

FINANCIAL REVIEW

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

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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, 2006.

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, 2006. 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 26, 2007

INTERNAL CONTROL OVER FINANCIAL REPORTING

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

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's Report on Internal Control Over Financial Reporting (page 20), that Southern Company (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, 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.

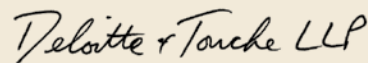
A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to 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 gener-

ally 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, 2006, 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, 2006, 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, 2006 of the Company and our report dated February 26, 2007 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding a change in the method of accounting for the funded status of defined benefit pension and other postretirement plans.

The logo for Deloitte & Touche LLP, featuring the company name in a stylized, cursive script.

Atlanta, Georgia
February 26, 2007

CONSOLIDATED FINANCIAL STATEMENTS

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

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, 2006 and 2005, 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, 2006. 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.

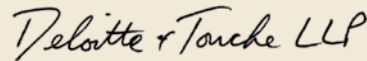
We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 46 to 81) present fairly, in all material respects, the financial position of Southern Company and Subsidiary Companies at December 31, 2006 and 2005, and the results of their operations and their cash flows for each

of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, in 2006 the Company changed its method of accounting for the funded status of defined benefit pension and other postretirement plans.

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, 2006, 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 26, 2007 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 26, 2007

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

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

OVERVIEW

Business Activities

The primary business of Southern Company (the Company) is electricity sales in the Southeast by the traditional operating companies—Alabama Power, Georgia Power, Gulf Power, and Mississippi Power—and Southern Power. Savannah Electric and Power Company (Savannah Electric) was also a traditional operating company subsidiary of Southern Company until being merged with and into Georgia Power effective July 1, 2006. Southern Power constructs, acquires, and manages 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 traditional operating companies' ability to maintain a stable regulatory environment, to achieve energy sales growth, and to effectively manage and secure timely recovery of 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 traditional operating companies completed successful retail base rate proceedings. These regulatory actions have provided earnings stability and enabled 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. During 2005 and 2006, each of the traditional operating companies completed proceedings as necessary to address fuel and storm damage cost recovery. Appropriately balancing environmental expenditures with customer prices will continue to challenge the Company for the foreseeable future.

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 2006 through the acquisition of power plants in North Carolina and Florida. Consistent with prior acquisitions, the newly acquired plants have associated power purchase agreements (PPAs) in place. 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 an investment in a synthetic fuel producing entity (which claims federal income tax credits designed to offset its 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. The synthetic fuel tax credits will no longer be available after December 31, 2007. 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 four 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), excluding earnings from synthetic fuel investments. 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. The 2006 Peak Season EFOR of 1.11 percent is better than the target and a significant improvement over 2005 Peak Season EFOR. 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 performance for 2006 exceeded most targets on these reliability measures.

Southern Company's synthetic fuel investments generate tax credits as a result of synthetic fuel production. Due to higher oil prices in 2006, these tax credits were partially phased out and one synfuel investment was terminated. As a result, Southern Company's synthetic fuel investments did not contribute significantly to earnings and EPS during 2006. These tax credits will no longer be available after December 31, 2007. Southern Company management uses EPS, excluding synfuel earnings, to evaluate the performance of Southern Company's ongoing business activities. Southern Company believes the presentation of earnings and EPS excluding the results of the synthetic fuel investments also is useful for investors because it provides investors with additional information for purposes of comparing Southern Company's performance for such periods. The presentation of this additional information is not meant to be considered a substitute for financial measures prepared in accordance with generally accepted accounting principles.

Southern Company's 2006 results compared with its targets for some of these key indicators are reflected in the following chart:

KEY PERFORMANCE INDICATOR	2006 TARGET PERFORMANCE	2006 ACTUAL PERFORMANCE
Customer Satisfaction	Top quartile in customer surveys	Top quartile
Peak Season EFOR	2.75% or less	1.11%
Basic EPS	\$2.15–\$2.20	\$2.12
EPS, excluding synfuel earnings	\$2.03–\$2.08	\$2.10

See RESULTS OF OPERATIONS herein for additional information on the Company's financial performance. The financial performance achieved in 2006 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.

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

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

Earnings

Southern Company's net income was \$1.57 billion in 2006, a decrease of 1.1 percent from the prior year. The lower earnings compared with the prior year were primarily the result of a reduction of tax credits related to the production of synthetic fuels. This decrease was largely offset by continued economic strength and a growing customer base. Net income was \$1.59 billion in 2005 and \$1.53 billion in 2004, reflecting increases over the prior year of 3.8 percent and 4.0 percent, respectively. Basic EPS, including discontinued operations, was \$2.12 in 2006, \$2.14 in 2005, and \$2.07 in 2004. Diluted EPS, which factors in additional shares related to stock options, was 2 cents lower than basic EPS for 2006 and 1 cent lower for each of 2005 and 2004.

Dividends

Southern Company has paid dividends on its common stock since 1948. Dividends paid per share of common stock were \$1.535 in 2006, \$1.475 in 2005, and \$1.415 in 2004. In January 2007, Southern Company declared a quarterly dividend of 38.75 cents per share. This is the 237th consecutive quarter that Southern Company has paid a dividend equal to or higher than the previous quarter. The Company targets a dividend payout ratio of approximately 70 to 75 percent of net income, excluding earnings from synthetic fuel businesses. For 2006, the actual payout ratio was 73 percent, excluding synthetic fuel earnings, and 72.5 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		
		2006	2005	2004
Electric operating revenues	\$14,088	\$ 810	\$1,813	\$ 718
Fuel	5,143	655	1,089	400
Purchased power	543	(188)	88	170
Other operations and maintenance	3,290	70	215	148
Depreciation and amortization	1,164	27	229	(64)
Taxes other than income taxes	715	39	52	40
Total electric operating expenses	10,855	603	1,673	694
Operating income	3,233	207	140	24
Other income, net	53	(9)	38	22
Interest expenses	751	75	62	19
Income taxes	949	50	24	30
Net income	\$ 1,586	\$ 73	\$ 92	\$ (3)

Revenues

Details of electric operating revenues are as follows:

(in millions)	2006	2005	2004
Retail—prior year	\$11,165	\$ 9,732	\$ 8,875
Change in—			
Base rates	72	236	41
Sales growth	40	184	216
Weather	35	34	48
Fuel and other cost recovery clauses	489	979	552
Retail—current year	11,801	11,165	9,732
Sales for resale	1,822	1,667	1,341
Other electric operating revenues	465	446	392
Electric operating revenues	\$14,088	\$13,278	\$11,465
Percent change	6.1%	15.8%	6.7%

Retail revenues increased \$636 million, \$1.4 billion, and \$857 million in 2006, 2005, and 2004, respectively. 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 a retail base rate increase at Georgia Power. Electric rates for the traditional operating companies include provisions to adjust billings for fluctuations in fuel costs, including the energy component of purchased power costs. Under these provisions, fuel revenues generally equal fuel expenses, including the fuel component of purchased power, and do not affect net income. Certain of the traditional operating companies also have clauses to recover other costs, such as environmental, storm damage, new plants, and PPAs.

Sales for resale revenues consist of PPAs with investor-owned utilities and electric cooperatives, short-term opportunity sales, and unit power sales contracts. Southern Company's average wholesale contract extends more than 10 years and, as a result, the Company has significantly limited its remarketing risk. Short-term 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 PPAs and opportunity sales were as follows:

(in millions)	2006	2005	2004
Other power sales—			
Capacity and other	\$ 499	\$ 430	\$308
Energy	841	799	635
Total	\$1,340	\$1,229	\$943

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 kilowatt-hour (KWH) sales increased 0.2 percent, 1.7 percent, and 1.9 percent in 2006, 2005, and 2004, respectively. Fluctuations in oil and natural gas prices, which are the primary fuel sources for unit power sales customers, influence

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FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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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 sales contracts were as follows:

(in millions)	2006	2005	2004
Unit power—			
Capacity	\$208	\$201	\$185
Energy	274	237	213
Total	\$482	\$438	\$398

In 2006, sales for resale revenues increased \$155 million as a result of a 10.5 percent increase in the average cost of fuel per net KWH generated, as well as revenues resulting from new PPAs in 2006. In addition, Southern Company assumed four PPAs through the acquisitions of Plants DeSoto and Rowan in June and September 2006, respectively. The 2006 increase was partially offset by a decrease in opportunity sales.

In 2005, sales for resale revenues increased \$326 million primarily due to a 26.5 percent increase in the average cost of fuel per net 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 assumed two PPAs in June 2005 in connection with the acquisition of Plant Oleander.

In 2004, sales for resale revenues decreased \$17 million primarily due to a lower price differential between market prices and the Company's marginal cost that reduced the availability of short-term opportunity sales. Milder summer weather throughout the Southeast also reduced demand.

Energy Sales

Changes in revenues are influenced heavily by the volume of energy sold each year. KWH sales for 2006 and the percent change by year were as follows:

(in billions)	KWH	PERCENT CHANGE		
	2006	2006	2005	2004
Residential	52.4	2.5%	2.8%	3.9%
Commercial	53.0	2.2	3.6	3.4
Industrial	55.0	(0.2)	(2.2)	3.6
Other	0.9	(7.6)	(0.9)	0.8
Total retail	161.3	1.4	1.2	3.6
Sales for resale	40.1	6.1	7.3	(13.0)
Total	201.4	2.3	2.3	0.1

Retail energy sales in 2006 increased 2.3 billion KWH as a result of customer growth of 1.7 percent, sustained economic growth primarily in the residential and commercial customer classes, and warmer weather in 2006 when compared to 2005. Retail energy sales in 2005 increased 1.9 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. Retail energy sales in 2004 were strong across all customer classes as a result of an improved economy in the Southeast and customer growth of 1.5 percent.

Energy sales for resale increased by 2.3 billion KWH in 2006, increased by 2.6 billion KWH in 2005, and decreased by 5.3 billion KWH in 2004. The increases in sales for resale in 2006 and 2005 are related primarily to the new PPAs discussed above. The decrease in 2004 compared with 2003 is primarily due to a lower price differential between market prices and the Company's marginal cost that reduced the availability of short-term opportunity sales. Milder summer weather throughout the Southeast also reduced demand.

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. Details of Southern Company's generation, fuel, and purchased power are as follows:

	2006	2005	2004
Total generation (billions of KWH)	201	195	188
Total purchased power (billions of KWH)	10	11	15
Sources of generation (percent)—			
Coal	70%	71%	69%
Nuclear	15	15	16
Gas	13	11	12
Hydro	2	3	3
Cost of fuel, generated (cents per net KWH)—			
Coal	2.40	1.93	1.75
Nuclear	0.47	0.47	0.46
Gas	6.63	8.52	4.90
Average cost of fuel, generated (cents per net KWH)	2.64	2.39	1.89
Average cost of purchased power (cents per net KWH)	5.64	7.14	4.48

Fuel and purchased power expenses were \$5.7 billion in 2006, an increase of \$467 million or 8.9 percent above the prior year costs. This increase was the result of a \$319 million increase in the cost of fuel and purchased power and \$148 million related to an increase in total KWH generated and purchased.

