STATEMENTS

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, changes in the fair value of qualifying cash flow hedges and marketable securities, and changes in additional minimum pension liability, less income taxes and reclassifications for amounts included in net income.

Variable Interest Entities

The primary beneficiary of a variable interest entity must consolidate the related assets and liabilities. Southern Company has established certain wholly-owned trusts established to issue preferred securities. See Note 6 under "Mandatorily Redeemable Preferred Securities/Long-Term Debt Payable to Affiliated Trusts" for additional information. However, Southern Company and the retail operating companies are not the primary beneficiaries of the trusts. Therefore, the investments in these trusts are reflected as Other Investments, and the related loans from the trusts are reflected as Long-term Debt Payable to Affiliated Trusts in the balance sheets.

In addition, Southern Company holds an 85 percent limited partnership investment in an energy/technology venture capital fund that is consolidated in the financial statements. During the third quarter of 2004, Southern Company terminated new investments in this fund; however, additional contributions to existing investments will still occur. Southern Company has committed to a maximum investment of \$50 million. At December 31, 2005, Southern Company's investment totaled \$25.6 million.

NOTE 2: RETIREMENT BENEFITS

Southern Company has a defined benefit, trustee, pension plan covering substantially all employees. The plan is funded in accordance with requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA). In 2005, the plan was amended to provide an additional monthly supplement to certain retirees. No contributions to the plan are expected for the year ending December 31, 2006. 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, 2006, postretirement trust contributions are expected to total approximately \$45 million.

The measurement date for plan assets and obligations is September 30 for each year presented.

Pension Plans

The total accumulated benefit obligation for the pension plans was \$5.2 billion in 2005 and \$4.6 billion in 2004. Changes during the year in the projected benefit obligations, accumulated benefit obligations, and fair value of plan assets were as follows:

(in millions)	PROJECTED BENEFIT OBLIGATIONS	
	2005	2004
Balance at beginning of year	\$5,075	\$4,573
Service cost	138	128
Interest cost	286	270
Benefits paid	(214)	(207)
Plan amendments	32	6
Actuarial (gain) loss	240	305
Balance at end of year	\$5,557	\$5,075

(in millions)	PLAN ASSETS	
	2005	2004
Balance at beginning of year	\$5,476	\$5,159
Actual return on plan assets	866	501
Employer contributions	19	23
Benefits paid	(214)	(207)
Balance at end of year	\$6,147	\$5,476

In 2005, the projected benefit obligations for the qualified and non-qualified pension plans were \$5.2 billion and \$0.4 billion, respectively. All plan assets are related to the qualified plan.

Pension plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the Internal Revenue Code of 1986, as amended (Internal 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.

	Target	PLAN ASSETS	
		2005	2004
Domestic equity	36%	40%	36%
International equity	24	24	20
Fixed income	15	17	26
Real estate	15	13	10
Private equity	10	6	8
Total	100%	100%	100%

NOTES TO FINANCIAL STATEMENTS

The reconciliations of the funded status with the accrued pension costs recognized in the balance sheets were as follows:

(in millions)	2005	2004
Funded status	\$590	\$401
Unrecognized transition amount	(6)	(14)
Unrecognized prior service cost	293	292
Unrecognized net (gain) loss	3	185
Prepaid pension asset, net	\$880	\$864

The prepaid pension asset, net is reflected in the balance sheets in the following line items:

(in millions)	2005	2004
Prepaid pension asset	\$1,022	\$ 986
Employee benefit obligations	(310)	(280)
Other property and investments	43	50
Accumulated other comprehensive income	125	108
Prepaid pension asset, net	\$ 880	\$ 864

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

(in millions)	2005	2004	2003
Service cost	\$ 138	\$ 128	\$ 115
Interest cost	286	269	261
Expected return on plan assets	(456)	(452)	(450)
Recognized net gain	10	(7)	(42)
Net amortization	24	18	17
Net pension cost (income)	\$ 2	\$ (44)	\$ (99)

Future benefit payments reflect expected future service and are estimated based on assumptions used to measure the projected benefit obligation for the pension plans. At December 31, 2005, estimated benefit payments were as follows:

(in millions)	2006	2007	2008	2009	2010	2011 to 2015
						\$ 222
						230
						238
						248
						262
						1,596

Postretirement Benefits

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

(in millions)	2005	2004
		ACCUMULATED BENEFIT OBLIGATIONS
Balance at beginning of year	\$1,712	\$1,655
Service cost	28	27
Interest cost	96	93
Benefits paid	(78)	(68)
Actuarial (gain) loss	68	72
Plan amendments	–	(67)
Balance at end of year	\$1,826	\$1,712

(in millions)	2005	2004
		PLAN ASSETS
Balance at beginning of year	\$592	\$522
Actual return on plan assets	78	64
Employer contributions	92	74
Benefits paid	(78)	(68)
Balance at end of year	\$684	\$592

Postretirement benefits plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the Internal 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.

	TARGET	2005	2004
Domestic equity	44%	46%	43%
International equity	17	18	18
Fixed income	29	29	32
Real estate	6	5	4
Private equity	4	2	3
Total	100%	100%	100%

The accrued postretirement costs recognized in the balance sheets were as follows:

(in millions)	2005	2004
Funded status	\$(1,142)	\$(1,120)
Unrecognized transition obligation	114	129
Unrecognized prior service cost	121	130
Unrecognized net loss (gain)	428	408
Fourth quarter contributions	40	30
Accrued liability recognized in the balance sheets	\$ (439)	\$ (423)

NOTES TO FINANCIAL STATEMENTS

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

(in millions)	2005	2004	2003
Service cost	\$ 28	\$ 28	\$ 25
Interest cost	97	93	93
Expected return on plan assets	(45)	(50)	(47)
Net amortization	38	35	30
Net postretirement cost	\$118	\$106	\$101

In the third quarter 2004, Southern Company prospectively adopted FASB Staff Position (FSP) 106-2, Accounting and Disclosure Requirements related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Act). The Medicare Act provides a 28 percent prescription drug subsidy for Medicare eligible retirees. FSP 106-2 requires recognition of the impacts of the Medicare Act in the accumulated postretirement benefit obligation (APBO) and future cost of service for postretirement medical plan. The effect of the subsidy reduced Southern Company's expenses for the six months ended December 31, 2004 and for the year ended December 31, 2005 by approximately \$10.6 million and \$26 million, respectively, and is expected to have a similar impact on future expenses.

Future benefit payments, including prescription drug benefits, reflect expected future service and are estimated based on assumptions used to measure the accumulated benefit obligation for the postretirement plans. Estimated benefit payments are reduced by drug subsidy receipts expected as a result of the Medicare Act as follows:

(in millions)	BENEFIT PAYMENTS	SUBSIDY RECEIPTS	TOTAL
2006	\$ 86	\$ (7)	\$ 79
2007	92	(9)	83
2008	100	(10)	90
2009	110	(11)	99
2010	119	(12)	107
2011 to 2015	668	(88)	580

Actuarial Assumptions

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:

	2005	2004	2003
Discount	5.50%	5.75%	6.00%
Annual salary increase	3.00	3.50	3.75
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 APBO was a weighted average medical care cost trend rate of 10.25 percent for 2005, decreasing gradually to 4.75 percent through the year 2014 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, 2005 as follows:

(in millions)	1 PERCENT INCREASE	1 PERCENT DECREASE
Benefit obligation	\$149	\$132
Service and interest costs	10	9

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 2005, 2004, and 2003 were \$58 million, \$56 million, and \$55 million, respectively.

NOTE 3:

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 such as opacity and other air quality standards, 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 pending or potential litigation against Southern Company and its subsidiaries cannot be predicted at this time; however, for current proceedings not specifically reported herein, 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 Matters

Mirant Corporation (Mirant) is an energy company with businesses that include independent power projects and energy trading and risk management companies in the U.S. and selected other countries. It was a wholly-owned subsidiary of Southern Company until its initial public offering in October 2000. In April 2001, Southern Company completed a spin-off to its shareholders of its remaining ownership and Mirant became an independent corporate entity.

Mirant Bankruptcy

In July 2003, Mirant and certain of its affiliates filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court for the Northern District of Texas. The Bankruptcy

NOTES TO FINANCIAL STATEMENTS

Court entered an order confirming Mirant's plan of reorganization on December 9, 2005, and Mirant announced that this plan became effective on January 3, 2006. As part of the plan, Mirant transferred substantially all of its assets and its restructured debt to a new corporation that adopted the name Mirant Corporation (Reorganized Mirant).

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 below. Southern Company has paid approximately \$1.4 million in connection with the guarantees. Also, Southern Company has joint and several liability with Mirant regarding the joint consolidated federal income tax returns through 2001, as discussed in Note 5. In December 2004, as a result of concluding an IRS audit for the tax years 2000 and 2001, Southern Company paid \$39 million in additional tax and interest for issues related to Mirant tax items. Based on management's assessment of the collectibility of this receivable, Southern Company has reserved approximately \$12.5 million.

Under the terms of the separation agreements entered into in connection with the spin-off, Mirant agreed to indemnify Southern Company for costs associated with these guarantees, lawsuits, and additional IRS assessments. However, as a result of Mirant's bankruptcy, Southern Company sought reimbursement as an unsecured creditor in Mirant's Chapter 11 proceeding. Mirant and The Official Committee of Unsecured Creditors of Mirant Corporation (Unsecured Creditors' Committee) objected to and sought equitable subordination of Southern Company's claims, and Mirant moved to reject the separation agreements entered into in connection with the spin-off. If Southern Company's claims for indemnification with respect to these, or any additional future payments, are allowed, then Mirant's indemnity obligations to Southern Company would constitute unsecured claims against Mirant entitled to stock in Reorganized Mirant, the value of which is uncertain. The final outcome of this matter cannot now be determined.

Mirant Bankruptcy Litigation

In June 2005, Mirant, as a debtor in possession, and the Unsecured Creditors' Committee filed a complaint against Southern Company in the U.S. Bankruptcy Court for the Northern District of Texas, which was amended in July 2005 and February 2006. The complaint alleges that Southern Company caused Mirant to engage in certain fraudulent transfers and to pay illegal dividends to Southern Company prior to the spin-off. The alleged fraudulent transfers and illegal dividends include without limitation: (1) certain dividends from Mirant to Southern Company in the aggregate amount of \$668 million, (2) the repayment of certain intercompany loans and accrued interest in an aggregate amount of \$1.035 billion, and (3) the dividend distribution of one share of Series B Preferred Stock and its subsequent redemption in exchange for Mirant's 80 percent interest in a holding company that owned SE Finance Capital Corporation and Southern Company Capital Funding, Inc., which transfer Mirant asserts is valued at \$248 million. The complaint also seeks to recharacterize certain advances from Southern Company to Mirant for investments

in energy facilities from debt to equity. The complaint further alleges that Southern Company is liable to Mirant's creditors for the full amount of Mirant's liability under an alter ego theory of recovery and that Southern Company caused Mirant to breach its fiduciary duties to creditors. The complaint seeks monetary damages in excess of \$2 billion plus interest, punitive damages, attorneys' fees, and costs. Finally, Mirant objects to Southern Company's claims against Mirant in the Bankruptcy Court (which relate to reimbursement under the separation agreements of payments such as income taxes, interest, legal fees, and other guarantees described in Note 7) and seeks equitable subordination of Southern Company's claims to the claims of all other creditors. Southern Company served an answer to the second amended complaint in February 2006.

On December 29, 2005, the Bankruptcy Court entered an order transferring this proceeding, along with certain other actions, to a special purpose subsidiary of Reorganized Mirant. Under the order, Reorganized Mirant is obligated to fund up to \$20 million in professional fees in connection with the lawsuits, as well as certain additional amounts. Any net recoveries from these lawsuits will be distributed to and shared equally by the unsecured creditors and the original equity holders.

On January 10, 2006, the U.S. District Court for the Northern District of Texas granted Southern Company's motion to withdraw this action from the Bankruptcy Court, and on February 15, 2006 granted Southern Company's motion to transfer the case to the U.S. District Court for the Northern District of Georgia. Southern Company believes there is no meritorious basis for the claims in the complaint and is vigorously defending itself in this action. However, the final outcome of this matter cannot now be determined.

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 class action lawsuit that several Mirant shareholders originally filed against Mirant and certain Mirant officers in May 2002. 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.

In July 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 do not allege any improper trading and marketing activity, accounting errors, or material misstatements or omissions on the part of Southern Company but 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

NOTES TO FINANCIAL STATEMENTS

to the consolidated amended class action complaint in September 2003. Plaintiffs have also filed a motion for class certification.

During Mirant's Chapter 11 proceeding, the securities litigation was stayed, with the exception of limited discovery. Since Mirant's plan of reorganization has become effective, the stay has been lifted, and activity in this case is expected to resume.

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 who are also named as defendants in this lawsuit. The final outcome of this matter cannot now be determined.

Southern Company Employee Savings Plan Litigation

In June 2004, an employee of a Southern Company subsidiary filed a complaint, which was amended in December 2004 and November 2005 in the U.S. District Court for the Northern District of Georgia on behalf of a purported class of participants in or beneficiaries of The Southern Company Employee Savings Plan (Plan) at any time since April 2, 2001 and whose Plan accounts included investments in Mirant common stock. The complaint asserts claims under ERISA against defendants Southern Company, SCS, the Employee Savings Plan Committee, the Pension Fund Investment Review Committee, individual members of such committees, and the SCS Board of Directors during the putative class period. The plaintiff alleges that the various defendants had certain fiduciary duties under ERISA regarding the Mirant shares distributed to Southern Company shareholders in the spin-off and held in the Mirant Stock Fund in the Plan. The plaintiff alleges that the various defendants breached purported fiduciary duties by, among other things, failing to adequately determine whether Mirant stock was appropriate to hold in the Plan and failing to adequately inform Plan participants that Mirant stock was not an appropriate investment for their retirement assets based on Mirant's alleged improper energy trading and accounting practices, mismanagement, and business conditions. The plaintiff also alleges that certain defendants failed to monitor Plan fiduciaries and that certain defendants had conflicting interests regarding Mirant, which prevented them from acting solely in the interests of Plan participants and beneficiaries. The plaintiff seeks class-wide equitable relief and an unspecified amount of monetary damages.

On October 4, 2005, the court dismissed the plaintiff's claims for certain types of equitable relief, but allowed the remainder of the ERISA claims to proceed. The defendants filed answers to the second amended complaint in January 2006, and filed motions for summary judgment and to stay discovery in February 2006. The ultimate outcome of this matter cannot now be determined.

Environmental Matters

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 certain Southern Company subsidiaries, including Alabama Power and Georgia Power, alleging that these subsidiaries had violated the

New Source Review (NSR) provisions of the Clean Air Act and related state laws at certain coal-fired generating facilities. Through subsequent amendments and other legal procedures, the EPA added Savannah Electric as a defendant to the original action and filed a separate action against Alabama Power in the U.S. District Court for the Northern District of Alabama after it was dismissed from the original action. In these lawsuits, 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. On June 3, 2005, the U.S. District Court for the Northern District of Alabama issued a decision in favor of Alabama Power on two primary legal issues in the case; however, the decision does not resolve the case, nor does it address other legal issues associated with the EPA's allegations. In accordance with a separate court order, Alabama Power and the EPA are currently participating in mediation with respect to the EPA's claims. The action against Georgia Power and Savannah Electric has been administratively closed since the spring of 2001, and none of the parties has sought to reopen the case.

Southern Company believes that the retail operating companies complied with applicable laws and the EPA regulations and interpretations in effect at the time the work in question took place. The Clean Air Act authorizes maximum civil penalties of \$25,000 to \$32,500 per day, per violation at each generating unit, depending on the date of the alleged violation. 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 financial condition if such costs are not recovered through regulated rates.

Plant Wansley Environmental Litigation

In December 2002, the Sierra Club, Physicians for Social Responsibility, Georgia Forestwatch, and one individual filed a civil suit in the U.S. District Court for the Northern District of 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 liability phase of the case has concluded with the court ruling in favor of Georgia Power in part and the plaintiffs in part. In March 2005, the U.S. Court of Appeals for the Eleventh Circuit accepted Georgia Power's petition for review of the district court's order, and oral arguments were held on January 24, 2006. The district court case has been administratively closed pending that appeal. If necessary, the district court will hold a separate trial which will address civil penalties and possible injunctive relief requested by the plaintiffs.

The ultimate outcome of this matter cannot currently be determined; however, an adverse outcome could require substantial capital expenditures that cannot be determined at this time and could possibly require the payment of substantial penalties. This

NOTES TO FINANCIAL STATEMENTS

could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

Environmental Remediation

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. In 1995, the 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. As of December 31, 2005, Georgia Power had recorded approximately \$6 million in cumulative expenses associated with its agreed-upon share of the removal and remedial investigation and feasibility study costs for the Brunswick site. Additional claims for recovery of natural resource damages at the site are anticipated. Georgia Power has also recognized \$36 million in cumulative expenses through December 31, 2005 for the assessment and anticipated cleanup of other sites on the Georgia Hazardous Sites Inventory.