In 2005, fuel and purchased power expenses were \$5.2 billion, an increase of \$1.2 billion or 29.1 percent above 2004 costs. This increase was the result of a \$1.2 billion increase in the cost of fuel and purchased power, partially offset by \$47 million related to a decrease in total KWH generated and purchased.

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

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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 \$473 million increase in the cost of fuel and purchased power and \$97 million related to an increase in total KWH generated and purchased.

While prices have moderated somewhat in 2006, 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 and fuel transportation 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 production and supply interruptions, such as those caused 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 liquefied natural gas if new liquefied gas facilities are built. Fuel expenses generally do not affect net income, since they are offset by fuel revenues under the traditional 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 Operations and Maintenance Expenses

Other operations and maintenance expenses were \$3.3 billion, \$3.2 billion, and \$3.0 billion, increasing \$70 million, \$215 million, and \$148 million in 2006, 2005, and 2004, respectively. Other production expenses at fossil, hydro, and nuclear plants increased \$3 million, \$58 million, and \$53 million in 2006, 2005, and 2004, respectively. 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 \$29 million in 2006 as a result of a \$17 million increase in salaries and wages and a \$24 million increase in pension expense, partially offset by a \$16 million reduction in medical expenses. Administrative and general expenses increased \$73 million in 2005 related to a \$33 million increase in employee benefits; a \$22 million increase in shared service expenses, primarily increases in Sarbanes-Oxley Act compliance costs, legal costs, and other corporate expenses; and a \$9 million increase in property damage. Administrative and general expenses increased \$106 million in 2004 primarily related to a \$41 million increase in employee benefits, a \$23 million increase in shared service expenses, primarily nuclear security, and a \$13 million increase in property insurance.

Transmission and distribution expenses increased \$30 million, \$60 million, and \$49 million in 2006, 2005, and 2004, respectively. Transmission and distribution expenses increased in 2006 primarily due to expenses associated with recovery of prior year storm costs through natural disaster recovery clauses and additional investment in distribution to meet customer growth. 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 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 increase.

The 2004 increase in other operations and maintenance expenses was partially offset by a \$60 million regulatory liability related to Plant Daniel that was expensed in 2003.

Depreciation and Amortization Expenses

Depreciation and amortization expenses increased \$27 million in 2006 as a result of the acquisitions of Plants DeSoto, Rowan, and Oleander in June 2006, September 2006, and June 2005, respectively, and a reduction in the amortization of the Plant Daniel regulatory liability. An increase in depreciation rates at Southern Power associated with adoption of a new depreciation study also contributed to the 2006 increase. Partially offsetting the 2006 increase was the amortization of a Georgia Power regulatory liability related to the levelization of certain purchased power capacity costs as ordered by the Georgia PSC under the terms of the retail rate order effective January 1, 2005. See Note 3 to the financial statements under "Georgia Power Retail Regulatory Matters" for additional information.

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 capacity costs in rates evenly 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 capacity 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.

Taxes Other Than Income Taxes

Taxes other than income taxes increased by \$39 million in 2006 primarily as a result of increases in franchise and municipal gross receipts taxes

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

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associated with increases in revenues from energy sales as well as increases in property taxes associated with additional plant in service. 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 by \$40 million primarily as a result of additional plant in service and a higher property tax base.

Interest Expenses

Total interest charges and other financing costs increased by \$75 million in 2006 due to a \$78 million increase associated with \$708 million in additional debt outstanding at December 31, 2006 compared to December 31, 2005 and a \$7 million increase associated with an increase in average interest rates on variable rate debt, partially offset by a \$6 million increase in capitalized interest associated with construction projects and a \$3 million reduction in other interest costs. 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 (BMA) 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, and energy-related services. 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 traditional 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)	INCREASE (DECREASE) FROM PRIOR YEAR			
	AMOUNT 2006	2006	2005	2004
Operating revenues	\$268	\$ (8)	\$ 12	\$ (7)
Other operations and maintenance	238	(59)	12	28
Depreciation and amortization	36	(3)	(2)	(9)
Taxes other than income taxes	3	(1)	1	1
Total operating expenses	277	(63)	11	20
Operating income/(loss)	(9)	55	1	(27)
Equity in losses of				
unconsolidated subsidiaries	(60)	62	(25)	3
Leveraged lease income	69	(5)	4	4
Other income, net	(31)	(18)	(6)	(15)
Interest expenses	149	48	18	(21)
Income taxes	(168)	136	(14)	(63)
Discontinued operations, net of tax	(1)	(1)	(3)	12
Net income/(loss)	\$ (13)	\$ (91)	\$ (33)	\$ 61

Southern Company's non-electric operating revenues decreased \$8 million in 2006 primarily as a result of a \$21 million decrease in revenues at SouthernLINC Wireless related to lower average revenue per subscriber and lower equipment and accessory sales. The 2006 decrease was partially offset by a \$12 million increase in fuel procurement service revenues. Higher production and increased fees in the synthetic fuel business contributed to the \$12 million increase in 2005. The \$7 million decrease in 2004 was primarily due to lower operating revenues in one of the Company's energy-related services businesses, partially offset by an increase in SouthernLINC Wireless revenues as a result of increased wireless subscribers.

Other operations and maintenance expenses for these other businesses declined \$59 million in 2006 primarily as a result of \$32 million of lower production expenses related to the termination of Southern Company's membership interest in one of the synthetic fuel entities, \$13 million attributed to the wind-down of one of the Company's energy-related services businesses, and \$7 million of lower expenses resulting from the March 2006 sale of a subsidiary that provided rail car maintenance services. Other operations and maintenance expenses 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 an \$11 million increase in shared service expenses, partially offset by the \$12.5 million bad debt reserve in 2004 discussed below. Other operations 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 Matters" herein and Note 3 to the financial statements under "Mirant Matters—Mirant Bankruptcy" for additional information.

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The 2006 and 2005 decreases in depreciation and amortization expenses when compared to the prior years were not material. Depreciation and amortization expenses decreased \$9 million in 2004 primarily as a result of \$10 million of expenses associated with the repurchase of debt at Southern Company Holdings in 2003.

Southern Company made investments in two synthetic fuel production facilities that generate operating losses. These investments also allow Southern Company to claim federal income tax credits that offset these operating losses and make the projects profitable. The decrease in equity in losses of unconsolidated subsidiaries in 2006 reflects the result of terminating Southern Company's membership interest in one of the synthetic fuel entities which reduced the amount of Southern Company's share of the losses and, therefore, the funding obligation for the year. The decrease also resulted from lower operating expenses while the production facilities at the other synthetic fuel entity were idled from May to September 2006 due to higher oil prices. The increase in equity in losses of unconsolidated subsidiaries in 2005 reflects the results of additional production expenses at the synthetic fuel production facilities. The 2004 decrease in equity in losses of unconsolidated subsidiaries when compared to the prior year was not material. The federal income tax credits resulting from these investments totaled \$65 million in 2006, \$177 million in 2005, and \$146 million in 2004. 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—Synthetic Fuel Tax Credits" herein for further information.

The \$18 million decrease in other income in 2006 as compared with 2005 resulted from a \$25 million decrease related to changes in the value of derivative transactions in the synthetic fuel business and a \$16 million decrease related to the impairment of investments in the synthetic fuel entities, partially offset by the release of \$6 million in certain contractual obligations associated with these investments. The 2005 decrease in other income when compared to the prior year was not material. The decrease in other income in 2004 as compared with 2003 reflects a \$15 million gain for a Southern Telecom contract settlement during 2003.

Total interest charges and other financing costs increased by \$48 million in 2006 due to a \$19 million increase associated with \$149 million in additional debt outstanding at December 31, 2006 as compared to December 31, 2005, a \$12 million increase associated with an increase in average interest rates on variable rate debt, a \$6 million loss on the early redemption of long-term debt payable to affiliated trusts in January 2006, and a \$16 million loss on the repayment of long-term debt payable to affiliated trusts in December 2006. The 2006 increase is partially offset by a \$4 million reduction in other interest costs. Interest expense 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.

The \$136 million increase in income taxes in 2006 as compared with 2005 resulted from an \$80 million decrease in synthetic fuel tax credits as a result of terminating the Company's membership interest in one of the synthetic fuel entities and curtailing production at the other synthetic fuel entity from May to September 2006. In addition, \$32 million of tax credit reserves were recorded in 2006 due to an anticipated phase-out of synthetic fuel tax credits due to higher oil prices. See FUTURE EARNINGS POTENTIAL—"Income Tax Matters—Synthetic Fuel Tax Credits" herein for further information. The 2005 decrease in income taxes when compared to the prior year was not material. The \$63 million decrease in income taxes in 2004 as compared with 2003 resulted from a \$19 million increase in synthetic fuel tax credits as a result of increased production and a \$44 million change in a reserve recorded related to these tax credits.

Effects of Inflation

The traditional operating companies and Southern Power are subject to rate regulation and party to long-term contracts that are generally based on the recovery of historical costs. When historical costs are included, or when inflation exceeds projected costs used in rate regulation, the effects of inflation can create an economic loss since the recovery of costs could be in dollars that have less purchasing power. In addition, the income tax laws are based on historical costs. 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 traditional operating companies' approved electric rates.

FUTURE EARNINGS POTENTIAL

General

The four traditional operating companies operate as vertically integrated utilities 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 Power 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 Federal Energy Regulatory Commission's (FERC) market-based rate investigation, credit-worthiness 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 regulatory matters.

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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 traditional operating companies' ability to maintain a stable regulatory environment that continues to allow for the recovery of all prudently incurred costs during a time of increasing 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 1,276 megawatts in 2006. The acquisition by Southern Power of Plants DeSoto and Rowan added 1,330 megawatts to the fleet while generating capacity was reduced by 54 megawatts due to the retirement of two fossil units and the re-rating of one hydro unit. 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

Compliance costs related to the Clean Air Act and other environmental regulations could affect earnings if such costs cannot be fully recovered in rates on a timely basis. Environmental compliance spending over the next several years may exceed amounts estimated. Some of the factors driving the potential for such an increase are higher commodity costs, market demand for labor, and scope additions and clarifications. The timing, specific requirements, and estimated costs could also change as environmental regulations are modified. See Note 3 to the financial statements under "Environmental Matters" for additional information.