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

FERC Matters

Market-Based Rate Authority

Each of the retail operating companies and Southern Power has authorization from the FERC to sell power to non-affiliates at market-based prices. The retail operating companies and Southern Power 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 December 2004, the FERC initiated a proceeding to assess Southern Company's generation dominance within its retail service territory. The ability to charge market-based rates in other markets is not an issue in that proceeding. In February 2005, Southern Company submitted responsive information. In February 2006, the FERC suspended the proceeding to allow the parties to conduct settlement discussions. Any new market-based rate transactions in its retail service territory entered into after February 27, 2005 are subject to refund to the level of the default cost-based rates, pending the outcome of the proceeding. The impact of such sales through December 31, 2005 is not expected to exceed \$16 million. The refund period covers 15 months. In the event that the FERC's default mitigation measures for entities that are found to have market power are ultimately applied, the retail operating companies and Southern Power may be required to charge cost-based rates for certain wholesale sales in the Southern Company retail service territory, which may be lower than negotiated market-based rates. The final outcome of this matter will depend on the form in which the final methodology for assessing generation market power and mitigation rules may be ultimately adopted and cannot be determined at this time.

In addition, in May 2005, the FERC started an investigation to determine whether Southern Company satisfies the other three parts of the FERC's market-based rate analysis: transmission market power, barriers to entry, and affiliate abuse or reciprocal dealing. The FERC established a new refund period related to this expanded investigation. Any and all new market-based rate transactions both inside and outside Southern Company's retail service territory involving any Southern Company subsidiary will be subject to refund to the extent the FERC orders lower rates as a result of this new investigation, with the 15-month refund period beginning July 19, 2005. The impact of such sales through December 31, 2005 is not expected to exceed \$31 million, of which \$11 million relates to sales inside the retail service territory discussed above. The FERC also directed that this expanded proceeding be held in abeyance pending the outcome of the proceeding on the Intercompany Interchange Contract (IIC) discussed below.

Southern Company and its subsidiaries believe that there is no meritorious basis for this proceeding and are vigorously defending themselves in this matter. However, the final outcome of this matter, including any remedies to be applied in the event of an adverse ruling in this proceeding, cannot now be determined.

Intercompany Interchange Contract

The Company's generation fleet in its retail service territory is operated under the IIC, as approved by the FERC. In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among Alabama Power, Georgia Power, Gulf Power, Mississippi Power, Savannah Electric, Southern Power, and SCS, as agent, under the terms of which the power pool of Southern Company is operated, and, in particular, the propriety of the continued inclusion of Southern Power as a party to the IIC, (2) whether any parties to the IIC have violated the FERC's standards of conduct applicable to utility companies that are transmission providers, and (3) whether Southern Company's code of conduct defining Southern Power as a "system company" rather than a "marketing affiliate" is just and reasonable. In connection with the formation of Southern Power, the FERC authorized Southern Power's inclusion in the IIC in 2000. The FERC also previously approved Southern Company's code of conduct. The FERC order directs that the administrative law judge who presided over a proceeding involving approval of PPAs between Southern Power and Georgia Power and Savannah Electric be assigned to preside over the hearing in this proceeding and that the testimony and exhibits presented in that proceeding be preserved to the extent appropriate. Hearings are scheduled for September 2006. Effective July 19, 2005, revenues from transactions under the IIC involving any Southern Company subsidiaries will be subject to refund to the extent the FERC orders any changes to the IIC.

Southern Company and its subsidiaries believe that there is no meritorious basis for this proceeding and are vigorously defending themselves in this matter. However, the final outcome of this matter, including any remedies to be applied in the event of an adverse ruling in this proceeding, cannot now be determined.

NOTES TO FINANCIAL STATEMENTS

Generation Interconnection Agreements

In July 2003, the FERC issued its final rule on the standardization of generation interconnection agreements and procedures (Order 2003). Order 2003 shifts much of the financial burden of new transmission investment from the generator to the transmission provider. The FERC has indicated that Order 2003, which was effective January 20, 2004, is to be applied prospectively to interconnection agreements. Subsidiaries of Tenaska, Inc., as counterparties to three previously executed interconnection agreements with subsidiaries of Southern Company, have filed complaints at the FERC requesting that the FERC modify the agreements and that Southern Company refund a total of \$19 million previously paid for interconnection facilities, with interest. These proceedings are still pending at the FERC. Southern Company has also received similar requests from other entities totaling approximately \$14 million. Southern Company has opposed all such requests. The impact of Order 2003 and its subsequent rehearings on Southern Company and the final results of these matters cannot be determined at this time.

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 and amended to add four more plaintiffs. The lawsuit also raised claims on behalf of a purported class. The plaintiffs sought compensatory and punitive damages in an unspecified amount, as well as injunctive relief.

Following various court decisions in favor of the defendants and subsequent appeals by the plaintiffs, on July 13, 2005, the plaintiffs filed a petition for writ of certiorari to the U.S. Supreme Court. On October 17, 2005, the petition was denied. This matter is now concluded.

Right of Way Litigation

Southern Company and certain of its subsidiaries, including Georgia Power, Gulf Power, Mississippi Power, and Southern Telecom, have been named as defendants in numerous lawsuits brought by landowners since 2001. 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 exceed the easements or other property rights held by defendants. The plaintiffs assert claims for, among other things, trespass and unjust enrichment and seek compensatory and punitive damages and injunctive relief. Management of Southern Company and its subsidiaries believe that they have complied with applicable laws and that the plaintiffs' claims are without merit.

In November 2003, the Second Circuit Court in Gadsden County, Florida, ruled in favor of the plaintiffs on their motion for partial summary judgment concerning liability in 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. Subsequently, the plaintiffs sought to amend their complaint and asked the court to enter a final declaratory judgment and to enter an order

enjoining Gulf Power from allowing expanded general telecommunications use of the fiber optic cables that are the subject of this litigation. In January 2005, the trial court granted in part the plaintiffs' motion to amend their complaint and denied the requested declaratory and injunctive relief. In November 2005, the trial court ruled in favor of the plaintiffs and against Gulf Power on their respective motions for partial summary judgment. In that same order, the trial court also denied Gulf Power's motion to dismiss certain claims. The court's ruling allowed for an immediate appeal to the Florida First District Court of Appeal, which Gulf Power filed on December 20, 2005. If the appeal is not successful, damages will be decided at a future trial.

In January 2005, the Superior Court of Decatur County, Georgia, granted partial summary judgment in another such lawsuit brought by landowners against Georgia Power on the plaintiffs' declaratory judgment claim that the easements do not permit general telecommunications use. The court also dismissed Southern Telecom from this case. The question of damages and other liability or remedies issues with respect to these actions, if any, will be decided at future trials. Georgia Power appealed this ruling to the Georgia Court of Appeals. The Georgia Court of Appeals reversed, in part, the court's order and remanded the case to the trial court for the determination of further issues. After the Court of Appeals' decision, the plaintiffs filed a motion for reconsideration, which was denied, and a petition for certiorari to the Georgia Supreme Court, which is currently pending. In the event of an adverse verdict in either case, Gulf Power or Georgia Power, as applicable, could appeal the issues of both liability and damages or other relief granted.

To date, Mississippi Power has entered into agreements with plaintiffs in approximately 90 percent of the actions pending against Mississippi Power to clarify its easement rights in the State of Mississippi. These agreements have been approved by the Circuit Courts of Harrison County and Jasper County, Mississippi (First Judicial Circuit), and dismissals of the related cases are in progress. These agreements have not resulted in any material effects on Mississippi Power's financial statements.

In addition, in late 2001, certain subsidiaries of Southern Company, including Alabama Power, Georgia Power, Gulf Power, Mississippi Power, Savannah Electric, and Southern Telecom, 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 it in pending and future right of way litigation. The Company believes that the plaintiff's claims are without merit. In the fall of 2004, the trial court stayed the case until resolution of the underlying landowner litigation discussed above. In January 2005, the Georgia Court of Appeals dismissed the telecommunications company's appeal of the trial court's order for lack of jurisdiction. 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 TO FINANCIAL STATEMENTS

Income Tax Matters

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 2001. Southern Company participates in four international leveraged lease transactions and receives federal income tax deductions for depreciation and amortization, as well as interest on related debt. The IRS proposed to disallow the tax losses for one of these leases (a lease-in-lease-out, or LILO) in connection with its audit of 1996 through 2001. In October 2004, Southern Company submitted the issue to the IRS appeals division and in February 2005 reached a negotiated settlement with the IRS, which is subject to final approval. Under current accounting rules, the settlement of this transaction will have no material impact on Southern Company's financial statements.

In connection with its audit of 2000 and 2001, the IRS also challenged Southern Company's deductions related to three other international lease (sale-in-lease-out, or SILO) transactions. If the IRS is ultimately successful in disallowing the tax deductions related to these three transactions, beginning with the 2000 tax year, Southern Company would be subject to additional interest charges of up to \$34 million. The IRS has also proposed a penalty of approximately \$16 million. Southern Company believes these transactions are valid leases for U.S. tax purposes, the related deductions are allowable, and the assessment of a penalty is inappropriate. Southern Company is continuing to pursue resolution of these matters with the IRS and expects to litigate the issue if necessary. Although the payment of the tax liability, exclusive of interest, would not affect Southern Company's results of operations under current accounting standards, it could have a material impact on cash flow. Through December 31, 2005, Southern Company has claimed \$241 million in tax benefits related to these SILO transactions challenged by the IRS. See Note 1 under "Leveraged Leases" for additional information.

Alabama Power Retail Regulatory Matters

Alabama Power operates under a Rate Stabilization and Equalization plan (Rate RSE) approved by the Alabama PSC. Rate RSE provides for periodic annual adjustments based upon Alabama Power's earned return on end-of-period retail common equity; however, in October 2005, Alabama Power and the Alabama PSC agreed to a moratorium on any rate increase under Rate RSE until January 2007. In October 2005, the Alabama PSC approved a revision to Rate RSE requested by Alabama Power. Effective January 2007, Rate RSE adjustments will be based on forward-looking information for the applicable upcoming calendar year. Rate adjustments for any two-year period, when averaged together, cannot exceed 4 percent per year and any annual adjustment is limited to 5 percent. Rates will remain unchanged if the return on equity (ROE) is between 13 percent and 14.5 percent. If Alabama Power's actual retail ROE is above the allowed equity return range, customer refunds will be required; however, there is no provision for additional customer billings should the actual retail return on common equity fall below the allowed equity return range. Alabama Power will make its initial submission of projected data for calendar year 2007 by December 1, 2006. The ratemaking

procedures will remain in effect until the Alabama PSC votes to modify or discontinue them.

The Alabama PSC has also approved a rate mechanism that provides 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 (Rate CNP).

To recover certificated purchased power costs under Rate CNP, increases of 2.6 percent or \$79 million annually and 0.8 percent or \$25 million annually were effective July 2003 and June 2004, respectively. In April 2005, an annual true-up adjustment to Rate CNP decreased retail rates by approximately 0.5 percent or \$18.5 million annually.

In October 2004, the Alabama PSC approved a request by Alabama Power to amend Rate CNP to also provide for the recovery of retail costs associated with environmental laws and regulations, effective in January 2005. The rate mechanism began operation in January 2005 and provides for the recovery of these costs pursuant to a factor that will be calculated annually. Environmental costs to be recovered include operation and maintenance expenses, depreciation, and a return on invested capital. Retail rates increased approximately 1 percent in both January 2005 and 2006.

Alabama Power fuel costs are recovered under Rate ECR (Energy Cost Recovery), which provides for the addition of a fuel and energy cost factor to base rates. In December 2005, the Alabama PSC approved an increase that allows for the recovery of approximately \$227 million in existing under recovered fuel costs over a two-year period. Based on the order, a portion of the under recovered regulatory clause revenues was reclassified from current assets to deferred charges and other assets in the balance sheet.

Georgia Power Retail Regulatory Matters

In December 2004, the Georgia PSC approved a three-year retail rate plan ending December 31, 2007 (2004 Retail Rate Plan) for Georgia Power. Under the terms of the 2004 Retail Rate Plan, Georgia Power's earnings are evaluated against a retail ROE range of 10.25 percent to 12.25 percent. Two-thirds of any earnings above 12.25 percent will be applied to rate refunds, with the remaining one-third retained by Georgia Power. Retail rates and customer fees were increased by approximately \$203 million effective January 1, 2005 to cover the higher costs of purchased power, operating and maintenance expenses, environmental compliance, and continued investment in new generation, transmission, and distribution facilities to support growth and ensure reliability. In 2005, Georgia Power recorded \$5.3 million in revenue subject to refund related to earnings in excess of a 12.25 percent retail ROE.

Georgia Power is required to file a general rate case by July 1, 2007 in response to which the Georgia PSC would be expected to determine whether the rate order should be continued, modified, or discontinued. Until then, Georgia Power may not file for a general base rate increase unless its projected retail return on common equity falls below 10.25 percent.

In December 2001, the Georgia PSC approved a three-year retail rate plan (2001 Retail Rate Plan) for Georgia Power ending

NOTES TO FINANCIAL STATEMENTS

December 31, 2004. Under the terms of the 2001 Retail Rate Plan, earnings were evaluated against a retail return on common equity range of 10 percent to 12.95 percent. Georgia Power's earnings in all three years were within the common equity range. Under the 2001 Retail Rate Plan, Georgia Power amortized a regulatory liability of \$333 million, related to previously recorded accelerated amortization expenses, equally over three years beginning in 2002. Also, the 2001 Retail Rate Plan 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.

On May 17, 2005, the Georgia PSC approved Georgia Power's request to increase customer fuel rates by approximately 9.5 percent to recover under recovered fuel costs of approximately \$508 million existing as of May 31, 2005 over a four-year period that began June 1, 2005. Based on the order, a portion of the under recovered regulatory clause revenues was reclassified from current assets to deferred charges and other assets in the balance sheet.

Under recovered fuel amounts for the period subsequent to June 1, 2005 totaled \$327.5 million through December 31, 2005. The Georgia PSC's order instructs that such amounts be reviewed semi-annually beginning February 2006. If the amount under or over recovered exceeds \$50 million at the evaluation date, Georgia Power will be required to file for a temporary fuel rate change. In addition, Savannah Electric's under recovered fuel costs totaled \$77.7 million at December 31, 2005. In accordance with a Georgia PSC order, Savannah Electric was scheduled to file an additional request for a fuel cost recovery increase in January 2006. In connection with the proposed merger, Georgia Power has agreed with a Georgia PSC staff recommendation to forego the temporary fuel rate process, and Savannah Electric has postponed its scheduled filing. Instead, Georgia Power and Savannah Electric will file a combined request in March 2006 to increase its fuel cost recovery rate.

The case will seek approval of a fuel cost recovery rate based upon future fuel cost projections for the combined Georgia Power and Savannah Electric generating fleet, as well as the under recovered balances existing at June 30, 2006. The new fuel cost recovery rate would be billed beginning in July 2006 to all Georgia Power customers, including the existing Savannah Electric customers. Under recovered amounts as of the date of the merger will be paid by the appropriate customer groups. For additional information regarding the pending merger, see "Merger of Georgia Power and Savannah Electric" below.

In August 2005, the Georgia PSC initiated an investigation of Savannah Electric's fuel practices. In February 2006, an investigation of Georgia Power's fuel practices was initiated. Georgia Power and Savannah Electric are responding to data requests and cooperating in the investigations. The final outcome of these matters cannot now be determined.

Storm Damage Cost Recovery

Each retail operating company maintains a reserve to cover the cost of damages from major storms to its transmission and distribution

facilities and the cost of uninsured damages to its generation facilities and other property. Following Hurricanes Ivan, Dennis, and Katrina in September 2004, July 2005, and August 2005, respectively, each of the affected retail operating companies has been authorized by its respective state PSC to defer the portion of the storm restoration costs incurred that exceeded the balance in its storm damage reserve account. As of December 31, 2005, the deficit balance in Southern Company's storm damage reserve accounts totaled approximately \$366 million, of which approximately \$70 million and \$296 million, respectively, is included in the condensed balance sheets herein under Other Current Assets and Other Regulatory Assets. Approximately \$81 million of the deficit balances are being recovered through separate surcharges or rate riders approved by the Florida and Alabama PSCs, as discussed further below. The recovery of the remaining deferred costs is subject to the approval of the respective state PSC.

Hurricane Ivan caused significant damage to the service areas of both Gulf Power and Alabama Power. In February and December 2005, Alabama Power requested and received Alabama PSC approval of accounting orders that allowed Alabama Power to immediately return certain regulatory liabilities to the retail customers. The orders also allowed Alabama Power to simultaneously recover from customers accruals of approximately \$48 million primarily to offset the costs of Hurricane Ivan and restore a positive balance in the natural disaster reserve. The combined effect of these orders had no impact on net income in 2005. In March 2005, the Florida PSC approved a Stipulation and Settlement among Gulf Power, the Office of Public Counsel for the State of Florida, and the Florida Industrial Power Users Group. The agreement allows Gulf Power to recover approximately \$51.7 million in storm damage costs, plus interest and revenue taxes, from customers over a 24-month period that began in April 2005. Gulf Power also agreed that it will not seek any additional increase in its base rates and charges to become effective on or before March 1, 2007.

Hurricanes Dennis and Katrina caused significant damage within Southern Company's service area, including portions of the service areas of Alabama Power and Gulf Power and all of Mississippi Power's service area. Hurricane Dennis and Katrina restoration costs are currently estimated to total approximately \$506 million, of which approximately \$287 million relates to operation and maintenance expenditures. Approximately \$60 million of these costs is expected to be covered through external insurance. Restoration efforts following Hurricane Katrina are ongoing for approximately 19,200 Mississippi Power customers who remain unable to receive power, as well as to make permanent improvements in areas where temporary emergency repairs were necessary. In addition, business and governmental authorities are still reviewing redevelopment plans for portions of the most severely damaged areas along the Mississippi shoreline. Until such plans are complete, Mississippi Power cannot determine the related electric power needs or associated cost estimates. The ultimate impact of redevelopment plans in these areas on the cost estimates cannot now be determined.