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 filed a separate action in January 2001 against Alabama Power in the U.S. District Court for the Northern District of Alabama after Alabama Power was dismissed from the original action. In these lawsuits, the EPA alleged that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power and Georgia Power (including a facility formerly owned by 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 19, 2006, the U.S. District Court for the Northern District of Alabama entered a consent decree between Alabama Power and the EPA, resolving the alleged NSR violations at Plant Miller. The consent decree required Alabama Power to pay \$100,000 to resolve the government's claim for a civil penalty and to donate \$4.9 million of sulfur dioxide emission allowances to a nonprofit charitable organization and formalized specific emissions reductions to be accomplished by Alabama Power, consistent with other Clean Air Act programs that require emissions reductions. On August 14, 2006, the district court in Alabama granted Alabama Power's motion for summary judgment and entered final judgment in favor of Alabama Power on the EPA's claims related to Plants Barry, Gaston, Gorgas, and Greene County. The plaintiffs have appealed this decision to the U.S. Court of Appeals for the Eleventh Circuit and, on November 14, 2006, the Eleventh Circuit granted plaintiffs' request to stay the appeal, pending the U.S. Supreme Court's ruling in a similar NSR case filed by the EPA against Duke Energy. The action against Georgia Power 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 traditional 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. Such expenditures could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

The EPA has issued a series of proposed and final revisions to its NSR regulations under the Clean Air Act, many of which have been subject to legal challenges by environmental groups and states. On June 24, 2005, the

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U.S. Court of Appeals for the District of Columbia Circuit upheld, in part, the EPA's revisions to NSR regulations that were issued in December 2002 but vacated portions of those revisions addressing the exclusion of certain pollution control projects. These regulatory revisions have been adopted by each of the states within Southern Company's service territory. On March 17, 2006, the U.S. Court of Appeals for the District of Columbia Circuit also vacated an EPA rule which sought to clarify the scope of the existing Routine Maintenance, Repair, and Replacement exclusion. In October 2005 and September 2006, the EPA also published proposed rules clarifying the test for determining when an emissions increase subject to the NSR permitting requirements has occurred. The impact of these 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 in October 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 requested injunctive and declaratory relief, civil penalties, a supplemental environmental project, and attorneys' fees. In January 2007, following the March 2006 reversal and remand by the U.S. Court of Appeals for the Eleventh Circuit, the district court ruled for Georgia

Power on all remaining allegations in this case. The only issue remaining for resolution by the district court is the appropriate remedy for two isolated, short-term, technical violations of the plant's Clean Air Act operating permit. The court has asked the parties to submit a joint proposed remedy or individual proposals in the event the parties cannot agree. Although the ultimate outcome of this matter cannot currently be determined, the resulting liability associated with the two events is not expected to have a material impact on the Company's financial statements.

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 2006, Southern Company had invested approximately \$3.1 billion in capital projects to comply with these requirements, with annual totals of \$661 million, \$423 million, and \$300 million for 2006, 2005, and 2004, respectively. The Company expects that capital expenditures to assure compliance with existing and new regulations will be an additional \$1.66 billion, \$1.65 billion, and \$1.27 billion for 2007, 2008, and 2009, 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 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 2006, the Company had spent approximately \$2.5 billion in reducing

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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, NO_x, and mercury emissions, maintain compliance with existing regulations, and meet new requirements.

Approximately \$1.3 billion of the expenditures related to reducing NO_x emissions pursuant to state and federal requirements were in connection with the EPA's one-hour ozone air quality standard and the 1998 regional NO_x reduction rules. In addition, in 2006, Gulf Power completed implementation of 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, totaled approximately \$133.8 million, and have been approved under Gulf Power's environmental cost recovery clause.

In 2005, the EPA revoked the one-hour ozone air quality standard and published the second of two sets of final rules for implementation of the new, more stringent eight-hour ozone standard. Areas within Southern Company's service area that were designated as nonattainment under the eight-hour ozone standard included Macon (Georgia), Jefferson and Shelby Counties, near and including Birmingham (Alabama), and a 20-county area within metropolitan Atlanta. Macon is in the process of seeking redesignation by the EPA as an attainment area and is preparing a maintenance plan for approval. The Birmingham area was redesignated to attainment with the eight-hour ozone standard by the EPA on June 12, 2006, and the EPA subsequently approved a maintenance plan for the area to address future exceedances of the standard. On December 22, 2006, the U.S. Court of Appeals for the District of Columbia Circuit vacated the first set of implementation rules adopted in 2004 and remanded the rules to the EPA for further refinement. The impact of this decision, if any, cannot be determined at this time and will depend on subsequent legal action and/or rulemaking activity. State implementation plans, including new emission control regulations necessary to bring ozone nonattainment areas into attainment, are currently required for most areas by June 2007. These state implementation plans could require further reductions in NO_x emissions from power plants.

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 is expected to publish its final rule for implementation of the existing fine particulate matter standard in early 2007. State plans for addressing the nonattainment designations under the existing standard are required by April 2008 and could require further reductions in SO₂ and NO_x emissions from power plants. On September 21, 2006, the EPA published a final rule lowering the 24-hour fine particulate matter air quality standard even further and plans to designate nonattainment areas based on the new standard by December 2009. The final outcome of this matter cannot be determined at this time.

The EPA issued the final Clean Air Interstate Rule in March 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 in July 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 (1) the application of Best Available Retrofit Technology (BART) to certain sources built between 1962 and 1977 and (2) the application of any additional emissions reductions which may be deemed necessary for each designated area to achieve reasonable progress toward the natural conditions goal by 2018. Thereafter, for each 10-year planning period, additional emissions reductions will be required to continue to demonstrate reasonable progress in each area during that period. 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 BART requirements for particulate matter could be imposed, and the reasonable progress provisions could result in requirements for additional SO₂ controls. By December 17, 2007, states must submit implementation plans that contain strategies for BART and any other control measures required to achieve the first phase of reasonable progress.

In March 2005, the EPA published 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 air quality standards will also result in mercury emission reductions. However, the long-term capability of emission control equipment to reduce mercury emissions is still being evaluated, and the installation of additional control technologies may be required.

The impacts of the eight-hour ozone and 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. Impacts will also depend on resolution of pending legal challenges to these rules. Therefore, the full effects of

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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 its final technology-based regulations under the Clean Water Act for the purpose of reducing impingement and entrainment of fish, shellfish, and other forms of aquatic life at existing power plant cooling water intake structures. The rules require baseline biological information and, perhaps, installation of fish protection technology near some intake structures at existing power plants. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit overturned and remanded several provisions of the rule to the EPA for revisions. Among other things, the court rejected the EPA's use of "cost-benefit" analysis and suggested some ways to incorporate cost considerations. The full impact of these regulations will depend on subsequent legal proceedings, further rulemaking by the EPA, 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.

Georgia Power is retrofitting a closed-loop recirculating cooling tower at one facility under the Clean Water Act to cool water prior to discharge and is considering undertaking similar work at an additional facility. The total estimated capital cost for this project is \$96 million. Southern Company is also considering similar projects at other facilities.

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 traditional operating companies could incur substantial costs to clean up properties. The traditional 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 traditional 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 negotiations under the Framework Convention on Climate Change and specifically the Kyoto Protocol, which proposes a binding limitation on the emissions of greenhouse gases for 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. economy, the ratio of greenhouse gas emissions to the value of U.S. economic output, by 18 percent by 2012. Southern Company is participating in the voluntary electric utility sector climate change initiative, known as Power Partners, under the Bush Administration's Climate VISION program. The utility sector pledged to reduce its greenhouse gas emissions rate by 3 percent to 5 percent by 2010-2012. The Company continues to evaluate future energy and emission profiles relative to the Power Partners program and is participating in voluntary programs to support the industry initiative. In addition, the Company is participating in the Bush Administration's Asia Pacific Partnership on Clean Development and Climate, a public/private partnership to work together to meet goals for energy security, national air pollution reduction, and climate change in ways that promote sustainable economic growth and poverty reduction. Legislative proposals that would impose mandatory restrictions on carbon dioxide emissions continue to be considered in Congress. The ultimate outcome cannot be determined at this time; however, mandatory restrictions on the Company's carbon dioxide emissions could result in significant additional compliance costs that could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

FERC Matters

Market-Based Rate Authority

Each of the traditional operating companies and Southern Power has authorization from the FERC to sell power to non-affiliates, including short-term opportunity sales, at market-based prices. 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. Any new market-based rate sales by any subsidiary of Southern Company in Southern Company's retail service territory entered into during a 15-month refund period beginning February 27, 2005 could be subject to refund to the level of the default cost-based rates, pending the outcome of the proceeding. Such sales through May 27, 2006, the end of the refund period, were approximately \$19.7 million for the Southern Company system. In the event that the FERC's default mitigation measures for entities that are found to have market power are ultimately applied, the traditional 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.

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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 15-month refund period related to this expanded investigation. Any new market-based rate sales involving any Southern Company subsidiary could be subject to refund to the extent the FERC orders lower rates as a result of this new investigation. Such sales through October 19, 2006, the end of the refund period, were approximately \$55.4 million for the Southern Company system, of which \$15.5 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. On January 3, 2007, the FERC issued an order noting settlement of the IIC proceeding and seeking comment identifying any remaining issues and the proper procedure for addressing any such issues.

Southern Company and its subsidiaries believe that there is no meritorious basis for these proceedings 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 these proceedings, 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 Southern Company Services, Inc. (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.

On October 5, 2006, the FERC issued an order accepting a settlement resolving the proceeding subject to Southern Company's agreement to accept certain modifications to the settlement's terms. On October 20, 2006, Southern Company notified the FERC that it accepted the modifications. The modifications largely involve functional separation and information restrictions related to marketing activities conducted on behalf of Southern Power. Southern Company filed with the FERC on November 6, 2006 an implementation plan to comply with the modifications set forth in the order. The impact of the modifications is not expected to have a material impact on Southern Company's 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 new generating facilities interconnecting to a transmission system. Order 2003 was affirmed by the U.S. Court of Appeals for the District of Columbia Circuit on January 12, 2007. The cost impact resulting from Order 2003 will vary on a case-by-case basis for each new generator interconnecting to the transmission system.

On November 22, 2004, generator company subsidiaries of Tenaska, Inc. (Tenaska), as counterparties to three previously executed interconnection agreements with subsidiaries of Southern Company, filed complaints at the FERC requesting that the FERC modify the agreements and that those Southern Company subsidiaries refund a total of \$19 million previously paid for interconnection facilities, with interest. Southern Company has also received requests for similar modifications from other entities, though no other complaints are pending with the FERC. On January 19, 2007, the FERC issued an order granting Tenaska's requested relief. Although the FERC's order requires the modification of Tenaska's interconnection agreements, the order reduces the amount of the refund that had been requested by Tenaska. As a result, Southern Company estimates indicate that no refund is due Tenaska. Southern Company has requested rehearing of the FERC's order. The final outcome of this matter cannot now be determined.

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.

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PSC Matters

Alabama Power

In October 2005, the Alabama PSC approved a revision to the Rate Stabilization and Equalization Plan (Rate RSE) requested by Alabama Power. Effective January 2007, Rate RSE adjustments are 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 remain unchanged when the projected return on common equity (ROE) ranges 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 made its initial submission of projected data for calendar year 2007 on December 1, 2006. The Rate RSE increase for 2007 is 4.76 percent, or \$193 million annually and, became effective in January 2007. 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 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 are 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, operations 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. See Note 3 to the financial statements under "Georgia Power Retail Regulatory Matters" for additional information.

Effective July 1, 2006, Savannah Electric was merged into Georgia Power. See "Fuel Cost Recovery" herein for additional information.

Mississippi Power

In February 2007, Mississippi Power filed with the Mississippi PSC its annual Environmental Compliance Overview (ECO) Plan evaluation for 2007. Mississippi Power requested an 86 cent per 1,000 KWH increase for retail customers. This increase represents approximately \$7.5 million per year in annual revenues for Mississippi Power. Hearings with the Mississippi PSC are expected to be held in April 2007. The outcome of the

2007 filing cannot now be determined. In April 2006, the Mississippi PSC approved Mississippi Power's 2006 ECO Plan, which included a 12 cent per 1,000 KWH reduction for retail customers. This decrease represented a reduction of approximately \$1.3 million per year in annual revenues for Mississippi Power. The new rates were effective in April 2006.

In December 2006, Mississippi Power submitted its annual Performance Evaluation Plan (PEP) filing for 2007, which resulted in no rate change. Pursuant to the rate schedule, an order is not required from the Mississippi PSC for Mississippi Power to continue to bill the filed rate in effect. In March 2006, the Mississippi PSC approved Mississippi Power's 2006 PEP filing, which included an annual retail base rate increase of 5 percent, or \$32 million that was effective in April 2006. Ordinarily, PEP limits annual rate increases to 4 percent; however, Mississippi Power had 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.

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 order 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 traditional operating companies each have established fuel cost recovery rates approved by their respective state PSCs. Over the past two years, the traditional operating companies have continued to experience higher than expected fuel costs for coal, natural gas, and uranium. These higher fuel costs have increased the under recovered fuel costs included in the balance sheets to \$1.3 billion at December 31, 2006. The traditional operating companies continuously monitor the under recovered fuel cost balance in light of these higher fuel costs. Each of the traditional operating companies received approval in 2005 and/or 2006 to increase its 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. As of December 31, 2006, Alabama Power had an under recovered fuel balance of approximately \$301 million.

In March 2006, Georgia Power and Savannah Electric filed a combined request for fuel cost recovery rate changes with the Georgia PSC to be effective July 1, 2006, the effective date of the merger of Savannah

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Electric into Georgia Power. On June 15, 2006, the Georgia PSC ruled on the request and approved an increase in Georgia Power's total annual fuel billings of approximately \$400 million. The Georgia PSC order provided for a combined ongoing fuel forecast but reduced the requested increase related to such forecast by \$200 million. The order also required Georgia Power to file for a new fuel cost recovery rate on a semi-annual basis, beginning in September 2006. Accordingly, on September 15, 2006, Georgia Power filed a request to recover fuel costs incurred through August 2006 by increasing the fuel cost recovery rate.

On November 13, 2006, under an agreement with the Georgia PSC staff, Georgia Power filed a supplementary request reflecting a forecast of annual fuel costs, as well as updated information for previously incurred fuel costs. On February 6, 2007, the Georgia PSC ruled on the request and approved an increase in Georgia Power's total annual billings of approximately \$383 million. The Georgia PSC order reduced Georgia Power's requested increase in the forecast of annual fuel costs by \$40 million and disallowed \$4 million of previously incurred fuel costs. The order also requires Georgia Power to file for a new fuel cost recovery rate no later than March 1, 2008. The new rates will become effective on March 1, 2007. Estimated under recovered fuel costs are to be recovered through May 2009 for customers in the former Georgia Power territory and through November 2009 for customers in the former Savannah Electric territory. As of December 31, 2006, Georgia Power had an under recovered fuel balance of approximately \$898 million.

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, changing the billing factor has no significant effect on the Company's revenues or net income, but does impact annual cash flow. Based on their respective state PSC orders, a portion of the under recovered regulatory clause revenues for Alabama Power and Georgia Power 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

In July 2005 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 Gulf Power, Alabama Power, and Mississippi Power. In addition, Hurricane Ivan hit the Gulf Coast of Florida and Alabama in September 2004, causing significant damage to the service areas of both Gulf Power and Alabama Power. Each retail operating company maintains a reserve to cover the cost of damages from major storms to its transmission and distribution lines and the cost of uninsured damages to its generation facilities and other property. In addition, each of the affected traditional operating companies has been autho-

rized by its state PSC to defer the portion of the hurricane restoration costs that exceeded the balance in its storm damage reserve account. As of December 31, 2006, the under recovered balance in Southern Company's storm damage reserve accounts totaled approximately \$89 million, of which approximately \$57 million and \$32 million, respectively, are included in the balance sheets herein under "Other Current Assets" and "Other Regulatory Assets."

In June 2006, the Mississippi PSC issued an order based upon a stipulation between Mississippi Power and the Mississippi Public Utilities Staff. The stipulation and the associated order certified actual storm restoration costs relating to Hurricane Katrina through April 30, 2006 of \$267.9 million and affirmed estimated additional costs through December 31, 2007 of \$34.5 million, for total storm restoration costs of \$302.4 million which was net of insurance proceeds of approximately \$77 million, without offset for the property damage reserve of \$3.0 million. Of the total amount, \$292.8 million applies to Mississippi Power's retail jurisdiction. The order directed Mississippi Power to file an application with the Mississippi Development Authority (MDA) for a Community Development Block Grant (CDBG). Mississippi Power filed the CDBG application with the MDA in September 2006. On October 30, 2006, Mississippi Power received from the MDA a CDBG in the amount of \$276.4 million. Mississippi Power has appropriately allocated and applied these CDBG proceeds to both retail and wholesale storm restoration cost recovery.

Mississippi Power filed an application for a financing order with the Mississippi PSC on July 3, 2006 for restoration costs under the state bond program. On October 27, 2006, the Mississippi PSC issued a financing order that authorizes the issuance of \$121.2 million of system restoration bonds. This amount includes \$25.2 million for the retail storm recovery costs not covered by the CDBG, \$60 million for a property damage reserve, and \$36 million for the retail portion of the construction of the storm operations facility. The bonds will be issued by the Mississippi Development Bank on behalf of the State of Mississippi and will be reported as liabilities by the State of Mississippi. Periodic true-up mechanisms will be structured to comply with terms and requirements of the legislation. Details regarding the issuance of the bonds have not been finalized. The final outcome of this matter cannot now be determined.

As of December 31, 2006, Mississippi Power's under recovered balance in the property damage reserve account totaled approximately \$4.7 million which is included in the balance sheets herein under "Current Assets."

In July 2006, the Florida PSC issued its order approving a stipulation and settlement between Gulf Power and several consumer groups that resolved all matters relating to Gulf Power's request for recovery of incurred costs for storm-recovery activities and the replenishment of Gulf Power's property damage reserve. The order provides for an extension of the storm-recovery surcharge currently being collected by Gulf Power for an additional 27 months, expiring in June 2009. According to the stipulation, the funds resulting from the extension of the current surcharge will first be credited to the unrecovered balance of storm-recovery costs

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associated with Hurricane Ivan until these costs have been fully recovered. The funds will then be credited to the property reserve for recovery of the storm-recovery costs of \$52.6 million associated with Hurricanes Dennis and Katrina that were previously charged to the reserve. Should revenues collected by Gulf Power through the extension of the storm-recovery surcharge exceed the storm-recovery costs associated with Hurricanes Dennis and Katrina, the excess revenues will be credited to the reserve. The annual accrual to the reserve of \$3.5 million and Gulf Power's limited discretionary authority to make additional accruals to the reserve will continue as previously approved by the Florida PSC. Gulf Power made discretionary accruals to the reserve of \$3 million, \$6 million, and \$15 million in 2006, 2005, and 2004, respectively. As part of a March 2005 agreement regarding Hurricane Ivan costs that established the existing surcharge, Gulf Power agreed that it would not seek any additional increase in its base rates and charges to become effective on or before March 1, 2007. The terms of the stipulation do not alter or affect that portion of the prior agreement. According to the order, in the case of future storms, if Gulf Power incurs cumulative costs for storm-recovery activities in excess of \$10 million during any calendar year, Gulf Power will be permitted to file a streamlined formal request for an interim surcharge. Any interim surcharge would provide for the recovery, subject to refund, of up to 80 percent of the claimed costs for storm-recovery activities. Gulf Power would then petition the Florida PSC for full recovery through an additional surcharge or other cost recovery mechanism.

As of December 31, 2006, Gulf Power's unrecovered balance in the property damage reserve totaled approximately \$45.7 million, of which approximately \$28.8 million and \$16.9 million, respectively, are included in the balance sheets herein under "Current Assets" and "Deferred Charges and Other Assets."

At Alabama Power, operation and maintenance expenses associated with Hurricane Ivan were \$57.8 million. In 2005, Alabama Power received Alabama PSC approvals to 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 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.

As of December 31, 2006, Alabama Power had recovered \$49.5 million of the costs allowed for storm-recovery activities, of which \$34.5 million was a reduction in the deficit balance in the natural disaster reserve account related to costs deferred from previous storms. The remaining under recovered balance in the property damage reserve account totaled approximately \$16.8 million at December 31, 2006 and is included

in the balance sheets herein under "Current Assets." The remaining \$15.0 million collected was used to establish the target reserve for future storms. The balance in the target reserve, reduced for current year activity, was \$13.2 million at December 31, 2006 and is included in the balance sheets herein under "Other Regulatory Liabilities."

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 Matters

Mirant was an energy company with businesses that included 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 and certain of its affiliates 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" and with various lawsuits discussed in Note 3 to the financial statements under "Mirant Matters."

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 the \$39 million receivable, Southern Company has reserved approximately \$13.7 million. In December 2006, Southern Company received approximately \$23 million in tax refunds from the IRS related to Mirant tax items. Additional refunds are expected. The amount of any unsecured claim ultimately allowed with respect to Mirant tax items is expected to be reduced dollar-for-dollar by the amount of all refunds received from the IRS by Southern Company.

If Southern Company is ultimately required to make any additional payments either with respect to the IRS audit or its contingent obligations under guarantees of Mirant subsidiaries, Mirant's indemnification obligation to Southern Company for these additional payments, if allowed, would constitute unsecured claims against Mirant, entitled to

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stock in Reorganized Mirant. 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, February 2006, and May 2006. The third amended complaint (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 breached its fiduciary duties to Mirant and its creditors, caused Mirant to breach fiduciary duties to its creditors, and aided and abetted breaches of fiduciary duties by Mirant's directors and officers. The complaint also seeks recoveries under theories of restitution, unjust enrichment, and alter ego. The complaint seeks monetary damages in excess of \$2 billion plus interest, punitive damages, attorneys' fees, and costs. Finally, the complaint includes an objection to Southern Company's pending 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 complaint in June 2006.

In January 2006, MC Asset Recovery, a special purpose subsidiary of Reorganized Mirant, was substituted as plaintiff. 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. On May 19, 2006, Southern Company filed a motion for summary judgment seeking entry of judgment against the plaintiff as to all counts in the complaint. On December 11, 2006, the U.S. District Court for the Northern District of Georgia granted in part and denied in part the motion. As a result, certain breach of fiduciary duty claims were barred; all other claims in the complaint may proceed. 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 "Mirant Matters—MC Asset Recovery 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 2003. 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 1997 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 now final.

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. In the third quarter 2006, Southern Company paid the full amount of the disputed tax and the applicable interest on the SILO issue for tax years 2000-2001 and filed a claim for refund which has been denied by the IRS. The disputed tax amount is \$79 million and the related interest is approximately \$24 million for these tax years. This payment, and the subsequent IRS disallowance of the refund claim, closed the issue with the IRS and Southern Company plans to proceed with litigation. The IRS has also raised the SILO issues for tax years 2002 and 2003. The estimated amount of disputed tax and interest for these years is approximately \$83 million and \$15 million, respectively. The tax and interest for these tax years was paid to the IRS in the fourth quarter 2006. Southern Company has accounted for both payments in 2006 as deposits, as management believes no additional tax or interest liabilities have been incurred.