In December 2005, the Alabama PSC approved Alabama Power's request for a separate rate rider to recover its \$51 million of

NOTES TO FINANCIAL STATEMENTS

deferred Hurricane Dennis and Katrina operation and maintenance costs over a two-year period and to replenish the reserve to a target balance of \$75 million over a five-year period.

Prior to Hurricane Katrina, Mississippi Power had a balance of approximately \$3 million in its property reserve. In October 2005, the Mississippi PSC issued an Interim Accounting Order requiring Mississippi Power to recognize a regulatory asset in an amount equal to the retail portion of the recorded Hurricane Katrina restoration costs, including both operation and maintenance expenditures and capital additions. Through December 31, 2005, these incremental costs totaled \$210 million, net of insurance proceeds of \$68 million. These costs include approximately \$133 million of operation and maintenance expenditures and approximately \$49 million of capital additions, of which approximately \$100 million are reflected as investing activities for purposes of the statement of cash flows. In December 2005, Mississippi Power filed with the Mississippi PSC a detailed review of all Hurricane Katrina restoration costs as required in the Interim Accounting Order. Mississippi Power is currently working with the Mississippi PSC to establish a method to recover all such prudently incurred costs upon resolution of uncertainties related to federal grant assistance and proposed state legislation to allow securitized financing. Also in December 2005, Mississippi Power submitted its annual Performance Evaluation Plan (PEP) filing to the Mississippi PSC. Ordinarily, PEP limits annual rate increases to 4 percent; however, Mississippi Power has requested that the Mississippi PSC approve a temporary change to allow them to exceed this cap as a result of the ongoing effects of Hurricane Katrina. Mississippi Power has requested a 5 percent or \$32 million retail base rate increase to become effective in April 2006 if approved. Hearings are scheduled for March 2, 2006.

In 2005, the Florida Legislature authorized securitized financing for hurricane costs. On February 22, 2006, Gulf Power filed a petition with the Florida PSC under this legislative authority requesting permission to issue \$87.2 million in securitized storm-recovery bonds. The bonds would be repaid over 8 years from revenues to be received from storm-recovery charges implemented under the securitization plan and billed to customers. If approved as proposed, the plan would resolve Gulf Power's remaining deferred costs, by refinancing, net of taxes, the remaining balance of storm damage costs currently being recovered from customers related to Hurricane Ivan and financing, net of taxes, restoration costs associated with Hurricanes Dennis and Katrina of approximately \$54 million. It would also replenish Gulf Power's property damage reserve with an additional \$70 million. A decision on the plan is expected prior to the end of the second quarter of 2006. The final outcome of these matters cannot now be determined; however, since Gulf Power will recognize expenses equal to the revenues billed to customers, the securitization plan would have no impact on net income, but would increase cash flow.

Plant Franklin Construction Project

Southern Power completed 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, 2005, Southern Power's investment in Unit 3 of Plant Franklin was \$172 million. The final outcome of this matter cannot now be determined.

Southern Company Gas Sale

On January 4, 2006, Southern Company completed the sale of substantially all the assets of Southern Company Gas, its competitive retail natural gas marketing subsidiary, including natural gas inventory, accounts receivable, and customer list, to Gas South, LLC, an affiliate of Cobb Electric Membership Corporation. Southern Company Gas' sale of such assets was pursuant to a Purchase and Sale Agreement dated November 18, 2005 between Southern Company Gas and Gas South, for an aggregate purchase price of approximately \$127 million, subject to certain adjustments. This sale will have no material impact on Southern Company's net income for the quarter ending March 31, 2006. As a result of the sale, Southern Company's financial statements and related information reflect Southern Company Gas as discontinued operations.

Merger of Georgia Power and Savannah Electric

On December 13, 2005, Georgia Power and Savannah Electric entered into a merger agreement, under which Savannah Electric will merge into Georgia Power, with Georgia Power continuing as the surviving corporation. At the effective date of the merger, each share of Georgia Power common stock will remain issued and outstanding; the issued and outstanding shares of Savannah Electric common stock, all of which are held by Southern Company, will be converted into the right to receive 1,500,000 shares of Georgia Power common stock; and each share of Savannah Electric preferred stock issued and outstanding immediately prior to the merger will be converted into the right to receive one share of a new series of Georgia Power Class A Preferred Stock. The merger must be approved by the preferred shareholders of Savannah Electric, and is subject to the receipt of regulatory approvals from the FERC, Georgia PSC, and Federal Communications Commission. Pending regulatory approvals, the merger is expected to occur by July 2006. The merger is not expected to have any material impact on Southern Company's financial statements.

NOTE 4:

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.

NOTES TO FINANCIAL STATEMENTS

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, 2005, 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:

	JOINTLY OWNED FACILITIES		
	PERCENT OWNERSHIP	(in millions)	
		AMOUNT OF INVESTMENT	ACCUMULATED DEPRECIATION
Plant Vogtle (nuclear)	45.7%	\$3,311	\$1,809
Plant Hatch (nuclear)	50.1	935	492
Plant Miller (coal)			
Units 1 and 2	91.8	940	374
Plant Scherer (coal)			
Units 1 and 2	8.4	115	56
Plant Wansley (coal)	53.5	395	172
Rocky Mountain (pumped storage)	25.4	169	92
Intercession City (combustion turbine)	33.3	12	2
Plant Stanton (combined cycle)			
Unit A	65.0	156	10

At December 31, 2005, the portion of total construction work in progress related to Plants Miller, Scherer, and Wansley was \$4.4 million, \$0.5 million, and \$8.3 million, respectively, primarily for environmental projects.

Alabama Power, Georgia Power, and Southern Power have contracted to operate and maintain the jointly owned facilities, except for Rocky Mountain 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 statements of income.

NOTE 5: INCOME TAXES

Southern Company files a consolidated federal income tax return and combined state income tax returns for the States of Alabama, Georgia, and Mississippi. Under a joint consolidated income tax allocation 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. In December 2004, the IRS concluded its audit for the tax years 2000 and 2001, and Southern Company paid \$39 million in additional tax and interest for issues related to Mirant tax items. Under the terms of the separation agreements, Mirant agreed to indemnify Southern Company for subsequent assessment of any additional taxes related to its transactions prior to the spin off. However, as a result of Mirant's bankruptcy, Southern Company sought reimbursement as an unsecured creditor. For additional information, see Note 3 under "Mirant Matters—Mirant Bankruptcy."

At December 31, 2005, the tax-related regulatory assets and liabilities were \$937 million and \$313 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.

Details of income tax provisions are as follows:

(in millions)	2005	2004	2003
Total provision for income taxes:			
Federal—			
Current	\$ 61	\$ 14	\$141
Deferred	419	482	393
	480	496	534
State—			
Current	35	15	44
Deferred	80	76	34
	115	91	78
Total	\$595	\$587	\$612

Net cash payments for income taxes in 2005, 2004, and 2003 were \$100 million, \$78 million, and \$189 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:

(in millions)	2005	2004
Deferred tax liabilities:		
Accelerated depreciation	\$4,613	\$4,290
Property basis differences	1,008	1,009
Leveraged lease basis differences	519	447
Employee benefit obligations	333	307
Under recovered fuel clause	528	210
Premium on reacquired debt	126	132
Storm reserve	68	47
Other	155	133
Total	7,350	6,575
Deferred tax assets:		
Federal effect of state deferred taxes	263	243
State effect of federal deferred taxes	88	111
Employee benefit obligations	210	177
Other property basis differences	148	157
Deferred costs	126	105
Unbilled revenue	58	61
Other comprehensive losses	96	94
Alternative minimum tax carryforward	202	106
Other	260	233
Total	1,451	1,287
Total deferred tax liabilities, net	5,899	5,288
Portion included in prepaid expenses		
(accrued income taxes), net	(180)	(57)
Deferred state tax assets	17	12
Accumulated deferred income taxes		
in the balance sheets	\$5,736	\$5,243

NOTES TO FINANCIAL STATEMENTS

The alternative minimum tax credits do not expire.