Although the payment of the tax liability did not affect Southern Company's results of operations under accounting standards in effect through December 31, 2006, it did impact cash flow. For tax years 2000 through 2006, Southern Company has claimed \$284 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. Southern Company believes these transactions are valid leases for U.S. tax purposes and thus the related deductions are allowable. The Company will continue to defend this position through administrative appeals or litigation. The ultimate outcome of these matters cannot now be determined.

In July 2006, the Financial Accounting Standards Board (FASB) released new interpretations for the accounting for both leveraged leases and uncertain tax positions that were adopted January 1, 2007. For the LILO transaction settled with the IRS in February 2005, the leveraged leases accounting interpretation requires that Southern Company recognize a cumulative effect reduction to beginning 2007 retained earnings of approximately \$17 million at adoption and change the timing of income recognized under the lease.

For the SILO transactions which are the subject of pending litigation, Southern Company is continuing to evaluate the impact of the new interpretations but estimates that the reduction to retained earnings in 2007 could be approximately \$115 million to \$135 million. The impact on Southern Company's net income of these accounting interpretations would also be dependent on the outcome of the pending litigation or changes in assumptions related to uncertain tax positions but could be significant, and potentially material.

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Synthetic Fuel Tax Credits

Southern Company had 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). During 2006, as discussed below, Southern Company's interest in one of the synthetic fuel entities was terminated. 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 U.S. Department of Energy (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, has continued to monitor oil prices. Reserves against these tax credits of \$32 million were recorded in 2006 due to projected phase-outs of the credits in 2006 as a result of higher oil prices. Synthetic fuel tax credits will end December 31, 2007.

In May 2006, production at one of the synthetic fuel investments was idled due to continued uncertainty over the value of tax credits. In addition, Southern Company entered into an agreement in June 2006 which terminated its ownership interest in its other synthetic fuel investment, effective July 1, 2006. Also, during 2006, Southern Company entered into derivative transactions designed to reduce its exposure to changes in the value of tax credits associated with its synthetic fuel investments. These derivative transactions were marked to market through other income (expense), net. As a result of these actions and the projected continued phase out of tax credits because of high oil prices, the investments in these two synthetic fuel entities were considered fully impaired and approximately \$16 million was written off and is reflected in the line item "Impairment loss on equity method investments" on the statements of income herein. In September 2006, due to reduced oil prices in the third quarter, production was restarted at the synthetic fuel facility in which Southern Company still has an ownership interest. In October 2006, Southern Company entered into additional derivative transactions to reduce its exposure to the potential phase-out of these income tax credits in 2007. Subsequent to December 31, 2006, the Company entered into additional derivative transactions to further reduce its exposure to potential phase-out of tax credits in 2007. See Note 6 to the financial statements under "Financial Instruments" for additional information regarding the impact of these derivatives. The final outcome of these matters cannot now be determined.

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) 285-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. The total cost related to the IGCC project is currently being reviewed, and may be higher than earlier estimates due to increases in commodity costs and increased market demand for labor. Southern Power had spent \$7.8 million as of December 31, 2006. Southern Power has the option under the agreements to end its participation in the IGCC project at the end of the project definition phase which is expected to be during 2007.

In June 2006, Mississippi Power filed an application with the DOE for certain tax credits available to projects using clean coal technologies under the Energy Policy Act of 2005. The proposed project is an advanced coal gasification facility located in Kemper County, Mississippi that would use locally mined lignite coal. The proposed 693 megawatt plant, excluding the mine cost, is expected to require an approximate investment of \$1.5 billion and is expected to be completed in 2013. The DOE subsequently certified the project and in November 2006 the IRS allocated Internal Revenue Code Section 48A tax credits to Mississippi Power of \$133 million. The utilization of these credits is dependent upon meeting the certification requirements for the project under the Internal Revenue Code. The plant would use an air-blown IGCC technology that generates power from low-rank coals and coals with high moisture or high ash content. These coals, which include lignite, make up half the proven U.S. and worldwide coal reserves. Mississippi Power is still undergoing a feasibility assessment of the project which could take up to two years. Approval by various regulatory agencies, including the Mississippi PSC, will also be required if the project proceeds.

The final outcome of these matters cannot now be determined.

Nuclear

On August 15, 2006, as part of a potential expansion of Plant Vogtle, Georgia Power and Southern Nuclear Operating Company, Inc. (SNC) filed an application with the Nuclear Regulatory Commission (NRC) for an early site permit (ESP) on behalf of the owners of Plant Vogtle. In addition, Georgia Power and SNC notified the NRC of their intent to apply for a combined construction and operating license (COL) in 2008. Ownership agreements have been signed with each of the existing Plant Vogtle co-owners. See Note 4 to the financial statements for additional

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information on these co-owners. In June 2006, the Georgia PSC approved Georgia Power's request to establish an accounting order that would allow Georgia Power to defer for future recovery the ESP and COL costs, of which Georgia Power's portion is estimated to total approximately \$51 million over the next four years. At this point, no final decision has been made regarding actual construction. Any new generation resource must be certified by the Georgia PSC in a separate proceeding.

On March 16, 2006, a subsidiary of Southern Company entered into a development agreement with Duke Energy Corporation (Duke Energy) to evaluate the potential construction of a new two-unit nuclear plant at a jointly owned site in Cherokee County, South Carolina. If constructed, Southern Company would own an interest in Unit 1, representing approximately 500 megawatts. Duke Energy will be the developer and licensed operator of any plant built at the site.

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. The final outcome of these matters cannot now be determined.

Other Matters

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 Estimate

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

Electric Utility Regulation

Southern Company's traditional operating companies, which comprise approximately 93 percent of Southern Company's total earnings for 2006, are subject to retail regulation by their respective state PSCs and wholesale regulation by the FERC. These regulatory agencies set the rates the traditional operating companies are permitted to charge customers based on allowable costs. As a result, the traditional operating companies apply FASB Statement No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS 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 SFAS 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 traditional 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 principles. The adequacy of reserves can be significantly affected by external events or conditions that can be unpredictable; thus, the ultimate outcome

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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 or state revenue department 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

Stock Options

On January 1, 2006, Southern Company adopted FASB Statement No. 123(R), "Share-Based Payment," using the modified prospective method. This statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements. That cost is 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."

Pensions and Other Postretirement Plans

On December 31, 2006, Southern Company adopted FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158), which requires recognition of the

funded status of its defined benefit postretirement plans in its balance sheet. With the adoption of SFAS No. 158, Southern Company recorded an additional prepaid pension asset of \$520 million with respect to its overfunded defined benefit plan and additional liabilities of \$45 million and \$553 million, respectively, related to its underfunded non-qualified pension plans and retiree benefit plans. Additionally, SFAS No. 158 will require Southern Company to change the measurement date for its defined benefit postretirement plan assets and obligations from September 30 to December 31 beginning with the year ending December 31, 2008. See Note 2 to the financial statements for additional information.

Guidance on Considering the Materiality of Misstatements

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires companies to quantify misstatements using both a balance sheet and an income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. When the effect of initial adoption is material, companies will record the effect as a cumulative effect adjustment to beginning of year retained earnings. The provisions of SAB 108 were effective for the Southern Company for the year ended December 31, 2006. The adoption of SAB 108 did not have a material impact on Southern Company's financial statements.

Income Taxes

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). This interpretation requires that tax benefits must be "more likely than not" of being sustained in order to be recognized. Southern Company adopted FIN 48 effective January 1, 2007. The impact on Southern Company's financial statements is estimated to be a reduction to retained earnings of \$15 million to \$25 million.

Leveraged Leases

In July 2006, the FASB issued FASB Staff Position No. FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction" (FSP 13-2). This staff position amends FASB Statement No. 13, "Accounting for Leases" to require recalculation of the rate of return and the allocation of income whenever the projected timing of the income tax cash flows generated by a leveraged lease is revised. Southern Company adopted FSP 13-2 effective January 1, 2007. This adoption required Southern Company to recognize a cumulative effect of an approximate \$17 million decrease to retained earnings related to the LILO transaction settled with the IRS in February 2005. The estimated impact of the

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adoption related to the SILO transactions is a reduction to retained earnings of approximately \$100 million to \$115 million. See FUTURE EARNINGS POTENTIAL—"Income Tax Matters—Leveraged Lease Transactions" above and Note 3 to the financial statements under "Income Tax Matters" herein for further details about the effect of FSP 13-2.

Fair Value Measurement

The FASB issued FASB Statement No. 157, "Fair Value Measurements" (SFAS No. 157) in September 2006. SFAS No. 157 provides guidance on how to measure fair value where it is permitted or required under other accounting pronouncements. SFAS No. 157 also requires additional disclosures about fair value measurements. Southern Company plans to adopt SFAS No. 157 on January 1, 2008 and is currently assessing its impact.

Fair Value Option

In February 2007, the FASB issued FASB Statement No. 159, "Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115" (SFAS No. 159). This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Southern Company plans to adopt SFAS No. 159 on January 1, 2008 and is currently assessing its impact.

FINANCIAL CONDITION AND LIQUIDITY

Overview

Southern Company's financial condition remained stable at December 31, 2006. Net cash flow from operations increased from 2005 by \$290 million. The increase was primarily the result of decreases in under recovered fuel cost receivables due to higher allowed fuel recovery rates, decreases in under recovered storm restoration costs, and decreases in accounts payable from year-end 2005 amounts that included substantial hurricane-related expenditures, partially offset by increases in fossil fuel inventory. The \$165 million decrease from 2005 to 2004 resulted primarily from higher fuel costs at the traditional operating companies, partially offset by increases in base rates and fuel recovery rates. See FUTURE EARNINGS POTENTIAL—"PSC Matters—Fuel Cost Recovery" and "Storm Damage Cost Recovery" for additional information.

Significant balance sheet changes include an increase in notes payable of \$683 million primarily to meet Southern Company's short-term financing needs until longer term financing is secured, an increase in securities due within one year of \$517 million for debt maturing within the next year, and an increase in property, plant, and equipment of \$1.6 billion. The majority of funds needed for property additions were provided from operating activities. The implementation of SFAS No. 158 resulted in significant balance sheet changes and accounts for a large portion of the increases in prepaid pension assets of \$527 million, other regulatory assets of \$417 million, employee benefit obligations of \$637 million, and other regulatory liabilities of \$471 million.

At the close of 2006, the closing price of Southern Company's common stock was \$36.86 per share, compared with book value of \$15.24 per share. The market-to-book value ratio was 242 percent at the end of 2006, compared with 240 percent at year-end 2005.

Southern Company, each of the traditional operating companies, and Southern Power, have received investment grade ratings from the major rating agencies with respect to debt, preferred securities, preferred stock, and/or preference stock. SCS has an investment grade corporate credit rating.

Sources of Capital

Southern Company intends to meet its future capital needs through internal cash flow and external security issuances. Equity capital can 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 2007, 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 2007 outside of its existing stock option plan, the employee savings plan, and the Southern Investment Plan.

The traditional operating companies and Southern Power 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, term loans, and short-term borrowings. See Note 3 to the financial statements under "Storm Damage Cost Recovery" for information regarding additional options that Mississippi Power may pursue for recovering storm damage 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 traditional 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 is generally subject to regulatory approval by the FERC. Additionally, with respect to the public offering of securities, Southern Company and certain of its subsidiaries file registration statements with the SEC 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, if any, registered under the 1933 Act, are continuously monitored and appropriate filings are made to ensure flexibility in the capital markets.

Southern Company, each traditional operating company, and Southern Power obtain 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.

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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 substantial cash flow from operating activities and access to the capital markets, including commercial paper programs, to meet liquidity needs.

At December 31, 2006, Southern Company and its subsidiaries had approximately \$167 million of cash and cash equivalents and \$3.3 billion of unused credit arrangements with banks, of which \$656 million expire in 2007 and \$2.7 billion expire in 2008 and beyond. Of the \$2.7 billion expiring in 2008 and beyond, \$2.4 billion does not expire until 2011. Approximately \$79 million of the credit facilities expiring in 2007 allow for the execution of term loans for an additional two-year period, and \$343 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 2006, Southern Company and its subsidiaries issued \$1.4 billion of senior notes, \$154 million of obligations related to pollution control revenue bonds, and \$150 million of preference stock. Interest rate hedges of \$1.1 billion notional amount were settled at a gain of \$2.7 million related to the issuances. The security issuances were used to redeem or extinguish \$1.2 billion of long-term debt, to redeem \$169 million of obligations related to pollution control revenue bonds, to redeem \$15 million of preferred stock, to fund Southern Company's ongoing construction program, and for general corporate purposes. In the second and fourth quarters of 2006, Alabama Power issued to Southern Company a total of 3 million shares of Alabama Power common stock at \$40.00 per share. The proceeds of \$120 million were used by Alabama Power to repay short-term indebtedness and for other general corporate purposes.

Subsequent to December 31, 2006, Southern Company issued \$500 million of senior notes. The proceeds from the sale of the senior notes were used by the Company to repay a portion of its outstanding short-term indebtedness, a portion of which was incurred to extinguish the 8.19% and 8.14% Southern Company Capital Funding Junior Subordinated Notes, and for other general corporate purposes. Also subsequent to December 31, 2006, Georgia Power entered into interest rate swap transactions with a notional amount of \$375 million, in order to reduce exposure to interest rate risk. The transactions will be settled over the next two years as the underlying debt is issued, and any resulting gain or loss will be amortized over a 10-year period.

On January 19, 2007, Gulf Power issued to Southern Company 800,000 shares of Gulf Power's common stock, without par value, for \$80 million. The proceeds were used by Gulf Power to repay short-term indebtedness

and for other general corporate purposes. On February 6, 2007, Alabama Power issued \$200 million in senior notes. The proceeds from the sale of the senior notes were used to repay a portion of Alabama Power's outstanding short-term debt and for other general corporate purposes.

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 credit rating change to BBB- or Baa3 or below. These contracts are primarily for physical electricity purchases and sales. At December 31, 2006, the maximum potential collateral requirements at a BBB- or Baa3 rating were approximately \$291 million. The maximum potential collateral requirements at a rating below BBB- or Baa3 were approximately \$711 million. Generally, collateral may be provided by a Southern Company guaranty, letter of credit, or cash. Southern Company's operating subsidiaries are 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 for Alabama Power and/or Georgia Power. These agreements are primarily for natural gas and power price risk management activities. At December 31, 2006, Southern Company's total exposure to these types of agreements was approximately \$27.4 million.

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

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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 enters into forward starting interest rate swaps that have been designated as hedges. The swaps outstanding at December 31, 2006 have a notional amount of \$725 million and are related to anticipated debt issuances over the next year. The weighted average interest rate on \$1.7 billion of long-term variable interest rate exposure that has not been hedged at January 1, 2007 was 5.1 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 \$17.9 million at January 1, 2007. For further information, see Notes 1 and 6 to the financial statements under "Financial Instruments."

Due to cost-based rate regulations, the traditional 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 generally shift substantially all fuel cost responsibility to the purchaser. To mitigate residual risks relative to movements in electricity prices, the traditional operating companies and Southern Power enter into fixed-price contracts for the purchase and sale of electricity through the wholesale electricity market and, to a lesser extent, into similar contracts for natural gas purchases. The traditional operating companies have implemented fuel-hedging programs at the instruction of their respective state PSCs.

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	
	2006	2005
Contracts beginning of year	\$ 101	\$ 11
Contracts realized or settled	93	(106)
New contracts at inception	-	-
Changes in valuation techniques	-	-
Current period changes ^(a)	(276)	196
Contracts end of year	\$ (82)	\$101

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

(in millions)	SOURCE OF 2006 YEAR-END VALUATION PRICES		
	TOTAL FAIR VALUE	MATURITY	
		2007	2008-2009
Actively quoted	\$(86)	\$(79)	\$(7)
External sources	4	4	-
Models and other	-	-	-
Contracts end of year	\$(82)	\$(75)	\$(7)

Unrealized gains and losses from mark-to-market adjustments on derivative contracts related to the traditional 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 traditional 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 statements of income as incurred. At December 31, 2006, the fair value gains/(losses) of energy-related derivative contracts was reflected in the financial statements as follows:

(in millions)	AMOUNT
Regulatory assets, net	\$(85)
Accumulated other comprehensive income	3
Net income	-
Total fair value	\$(82)

Unrealized pre-tax gains and losses from energy-related derivative contracts 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 energy-related derivative contracts. Southern Company's policy is to enter into agreements with counterparties that have investment grade credit ratings by Moody's and Standard & Poor's or with counterparties who have posted collateral to cover potential credit exposure. Therefore, Southern Company does not anticipate market risk exposure from nonperformance by the counterparties. For additional information, see Notes 1 and 6 to the financial statements under "Financial Instruments."

To reduce Southern Company's exposure to changes in the value of synthetic fuel tax credits, which are impacted by changes in oil prices, the Company has entered into derivative transactions indexed to oil prices. Because these transactions are not designated as hedges, the gains and losses are recognized in the statements of income as incurred. For 2006 and 2005, the fair value losses recognized in income to mark the transactions to market were \$32 million and \$7 million, respectively. In January 2007, Southern Company entered into additional derivative transactions with net initial premiums paid of \$3 million to further reduce its exposure to the potential phase-out of these income tax credits in 2007. For further 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 \$3.9 billion for 2007, \$4.5 billion for 2008, and \$4.8 billion for 2009. Environmental expenditures included in these amounts are \$1.66 billion, \$1.65 billion, and \$1.27 billion for 2007, 2008, and 2009, respectively. Actual construction costs may vary from this estimate because of changes

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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."

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 traditional 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.

Contractual Obligations

(in millions)	2007	2008-2009	2010-2011	AFTER 2011	TOTAL
Long-term debt ^(a) —					
Principal	\$ 1,418	\$ 1,103	\$ 615	\$10,803	\$13,939
Interest	738	1,307	1,205	10,572	13,822
Other derivative obligations ^(b) —					
Commodity	119	10	—	—	129
Interest	6	—	81	—	6
Preferred and preference stock dividends ^(c)	41	81	—	—	203
Operating leases	135	224	160	186	705
Purchase commitments ^(d) —					
Capital ^(e)	3,790	9,050	—	—	12,840
Coal	3,294	4,329	1,644	2,221	11,488
Nuclear fuel	120	231	305	236	892
Natural gas ^(f)	1,347	1,902	809	2,740	6,798
Purchased power	173	374	351	890	1,788
Long-term service agreements	74	156	193	1,231	1,654
Trusts—					
Nuclear decommissioning	7	14	14	110	145
Postretirement benefits ^(g)	41	91	—	—	132
Total	\$11,303	\$18,872	\$5,377	\$28,989	\$64,541

(a) All amounts are reflected based on final maturity dates. On February 1, 2007, \$400 million aggregate principal amount of long-term debt matured. The maturity was funded with short-term borrowings. 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, 2007, 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 operations and maintenance expenditures. Total other operations and maintenance expenses for 2006, 2005, and 2004 were \$3.5 billion, \$3.5 billion, and \$3.3 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, 2006, 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, 2006.

(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

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Southern Company's 2006 Annual Report contains forward-looking statements. Forward-looking statements include, among other things, statements concerning the strategic goals for the wholesale business, retail sales growth, customer growth, storm damage cost recovery and repairs, fuel cost recovery, environmental regulations and expenditures, earnings growth, dividend payout ratios, access to sources of capital, projections for postretirement benefit trust contributions, synthetic fuel investments, financing activities, completion of construction projects, impacts of adoption of new accounting rules, 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, 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 actions relating to fuel and storm restoration cost recovery;
- the performance of projects undertaken by the non-utility businesses and the success of efforts to invest in and develop new opportunities;
- fluctuations in the level of oil prices;
- the level of production, if any, by the synthetic fuel operations at Carbontrics Synfuels Investors LP and Alabama Fuel Products, LLC for fiscal year 2007;
- 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, pandemic health events such as an avian influenza, 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 the Company from time to time with the SEC.

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

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(in millions)	2006	2005	2004
Operating Revenues:			
Retail revenues	\$11,801	\$ 11,165	\$ 9,732
Sales for resale	1,822	1,667	1,341
Other electric revenues	465	446	392
Other revenues	268	276	264
Total operating revenues	14,356	13,554	11,729
Operating Expenses:			
Fuel	5,152	4,495	3,399
Purchased power	543	731	643
Other operations	2,423	2,394	2,263
Maintenance	1,096	1,116	1,027
Depreciation and amortization	1,200	1,176	949
Taxes other than income taxes	718	680	627
Total operating expenses	11,132	10,592	8,908
Operating Income	3,224	2,962	2,821
Other Income and (Expense):			
Allowance for equity funds used during construction	50	51	47
Interest income	41	36	27
Equity in losses of unconsolidated subsidiaries	(57)	(119)	(95)
Leveraged lease income	69	74	70
Impairment loss on equity method investments	(16)	–	–
Interest expense, net of amounts capitalized	(744)	(619)	(540)
Interest expense to affiliate trusts	(122)	(128)	(100)
Distributions on mandatorily redeemable preferred securities	–	–	(27)
Preferred and preference dividends of subsidiaries	(34)	(30)	(30)
Other income (expense), net	(56)	(41)	(59)
Total other income and (expense)	(869)	(776)	(707)
Earnings From Continuing Operations Before Income Taxes	2,355	2,186	2,114
Income taxes	781	595	585
Earnings From Continuing Operations	1,574	1,591	1,529
Earnings from discontinued operations, net of income taxes of \$(1), \$-, and \$2 for 2006, 2005, and 2004, respectively	(1)	–	3
Consolidated Net Income	\$ 1,573	\$ 1,591	\$ 1,532
Common Stock Data:			
Earnings per share from continuing operations–			
Basic	\$ 2.12	\$ 2.14	\$ 2.07
Diluted	2.10	2.13	2.06
Earnings per share including discontinued operations–			
Basic	\$ 2.12	\$ 2.14	\$ 2.07
Diluted	2.10	2.13	2.06
Average number of shares of common stock outstanding–(in millions)			
Basic	743	744	739
Diluted	748	749	743
Cash dividends paid per share of common stock	\$ 1.535	\$ 1.475	\$ 1.415