At December 31, 2005, 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 \$59 million, if utilized. These deductions will expire between 2006 and 2021. During 2005, Southern Company utilized \$11 million in available net operating losses, which resulted in a \$0.7 million state income tax benefit. Beginning in 2002, the State of Georgia allowed 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 statements of income. Credits amortized in this manner amounted to \$25 million in 2005, \$27 million in 2004, and \$29 million in 2003. At December 31, 2005, 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:

	2005	2004	2003
Federal statutory rate	35.0%	35.0%	35.0%
State income tax, net of federal deduction	3.4	2.8	2.4
Synthetic fuel tax credits	(8.0)	(8.5)	(5.7)
Employee stock plans dividend deduction	(1.5)	(1.5)	(1.5)
Non-deductible book depreciation	1.1	1.1	1.1
Difference in prior years'			
deferred and current tax rate	(1.8)	(0.7)	(0.7)
Other	(1.4)	(0.9)	(1.5)
Effective income tax rate	26.8%	27.3%	29.1%

NOTE 6: FINANCING

Mandatorily Redeemable Preferred Securities/ Long-Term Debt Payable to Affiliated Trusts

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 and are reflected in the balance sheets as Long-term Debt Payable to Affiliated Trusts

(including Securities Due Within One Year). Southern Company and the retail operating companies each consider 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, 2005, preferred securities of \$1.9 billion were outstanding. Southern Company guarantees \$574 million of notes related to these securities issued on its behalf. Subsequent to year-end, this amount has been reduced to \$502 million through the redemption of outstanding securities. See Note 1 under "Variable Interest Entities" for additional information on the accounting treatment for these trusts and the related securities.

Securities Due Within One Year

A summary of scheduled maturities and redemptions of securities due within one year at December 31 is as follows:

(in millions)	2005	2004
Capitalized leases	\$ 13	\$ 12
First mortgage bonds	45	-
Pollution control bonds	12	-
Senior notes	697	675
Long-term debt payable to affiliated trusts	72	-
Other long-term debt	47	296
Preferred stock	15	-
Total	\$901	\$983

Debt and preferred stock redemptions, and/or serial maturities through 2010 applicable to total long-term debt are as follows: \$901 million in 2006; \$1.5 billion in 2007; \$486 million in 2008; \$591 million in 2009, and \$243 million in 2010.

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. Alabama Power, Gulf Power, and Savannah Electric have mortgages that secure first mortgage bonds they have issued and constitute a direct first lien on substantially all of their respective fixed property and franchises. Mississippi Power discharged its mortgage in June 2005, and the lien was removed. The Georgia Power lien was removed in 2002. The remaining outstanding first mortgage bonds of Gulf Power and Savannah Electric mature in 2006. 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.

NOTES TO FINANCIAL STATEMENTS

Bank Credit Arrangements

At the beginning of 2006, unused credit arrangements with banks totaled \$3.3 billion, of which \$810 million expires during 2006 and \$2.5 billion expires during 2007 and beyond. The following table outlines the credit arrangements by company:

(in millions)	TOTAL	UNUSED	EXPIRES	
			2006	2007 & BEYOND
COMPANY:				
Alabama Power	\$ 878	\$ 878	\$ 428	\$ 450
Georgia Power	780	778	70	710
Gulf Power	121	121	121	–
Mississippi Power	326	276	101	225
Savannah Electric	80	80	60	20
Southern Company	750	750	–	750
Southern Power	400	399	–	400
Other	30	30	30	–
Total	\$3,365	\$3,312	\$810	\$2,555

Approximately \$228 million of the credit facilities expiring in 2006 allow the execution of term loans for an additional two-year period, and \$311 million allow execution of one-year term loans. Most of these agreements include stated borrowing rates.

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 one-eighth of 1 percent or less for Southern Company, the retail operating companies, and Southern Power. Compensating balances are not legally restricted from withdrawal. Included in the total \$3.3 billion of unused credit arrangements is \$2.3 billion of syndicated credit arrangements that require the payment of agent fees.

Most of the credit arrangements with banks have covenants that limit debt levels to 65 percent of total capitalization, as defined in the agreements. For purposes of these definitions, debt excludes the long-term debt payable to affiliated trusts. At December 31, 2005, Southern Company, Southern Power, and the retail operating companies were each 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. The cross default provisions are restricted only to the indebtedness, including any guarantee obligations, of the company that has such credit arrangements. Southern Company and its subsidiaries are currently in compliance with all such covenants. Borrowings under certain retail operating companies' unused credit arrangements totaling \$10 million would be prohibited if the borrower experiences a material adverse change, as defined in such arrangements.

A portion of the \$3.3 billion unused credit with banks is allocated to provide liquidity support to the retail operating companies' variable rate pollution control bonds. The amount of variable rate pollution control bonds requiring liquidity support as of December 31, 2005 was \$720 million.

Southern Company, the retail operating companies, and Southern Power borrow primarily through commercial paper programs that have the liquidity support of committed bank credit arrangements. Southern Company and the retail operating companies may also borrow through various other arrangements with banks and extendible commercial note programs. The amount of commercial paper outstanding and included in notes payable in the balance sheets at December 31, 2005 and December 31, 2004 was \$944 million and \$377 million, respectively.

During 2005, the peak amount outstanding for short-term debt was \$1.26 billion, and the average amount outstanding was \$738 million. The average annual interest rate on short-term debt was 3.5 percent for 2005 and 1.3 percent for 2004 and 2003.

Financial Instruments

The retail operating companies and Southern Power 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 state PSCs. Together with Southern Power, the retail operating companies may enter into hedges of forward electricity sales. In addition, Southern Company Gas had gas-hedging programs to substantially mitigate its exposure to price volatility for its gas purchases.

At December 31, 2005, the fair value of derivative energy contracts was reflected in the financial statements as follows:

(in millions)	AMOUNTS
Regulatory liabilities, net	\$103.4
Other comprehensive income	(0.3)
Net income	(2.6)
Total fair value	\$100.5

The fair value gains or losses for 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, the fair value gains or losses for cash flow hedges are recorded in other

NOTES TO FINANCIAL STATEMENTS

comprehensive income and are reclassified into earnings at the same time the hedged items affect earnings. For 2005, 2004, and 2003, approximately \$7 million, \$(3) million, and \$22 million, respectively, of pre-tax gains (losses) were reclassified from other comprehensive income to fuel expense. For the year 2006, no material amounts are expected to be reclassified from other comprehensive income to fuel expense. There was no significant ineffectiveness recorded in earnings for any period presented. Southern Company has energy-related hedges in place up to and including 2008.

Southern Company and certain subsidiaries also enter into derivatives to hedge exposure to changes in interest rates. 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. As the derivatives employed as hedging instruments are generally structured to match the critical terms of the hedged debt instruments, no material ineffectiveness has been recorded in earnings.

At December 31, 2005, Southern Company had \$2.8 billion notional amount of interest rate swaps and options outstanding with net fair value gains of \$31.7 million as follows:

Fair Value Hedges

(in millions)	MATURITY	VARIABLE RATE PAID	NOTIONAL AMOUNT	FAIR VALUE GAIN
COMPANY:				
Southern Company	2007	6-month LIBOR - 0.10%	\$400	\$3.0

Cash Flow Hedges

(in millions)	MATURITY	WEIGHTED AVERAGE FIXED RATE PAID	NOTIONAL AMOUNT	FAIR VALUE GAIN/(LOSS)
COMPANY:				
Alabama Power	2007	2.01%*	\$536	\$ 7.3
	2006	1.89%	195	2.5
	2016	4.82%	300	3.0
	2016	4.42%	300	12.5
Georgia Power	2006-2007	2.09-3.85%**	400	1.2
	2037	4.58-5.75%***	300	(1.1)
	2007	2.67%	300	2.4
Savannah Electric	2007	2.50%*	14	0.3
	2016	4.69%	30	0.6

* Hedged using the Bond Market Association Municipal Swap Index.

** Series of interest rate caps and collars (showing the lowest floor and highest cap) with variable rates based on one-month LIBOR.

*** Interest rate collar.

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 2005, 2004, and 2003, the Company incurred losses of \$19 million, \$7 million, and \$116 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 original interest derivative. For 2005, 2004, and 2003, approximately \$10 million, \$23 million, and \$26 million, respectively, of pre-tax losses were reclassified from other comprehensive income to interest expense. For 2006, pre-tax losses of approximately \$2 million are expected to be reclassified from other comprehensive income to interest expense.

NOTE 7: COMMITMENTS

Construction Program

Southern Company is engaged in continuous construction programs, currently estimated to total \$2.8 billion in 2006, \$3.6 billion in 2007, and \$3.1 billion in 2008. These amounts include \$63 million, \$39 million, and \$23 million in 2006, 2007, and 2008, respectively, for construction expenditures related to contractual purchase commitments for uranium and nuclear fuel conversion, enrichment, and fabrication services included herein 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 regulations; increasing costs of labor, equipment, and materials; and cost of capital. At December 31, 2005, significant purchase commitments were outstanding in connection with the ongoing construction program, which includes capital improvements to generation, transmission, and distribution facilities, including those to meet environmental standards.

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. The LTSAs provide 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.

NOTES TO FINANCIAL STATEMENTS

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 \$1.8 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.

Georgia Power has also entered into an LTSA with GE through 2014 for \$14.9 million worth of neutron monitoring system parts and electronics at Plant Hatch. Total remaining payments to GE under this agreement are currently estimated at \$13.1 million. The contract contains cancellation provisions at the option of Georgia Power.

Payments made to GE prior to the performance of any work are recorded as a prepayment in the balance sheets. All work performed by GE is capitalized or charged to expense (net of any joint owner billings), as appropriate based on the nature of the work.

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. Coal commitments include forward contract purchases for sulfur dioxide emission allowances. 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 Exchange future prices at December 31, 2005. Also, Southern Company has entered into various long-term commitments for the purchase of electricity. Total estimated minimum long-term obligations at December 31, 2005 were as follows:

(in millions)	COMMITMENTS			
	NATURAL GAS	COAL	NUCLEAR FUEL	PURCHASED POWER
2006	\$1,495	\$3,129	\$ 63	\$ 175
2007	805	2,509	39	176
2008	481	1,450	23	180
2009	371	864	14	162
2010	369	694	20	143
2011 and thereafter	3,046	364	89	541
Total	\$6,567	\$9,010	\$248	\$1,377

Additional commitments for fuel will be required to supply Southern Company's future needs.

Operating Leases

In May 2001, Mississippi Power began the initial 10-year term of a lease agreement for a combined cycle generating facility built at Plant Daniel for 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. In 2003, approximately \$11 million in lease termination costs were also included in operation expenses. 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. 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. Mississippi Power is required to amortize approximately 4 percent of the 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. A liability of approximately \$11 million for the fair market value of this residual value guarantee is included in the balance sheet as of December 31, 2005.

Southern Company also has other operating lease agreements with various terms and expiration dates. Total operating lease expenses were \$150 million, \$156 million, and \$172 million for 2005, 2004, and 2003, respectively. Southern Company includes any step rents, escalations, and lease concessions in its computation of minimum lease payments, which are recognized on a straight-line basis over the minimum lease term. At December 31, 2005, estimated minimum lease payments for noncancelable operating leases were as follows:

(in millions)	MINIMUM LEASE PAYMENTS			
	PLANT DANIEL	RAIL CARS	OTHER	TOTAL
2006	\$ 29	\$ 42	\$ 52	\$123
2007	29	34	46	109
2008	29	31	36	96
2009	29	24	30	83
2010	28	22	23	73
2011 and thereafter	28	84	147	259
Total	\$172	\$237	\$334	\$743

NOTES TO FINANCIAL STATEMENTS

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 leases with respect to the residual value of the leased property. These leases expire in 2006, 2009, and 2011, and the maximum obligations are \$66 million, \$20 million, and \$68 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

Prior to the spin-off, Southern Company made separate guarantees to certain counterparties regarding performance of contractual commitments by Mirant's trading and marketing subsidiaries. The total notional amount of guarantees outstanding at December 31, 2005 is less than \$20 million, all of which will expire by 2009.

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.

NOTE 8:

COMMON STOCK

Stock Issued

Southern Company raised \$213 million (10 million shares) in 2005 and \$124 million (7 million shares) in 2004 from the issuance of new common shares under the Company's various stock plans.

Stock Repurchased

During 2005, in a program designed primarily to offset the issuances discussed above, Southern Company repurchased 10 million shares of common stock at a total cost of \$352 million. The repurchase program was discontinued in early January 2006.

Shares Reserved

At December 31, 2005, a total of 64.9 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).

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, 2005, 6,329 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 stock option plan. Activity from 2003 to 2005 for the stock option plan is summarized below:

	SHARES SUBJECT TO OPTION	AVERAGE OPTION PRICE PER SHARE
Balance at December 31, 2002	32,674,814	19.72
Options granted	7,165,190	27.98
Options canceled	(181,381)	24.37
Options exercised	(5,725,336)	16.56
Balance at December 31, 2003	33,933,287	21.97
Options granted	7,231,703	29.49
Options canceled	(72,794)	26.85
Options exercised	(6,557,690)	18.11
Balance at December 31, 2004	34,534,506	24.27
Options granted	6,969,083	32.71
Options canceled	(83,366)	28.01
Options exercised	(10,072,868)	21.17
Balance at December 31, 2005	31,347,355	\$27.13

Shares reserved for future grants:

At December 31, 2003	39,751,477
At December 31, 2004	32,583,523
At December 31, 2005	25,687,333
Options exercisable:	
At December 31, 2003	18,874,426
At December 31, 2004	21,782,064
At December 31, 2005	18,535,238

The following table summarizes information about options outstanding at December 31, 2005:

	DOLLAR PRICE RANGE OF OPTIONS		
	13-21	21-28	28-35
Outstanding:			
Shares (in thousands)	4,157	13,370	13,821
Average remaining life (in years)	4.2	5.9	8.2
Average exercise price	\$17.25	\$26.10	\$31.10
Exercisable:			
Shares (in thousands)	4,157	11,465	2,914
Average exercise price	\$17.25	\$25.79	\$29.67

NOTES TO FINANCIAL STATEMENTS

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		
	2005	2004	2003
As reported shares	743,927	738,879	726,702
Effect of options	4,600	4,197	5,202
Diluted shares	748,527	743,076	731,904

Common Stock Dividend Restrictions

The income of Southern Company is derived primarily from equity in earnings of its subsidiaries. At December 31, 2005, consolidated retained earnings included \$4.5 billion of undistributed retained earnings of the subsidiaries. Of this amount, \$68 million was restricted against the payment of cash dividends on common stock by Savannah Electric under terms of its bond indenture. Southern Power's credit facility also contains potential limitations on the payment of common stock dividends; as of December 31, 2005, Southern Power was in compliance with all such requirements.

NOTE 9: NUCLEAR INSURANCE

Under the Price-Anderson Amendment Act (Act), 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 \$10.76 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 \$15 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 \$30 million per company to be paid for each incident in any one year.

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 the 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 \$41 million and \$48 million, respectively.

Following the terrorist attacks of September 2001, both ANI and NEIL confirmed that terrorist acts against commercial nuclear power plants would, subject to the normal policy limits, 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, which was renewed in 2005. The aggregate for all NEIL policies, which applies to non-certified property 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 nuclear liability cap is a \$300 million shared industry aggregate during the normal ANI policy period.

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 TO FINANCIAL STATEMENTS

NOTE 10: 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, and energy-related services. Southern Power's revenues from sales to the retail operating companies were \$557 million, \$425 million, and \$313 million in 2005, 2004, and 2003, respectively. In addition, see Note 1 under "Related Party Transactions" for information regarding revenues from services for synthetic fuel production that are included in the cost of fuel purchased by Alabama Power and Georgia Power. All other intersegment revenues are not material. Financial data for business segments and products and services are as follows:

Business Segment

(in millions)	ELECTRIC UTILITIES						
	RETAIL OPERATING COMPANIES	SOUTHERN POWER	ELIMINATIONS	TOTAL	ALL OTHER	ELIMINATIONS	CONSOLIDATED
2005							
OPERATING REVENUES	\$ 13,156	\$ 781	\$(659)	\$ 13,278	\$ 393	\$(117)	\$ 13,554
DEPRECIATION AND AMORTIZATION	1,083	54	-	1,137	39	-	1,176
INTEREST INCOME	30	2	-	32	5	(1)	36
INTEREST EXPENSE	567	79	-	646	101	-	747
INCOME TAXES	827	72	-	899	(304)	-	595
SEGMENT NET INCOME (loss)	1,398	115	-	1,513	80	(2)	1,591
TOTAL ASSETS	36,335	2,303	(179)	38,459	1,751	(333)	39,877
GROSS PROPERTY ADDITIONS	2,177	241	-	2,418	58	-	2,476

(in millions)	ELECTRIC UTILITIES						
	RETAIL OPERATING COMPANIES	SOUTHERN POWER	ELIMINATIONS	TOTAL	ALL OTHER	ELIMINATIONS	CONSOLIDATED
2004							
Operating revenues	\$ 11,300	\$ 701	\$(536)	\$ 11,465	\$ 375	\$(111)	\$ 11,729
Depreciation and amortization	857	51	-	908	41	-	949
Interest income	24	1	-	25	4	(2)	27
Interest expense	518	66	-	584	83	-	667
Income taxes	802	73	-	875	(290)	-	585
Segment net income (loss)	1,309	112	-	1,421	109	2	1,532
Total assets	33,517	2,067	(104)	35,480	1,895	(420)	36,955
Gross property additions	2,307	116	(415)	2,008	91	-	2,099