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(in millions)	2006	2005	2004
Operating Activities:			
Consolidated net income	\$1,573	\$ 1,591	\$ 1,532
Adjustments to reconcile consolidated net income to net cash provided from operating activities—			
Depreciation and amortization	1,421	1,398	1,161
Deferred income taxes and investment tax credits	202	499	559
Allowance for equity funds used during construction	(50)	(51)	(47)
Equity in losses of unconsolidated subsidiaries	57	119	95
Leveraged lease income	(69)	(74)	(70)
Pension, postretirement, and other employee benefits	46	(6)	(22)
Stock option expense	28	—	—
Tax benefit of stock options	4	50	31
Derivative fair value adjustments	32	8	2
Hedge settlements	13	(19)	(10)
Storm damage accounting order	—	48	—
Other, net	46	(30)	35
Changes in certain current assets and liabilities—			
Receivables	(69)	(1,045)	(392)
Fossil fuel stock	(246)	(110)	(8)
Materials and supplies	7	(78)	(31)
Other current assets	73	(1)	9
Accounts payable	(173)	71	29
Hurricane Katrina grant proceeds	120	—	—
Accrued taxes	(103)	28	(109)
Accrued compensation	(24)	13	(23)
Other current liabilities	(68)	119	(46)
Net cash provided from operating activities	2,820	2,530	2,695
Investing Activities:			
Property additions	(2,994)	(2,370)	(2,022)
Nuclear decommissioning trust fund purchases	(751)	(606)	(810)
Nuclear decommissioning trust fund sales	743	596	781
Proceeds from property sales	150	10	6
Hurricane Katrina capital grant proceeds	153	—	—
Investment in unconsolidated subsidiaries	(64)	(115)	(97)
Cost of removal net of salvage	(90)	(128)	(75)
Other	19	(16)	(41)
Net cash used for investing activities	(2,834)	(2,629)	(2,258)
Financing Activities:			
Increase (decrease) in notes payable, net	683	831	(141)
Proceeds—			
Long-term debt	1,564	1,608	1,861
Mandatorily redeemable preferred securities	—	—	200
Preferred and preference stock	150	55	175
Common stock	137	213	124
Redemptions—			
Long-term debt	(967)	(1,285)	(1,246)
Long-term debt to affiliate trusts	(399)	—	—
Mandatorily redeemable preferred securities	—	—	(240)
Preferred and preference stock	(15)	(4)	(28)
Common stock repurchased	—	(352)	—
Payment of common stock dividends	(1,140)	(1,098)	(1,045)
Other	(34)	(35)	(40)
Net cash (used for) provided from financing activities	(21)	(67)	(380)
Net Change in Cash and Cash Equivalents	(35)	(166)	57
Cash and Cash Equivalents at Beginning of Year	202	368	311
Cash and Cash Equivalents at End of Year	\$ 167	\$ 202	\$ 368

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

CONSOLIDATED BALANCE SHEETS

AT DECEMBER 31, 2006 AND 2005

ASSETS (in millions)	2006	2005
Current Assets:		
Cash and cash equivalents	\$ 167	\$ 202
Receivables—		
Customer accounts receivable	943	868
Unbilled revenues	283	304
Under recovered regulatory clause revenues	517	755
Other accounts and notes receivable	330	410
Accumulated provision for uncollectible accounts	(35)	(38)
Fossil fuel stock, at average cost	675	403
Materials and supplies, at average cost	648	666
Vacation pay	121	117
Prepaid expenses	128	129
Other	242	389
Total current assets	4,019	4,205
Property, Plant, and Equipment:		
In service	45,486	43,578
Less accumulated depreciation	16,582	15,727
	28,904	27,851
Nuclear fuel, at amortized cost	317	262
Construction work in progress	1,871	1,367
Total property, plant, and equipment	31,092	29,480
Other Property and Investments:		
Nuclear decommissioning trusts, at fair value	1,058	954
Leveraged leases	1,139	1,082
Other	296	337
Total other property and investments	2,493	2,373
Deferred Charges and Other Assets:		
Deferred charges related to income taxes	895	937
Prepaid pension costs	1,549	1,022
Unamortized debt issuance expense	172	162
Unamortized loss on reacquired debt	293	309
Deferred under recovered regulatory clause revenues	845	531
Other regulatory assets	936	519
Other	564	339
Total deferred charges and other assets	5,254	3,819
Total Assets	\$42,858	\$39,877

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

CONSOLIDATED BALANCE SHEETS CONTINUED

AT DECEMBER 31, 2006 AND 2005

LIABILITIES AND STOCKHOLDERS' EQUITY (in millions)	2006	2005
Current Liabilities:		
Securities due within one year	\$ 1,418	\$ 901
Notes payable	1,941	1,258
Accounts payable	1,081	1,229
Customer deposits	249	220
Accrued taxes—		
Income taxes	110	104
Other	391	319
Accrued interest	184	204
Accrued vacation pay	151	144
Accrued compensation	444	459
Other	384	402
Total current liabilities	6,353	5,240
Long-term Debt (See accompanying statements)	10,942	10,958
Long-term Debt Payable to Affiliated Trusts (See accompanying statements)	1,561	1,888
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	5,989	5,736
Deferred credits related to income taxes	291	311
Accumulated deferred investment tax credits	503	527
Employee benefit obligations	1,567	930
Asset retirement obligations	1,137	1,117
Other cost of removal obligations	1,300	1,295
Other regulatory liabilities	794	323
Other	306	267
Total deferred credits and other liabilities	11,887	10,506
Total Liabilities	30,743	28,592
Preferred and Preference Stock of Subsidiaries (See accompanying statements)	744	596
Common Stockholders' Equity (See accompanying statements)	11,371	10,689
Total Liabilities and Stockholders' Equity	\$ 42,858	\$ 39,877
Commitments and Contingent Matters (See notes)		

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

CONSOLIDATED STATEMENTS OF CAPITALIZATION

AT DECEMBER 31, 2006 AND 2005

(in millions)		2006	2005	PERCENT OF TOTAL	
				2006	2005
Long-Term Debt of Subsidiaries:					
First mortgage bonds—					
	Maturity	Interest Rates			
	2006	6.50% to 6.90%	\$ —	\$ 45	
Total first mortgage bonds			—	45	
Long-term senior notes and debt—					
	Maturity	Interest Rates			
	2006	2.65% to 6.20%	—	674	
	2007	3.50% to 7.13%	1,204	1,207	
	2008	2.54% to 6.55%	460	461	
	2009	4.10% to 7.00%	127	128	
	2010	4.70%	102	102	
	2011	4.00% to 5.10%	302	102	
	2012 through 2046	4.35% to 8.12%	6,730	5,535	
Adjustable rates (at 1/1/07):					
	2006	2.11%	—	27	
	2007	5.624%	169	265	
	2009	5.54% to 5.55%	440	440	
	2010	6.23%	221	154	
Total long-term senior notes and debt			9,755	9,095	
Other long-term debt—					
Pollution control revenue bonds—					
	Maturity	Interest Rates			
	2006	5.25%	—	12	
	2024	5.50%	—	3	
Variable rates (at 1/1/06):					
	2015 through 2017	2.01% to 2.16%	—	90	
	2012 through 2036	2.83% to 5.45%	812	850	
Variable rates (at 1/1/07):					
	2011 through 2041	3.50% to 4.07%	1,714	1,586	
Total other long-term debt			2,526	2,541	
Capitalized lease obligations			97	110	
Unamortized debt (discount), net			(18)	(19)	
Total long-term debt (annual interest requirement—\$643 million)			12,360	11,772	
Less amount due within one year			1,418	814	
Long-term debt excluding amount due within one year			10,942	10,958	44.5%
					45.4%

CONSOLIDATED STATEMENTS OF CAPITALIZATION CONTINUED

AT DECEMBER 31, 2006 AND 2005

(in millions)	2006	2005	PERCENT OF TOTAL	
			2006	2005
Long-Term Debt Payable to Affiliated Trusts:				
Maturity				
2027 through 2044				
Interest Rates				
4.75% to 8.19%				
(annual interest requirement—\$95 million)	1,561	1,960		
Less amount due within one year	—	72		
Total long-term debt payable to affiliated trusts				
excluding amount due within one year	1,561	1,888	6.3	7.8
Preferred and Preference Stock of Subsidiaries:				
<u>Cumulative preferred stock</u>				
\$100 par or stated value				
—4.20% to 5.44%				
Authorized				
—10 million shares				
Outstanding	81	96		
\$1 par value				
—4.95% to 5.83%				
Authorized				
—2006: 28 million shares				
Outstanding	294	294		
Outstanding	123	123		
—1,250 shares: \$100,000 stated value				
<u>Non-cumulative preferred stock</u>				
\$25 par value				
—6.00% to 6.13%				
Authorized				
—2006: 50 million shares				
—2005: 4 million shares				
Outstanding	45	44		
—2 million shares				
<u>Preference stock</u>				
Authorized				
—2006: 50 million shares				
—2005: 10 million shares				
Outstanding	147	—		
—\$1 par value—5.63%				
—2006: 6 million shares (non-cumulative)				
—2005: 0 shares				
Outstanding	54	54		
—\$100 par or stated value—6.00%				
—2006: 1 million shares (non-cumulative)				
—2005: 1 million shares (non-cumulative)				
Total preferred and preference stock of subsidiaries				
(annual dividend requirement—\$41 million)	744	611		
Less amount due within one year	—	15		
Preferred and preference stock of subsidiaries				
excluding amount due within one year	744	596	3.0	2.5
Common Stockholders' Equity:				
Common stock, par value \$5 per share —	3,759	3,759		
Authorized				
—1 billion shares				
Issued				
—2006: 752 million shares				
—2005: 752 million shares				
Treasury				
—2006: 5.6 million shares				
—2005: 10.4 million shares				
Paid-in capital	1,096	1,085		
Treasury, at cost	(192)	(359)		
Retained earnings	6,765	6,332		
Accumulated other comprehensive income (loss)	(57)	(128)		
Total common stockholders' equity	11,371	10,689	46.2	44.3
Total Capitalization	\$ 24,618	\$ 24,131	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, 2006, 2005 AND 2004

(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, 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	-	-	-	-	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
Net income	-	-	-	1,573	-	-	1,573
Other comprehensive income	-	-	-	-	19	-	19
Adjustment to initially apply	-	-	-	-	-	-	-
FASB Statement No. 158, net of tax	-	-	-	-	52	-	52
Stock issued	-	11	168	-	-	-	179
Stock repurchased, at cost	-	-	-	-	-	-	-
Cash dividends	-	-	-	(1,140)	-	-	(1,140)
Other	-	-	(1)	-	-	-	(1)
Balance at December 31, 2006	\$ 3,759	\$ 1,096	\$ (192)	\$ 6,765	\$ (57)	\$ -	\$ 11,371