(in millions)	ELECTRIC UTILITIES						
	RETAIL OPERATING COMPANIES	SOUTHERN POWER	ELIMINATIONS	TOTAL	ALL OTHER	ELIMINATIONS	CONSOLIDATED
2003							
Operating revenues	\$ 10,502	\$ 682	\$(437)	\$ 10,747	\$ 357	\$ (86)	\$ 11,018
Depreciation and amortization	933	39	-	972	49	1	1,022
Interest income	33	-	-	33	6	(3)	36
Interest expense	542	32	-	574	108	(4)	678
Income taxes	760	85	-	845	(228)	1	618
Segment net income (loss)	1,269	155	-	1,424	59	(9)	1,474
Total assets	31,503	2,409	(122)	33,790	1,574	(189)	35,175
Gross property additions	1,636	344	-	1,980	34	-	2,014

NOTES TO FINANCIAL STATEMENTS

Products and Services

(in millions)	ELECTRIC UTILITIES REVENUES			
	RETAIL	WHOLESALE	OTHER	TOTAL
2005	\$11,165	\$1,667	\$446	\$13,278
2004	9,732	1,341	392	11,465
2003	8,875	1,358	514	10,747

NOTE 11:

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial data for 2005 and 2004—including discontinued operations for net income and earnings per share—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 2005	\$2,787	\$ 560	\$323	\$0.43	\$0.3575	\$34.08	\$31.25
JUNE 2005	3,120	721	387	0.52	0.3725	34.91	31.78
SEPTEMBER 2005	4,358	1,277	722	0.97	0.3725	36.16	33.47
DECEMBER 2005	3,289	404	159	0.21	0.3725	36.07	33.28
March 2004	\$ 2,651	\$ 615	\$331	\$ 0.45	\$0.3500	\$ 30.87	\$ 29.10
June 2004	2,984	697	352	0.48	0.3500	30.59	27.86
September 2004	3,424	1,120	645	0.87	0.3575	30.65	28.86
December 2004	2,670	389	204	0.28	0.3575	33.92	29.95

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

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

FOR THE PERIODS ENDED DECEMBER 2001 THROUGH 2005

	2005	2004	2003	2002	2001
OPERATING REVENUES (in millions)	\$13,554	\$11,729	\$11,018	\$10,447	\$10,155
TOTAL ASSETS (in millions)	\$39,877	\$36,955	\$35,175	\$33,721	\$31,856
GROSS PROPERTY ADDITIONS (in millions)	\$2,476	\$2,099	\$2,014	\$2,728	\$2,617
RETURN ON AVERAGE COMMON EQUITY (percent)	15.17	15.38	16.05	15.79	13.51
CASH DIVIDENDS PAID PER SHARE OF COMMON STOCK	\$1.475	\$1.415	\$1.385	\$1.355	\$1.340
CONSOLIDATED NET INCOME (in millions):					
CONTINUING OPERATIONS	\$1,591	\$1,529	\$1,483	\$1,315	\$1,120
DISCONTINUED OPERATIONS	–	3	(9)	3	142
TOTAL	\$1,591	\$1,532	\$1,474	\$1,318	\$1,262
EARNINGS PER SHARE FROM CONTINUING OPERATIONS—					
Basic	\$2.14	\$2.07	\$2.04	\$1.86	\$1.62
Diluted	2.13	2.06	2.03	1.85	1.61
EARNINGS PER SHARE INCLUDING DISCONTINUED OPERATIONS—					
Basic	\$2.14	\$2.07	\$2.03	\$1.86	\$1.83
Diluted	2.13	2.06	2.02	1.85	1.82
CAPITALIZATION (in millions):					
Common stock equity	\$10,689	\$10,278	\$ 9,648	\$ 8,710	\$ 7,984
Preferred and preference stock	596	561	423	298	368
Mandatorily redeemable preferred securities	–	–	1,900	2,380	2,276
Long-term debt payable to affiliated trusts	1,888	1,961	–	–	–
Long-term debt	10,958	10,488	10,164	8,714	8,297
Total (excluding amounts due within one year)	\$24,131	\$23,288	\$22,135	\$20,102	\$18,925
CAPITALIZATION RATIOS (percent):					
Common stock equity	44.3	44.1	43.6	43.3	42.2
Preferred and preference stock	2.5	2.4	1.9	1.5	1.9
Mandatorily redeemable preferred securities	–	–	8.6	11.8	12.0
Long-term debt payable to affiliated trusts	7.8	8.4	–	–	–
Long-term debt	45.4	45.1	45.9	43.4	43.9
Total (excluding amounts due within one year)	100.0	100.0	100.0	100.0	100.0
OTHER COMMON STOCK DATA:					
Book value per share	\$14.42	\$13.86	\$13.13	\$12.16	\$11.43
Market price per share:					
High	36.160	33.920	31.810	30.850	26.000
Low	31.250	27.860	27.710	23.890	16.152
Close	34.530	33.520	30.250	28.390	25.350
Market-to-book ratio (year-end) (percent)	239.5	241.8	230.4	233.5	221.8
Price-earnings ratio (year-end) (times)	16.1	16.2	14.8	15.3	15.6
Dividends paid (in millions)	\$1,098	\$1,044	\$1,004	\$958	\$922
Dividend yield (year-end) (percent)	4.3	4.2	4.6	4.8	5.3
Dividend payout ratio (percent)	69.0	68.3	67.7	72.8	82.4
Shares outstanding (in thousands):					
Average	743,927	738,879	726,702	708,161	689,352
Year-end	741,448	741,495	734,829	716,402	698,344
Stockholders of record (year-end)	118,285	125,975	134,068	141,784	150,242
RETAIL OPERATING COMPANY CUSTOMERS (year-end) (in thousands):					
Residential	3,642	3,600	3,552	3,496	3,441
Commercial	586	578	564	553	539
Industrial	15	14	14	14	14
Other	5	5	6	5	4
Total	4,248	4,197	4,136	4,068	3,998
EMPLOYEES (year-end)	25,554	25,642	25,762	26,178	26,122

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

FOR THE PERIODS ENDED DECEMBER 2001 THROUGH 2005

	2005	2004	2003	2002	2001
OPERATING REVENUES (in millions):					
Residential	\$ 4,376	\$ 3,848	\$ 3,565	\$ 3,556	\$ 3,247
Commercial	3,904	3,346	3,075	3,007	2,966
Industrial	2,785	2,446	2,146	2,078	2,144
Other	100	92	89	87	83
Total retail	11,165	9,732	8,875	8,728	8,440
Sales for resale	1,667	1,341	1,358	1,168	1,174
Total revenues from sales of electricity	12,832	11,073	10,233	9,896	9,614
Other revenues	722	656	785	551	541
Total	\$13,554	\$11,729	\$11,018	\$10,447	\$10,155
KILOWATT-HOUR SALES (in millions):					
Residential	51,082	49,702	47,833	48,784	44,538
Commercial	51,857	50,037	48,372	48,250	46,939
Industrial	55,141	56,399	54,415	53,851	52,891
Other	996	1,005	998	1,000	977
Total retail	159,076	157,143	151,618	151,885	145,345
Sales for resale	37,801	35,239	40,520	32,551	30,768
Total	196,877	192,382	192,138	184,436	176,113
AVERAGE REVENUE PER KILOWATT-HOUR (cents):					
Residential	8.57	7.74	7.45	7.29	7.29
Commercial	7.53	6.69	6.36	6.23	6.32
Industrial	5.05	4.34	3.94	3.86	4.05
Total retail	7.02	6.19	5.85	5.75	5.81
Sales for resale	4.41	3.81	3.35	3.59	3.82
Total sales	6.52	5.76	5.33	5.37	5.46
AVERAGE ANNUAL KILOWATT-HOUR USE					
PER RESIDENTIAL CUSTOMER	14,084	13,879	13,562	14,036	13,014
AVERAGE ANNUAL REVENUE PER RESIDENTIAL CUSTOMER	\$1,207	\$1,074	\$1,011	\$1,023	\$949
PLANT NAMEPLATE CAPACITY RATINGS (year-end) (megawatts)	40,502	38,622	38,679	36,353	34,579
MAXIMUM PEAK-HOUR DEMAND (megawatts):					
Winter	30,384	28,467	31,318	25,939	26,272
Summer	35,050	34,414	32,949	32,355	29,700
SYSTEM RESERVE MARGIN (at peak) (percent)	14.4	20.2	21.4	13.3	19.3
ANNUAL LOAD FACTOR (percent)	60.2	61.4	62.0	51.1	62.0
PLANT AVAILABILITY (percent):					
Fossil-steam	89.0	88.5	87.7	84.8	88.1
Nuclear	90.5	92.8	94.4	90.3	90.8
SOURCE OF ENERGY SUPPLY (percent):					
Coal	67.0	64.6	66.4	65.7	67.5
Nuclear	13.9	14.4	14.8	14.7	15.2
Hydro	3.1	2.9	3.8	2.6	2.6
Oil and gas	10.9	10.9	8.8	11.4	8.4
Purchased power	5.1	7.2	6.2	5.6	6.3
Total	100.0	100.0	100.0	100.0	100.0