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004

(in millions)	2006	2005	2004
Consolidated Net Income	\$ 1,573	\$ 1,591	\$ 1,532
Other comprehensive income (loss)—continuing operations:			
Change in additional minimum pension liability, net of tax of \$10, \$(6), and \$(11), respectively	18	(11)	(20)
Change in fair value of marketable securities, net of tax of \$4, \$(2) and \$4, respectively	8	(4)	6
Changes in fair value of qualifying hedges, net of tax of \$(5), \$7, and \$(11), respectively	(8)	12	(16)
Less: Reclassification adjustment for amounts included in net income, net of tax of \$-, \$4, and \$8, respectively	1	6	14
Total other comprehensive income (loss)—continuing operations	19	3	(16)
Other comprehensive income (loss)—discontinued operations:			
Changes in fair value of qualifying hedges, net of tax of \$4 and \$(1), respectively	-	6	(2)
Less: Reclassification adjustment for amounts included in net income, net of tax of \$(3) and \$(1), respectively	-	(4)	(2)
Total other comprehensive income (loss)—discontinued operations	-	2	(4)
Consolidated Comprehensive Income	\$ 1,592	\$ 1,596	\$ 1,512

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

NOTES TO FINANCIAL STATEMENTS

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

NOTE ONE:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Southern Company (the Company) is the parent company of four traditional 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 traditional operating companies, Alabama Power, Georgia Power, Gulf Power, and Mississippi Power are vertically integrated utilities providing electric service in four Southeastern states. Southern Power constructs, acquires, and manages generation assets and sells electricity at market-based rates in the wholesale market. 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 traditional 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 company 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 of 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 all periods presented. 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.

The traditional operating companies, Southern Power, and certain of their subsidiaries are subject to regulation by the Federal Energy Regulatory Commission (FERC) and the traditional 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 held a 30 percent ownership interest until July 2006, when its ownership interest was terminated. Total fuel purchases through June 2006 and for the years 2005 and 2004 were \$354 million, \$507 million, and \$409 million, respectively. Synfuel Services, Inc. (SSI), another subsidiary of Southern Holdings, provided fuel transportation services to AFP that were 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 \$62 million, \$83 million, and \$82 million through June 2006 and for the years 2005 and 2004, respectively, have been eliminated against fuel expense in the financial statements. SSI also provided additional services to AFP, as well as to a related party of AFP. Revenues from these transactions totaled approximately \$24 million, \$40 million, and \$24 million through June 2006 and for the years 2005 and 2004, respectively.

Subsequent to the termination of Southern Company's membership interest in AFP, Alabama Power and Georgia Power continued to purchase an additional \$384 million in fuel from AFP in 2006. SSI continued to provide fuel transportation services of \$62 million, which were eliminated against fuel expense in the financial statements. In 2006, SSI also provided other additional services to AFP and a related party of AFP totaling \$21 million.

Regulatory Assets and Liabilities

The traditional 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" (SFAS No. 71). 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

NOTES TO FINANCIAL STATEMENTS

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

credited to customers through the ratemaking process. Regulatory assets and (liabilities) reflected in the balance sheets at December 31 relate to:

(in millions)	2006	2005	Note
Deferred income tax charges	\$ 896	\$ 937	(a)
Asset retirement obligations-asset	61	81	(a)
Asset retirement obligations-liab	(155)	(139)	(a)
Other cost of removal obligations	(1,300)	(1,295)	(a)
Deferred income tax credits	(293)	(313)	(a)
Loss on reacquired debt	293	309	(b)
Vacation pay	121	117	(c)
Under recovered regulatory clause revenues	411	351	(d)
Building lease	51	52	(d)
Generating plant outage costs-asset	56	54	(d)
Under recovered storm damage costs	89	366	(d)
Fuel hedging-asset	115	24	(d)
Fuel hedging-liability	(13)	(127)	(d)
Other assets	55	56	(d)
Environmental remediation-asset	57	58	(d)
Environmental remediation-liab.	(32)	(36)	(d)
Deferred purchased power	(38)	(52)	(d)
Other liabilities	(50)	(32)	(d)
Plant Daniel capacity	(6)	(19)	(e)
Overfunded retiree benefit plans	(508)	-	(f)
Underfunded retiree benefit plans	697	-	(f)
Total	\$ 507	\$ 392	

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 a four-year period ending in 2007.
- (f) Recovered and amortized over the average remaining service period which may range up to 21 years. See Note 2 under "Retirement Benefits."

In the event that a portion of a traditional operating company's operations is no longer subject to the provisions of SFAS 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 traditional 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. See Note 3 under "Alabama Power Retail Regulatory Matters," "Georgia Power Retail Regulatory Matters," and "Storm Damage Cost Recovery" for additional information.

Revenues

Wholesale 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 related to retail sales are accrued at the end of each fiscal period. Electric rates for the traditional 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 cost 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. Georgia Power is required to file a new fuel case no later than March 1, 2008. Gulf Power is required to notify the Florida PSC if the projected fuel revenue over or under recovery exceeds 10 percent of the projected fuel costs for the period and indicate if an adjustment to the fuel cost recovery factor is being requested. 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.

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 \$137 million in 2006, \$134 million in 2005, and \$134 million in 2004.

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 2014. Construction of an on-site dry storage facility at Plant Vogtle is expected 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 expected life of each plant.

Also, the Energy Policy Act of 1992 established a Uranium Enrichment Decontamination and Decommissioning Fund, which has been funded in part by a special assessment on utilities with nuclear plants. This assessment was paid over a 15-year period; the final installment occurred 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.

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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)	2006	2005
Generation	\$23,355	\$22,490
Transmission	6,352	6,031
Distribution	12,484	11,894
General	2,510	2,393
Plant acquisition adjustment	40	41
Utility plant in service	44,741	42,849
IT equipment and software	226	211
Communications equipment	445	431
Other	74	87
Other plant in service	745	729
Total plant in service	\$45,486	\$43,578

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 nuclear refueling costs in advance of the unit's next refueling outage. Georgia Power defers and amortizes nuclear 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 and Other 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. Taxes that are collected from customers on behalf of governmental agencies to be remitted to these agencies are presented net on the statements of income.

Depreciation and Amortization

Depreciation of the original cost of utility plant in service is provided primarily by using composite straight-line rates, which approximated 3.0 percent in 2006, 2.9 percent in 2005, and 3.0 percent in 2004. Depreciation studies are conducted periodically to update the compos-

ite rates. These studies are filed with the respective state PSC for the traditional operating companies. Accumulated depreciation for utility plant in service totaled \$16.2 billion and \$15.3 billion at December 31, 2006 and 2005, 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 the three-year retail rate plan for Georgia Power ending December 31, 2007 (2004 Retail Rate Plan), Georgia Power was ordered to recognize Georgia PSC-certified capacity costs in rates evenly over the three years covered by the 2004 Retail Rate Plan. As a result of the regulatory adjustment, Georgia Power recognized \$33 million in increased depreciation and amortization expense in 2005. Georgia Power recorded a credit to amortization of \$14 million in 2006. 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 also was ordered to recognize new certified capacity costs in rates evenly over the same three-year period under the 2001 rate order. As a result of this regulatory adjustment, Georgia Power recorded a reduction in depreciation and amortization expense of \$77 million in 2004. 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: \$17 million in 2004, \$25 million in 2005, \$13 million in 2006, and \$6 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 \$405 million and \$378 million at December 31, 2006 and 2005, 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" (SFAS No. 143), which established new accounting and reporting standards for legal obligations associated with the ultimate costs of retiring long-lived assets.

NOTES TO FINANCIAL STATEMENTS

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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" (FIN 47), 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 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 SFAS No. 143 or FIN 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, 2006 was \$1.1 billion. In addition, the Company has retirement obligations related to various landfill sites and underground storage tanks. In connection with the adoption of FIN 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 also has 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 differences between costs recognized under SFAS No. 143 and FIN 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)	2006	2005
Balance beginning of year	\$1,117	\$ 903
Liabilities incurred	8	155
Liabilities settled	(5)	(2)
Accretion	73	61
Cash flow revisions	(56)	-
Balance end of year	\$1,137	\$1,117

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. As the external trust funds are actively managed by unrelated parties with limited direction from the Company, the Company does not have the ability to choose to hold securities with unrealized losses until recovery. Through 2005, the Company considered other-than-temporary impairments to be immaterial. However, since the January 1, 2006 effective date of FASB Staff Position FAS 115-1/124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (FSP No. 115-1), the Company considers all unrealized losses to represent other-than-temporary impairments. The adoption of FSP No. 115-1 had no impact on the results of operations, cash flows, or financial condition of the Company as all losses have been and continue to be recorded through a regulatory liability, whether realized, unrealized, or identified as other-than-temporary. Details of the securities held in these trusts at December 31 are as follows:

(in millions)	UNREALIZED GAINS	OTHER-THAN TEMPORARY IMPAIRMENTS	FAIR VALUE
2006			
Equity	\$227.9	\$(10.3)	\$ 763.1
Debt	3.7	(2.1)	285.5
Other	-	-	8.9
Total	\$231.6	\$(12.4)	\$1,057.5
(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

The contractual maturities of debt securities at December 31, 2006 are as follows: \$8.0 million in 2007; \$70.5 million in 2008-2011; \$85.2 million in 2012-2016; and \$120.4 million thereafter.

Sales of the securities held in the trust funds resulted in \$743.1 million, \$596.3 million, and \$781.3 million in 2006, 2005, and 2004, respectively, all of which were re-invested. Realized gains and other-than-temporary impairment losses were \$39.8 million and \$30.3 million, respectively, in

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2006. Net realized gains were \$22.5 million and \$21.6 million in 2005 and 2004, respectively. Realized gains and other-than-temporary impairment 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 other-than-temporary impairment losses are considered non-cash transactions for purposes of the statements of cash flow.

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, 2006, the accumulated provisions for decommissioning were as follows:

(in millions)	PLANT FARLEY	PLANT HATCH	PLANT VOGTLE
External trust funds, at fair value	\$ 513	\$ 344	\$ 200
Internal reserves	28	-	1
Total	\$ 541	\$ 344	\$ 201

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 Plant Farley and in 2006 for the Georgia Power plants, were as follows for Alabama Power's Plant Farley and Georgia Power's ownership interests in Plants Hatch and Vogtle:

	PLANT FARLEY	PLANT HATCH	PLANT VOGTLE
Decommissioning periods:			
Beginning year	2017	2034	2027
Completion year	2046	2061	2051

(in millions)	PLANT FARLEY	PLANT HATCH	PLANT VOGTLE
Site study costs:			
Radiated structures	\$892	\$544	\$507
Non-radiated structures	63	46	67
Total	\$955	\$590	\$574

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 por-

tion of the facilities as of 2003. Georgia Power will include the 2006 study estimates as part of the retail base rate case to be filed with the Georgia PSC by July 2007. The estimates used in current rates are \$421 million and \$326 million for Plants Hatch and Vogtle, respectively. Amounts expensed in 2006, 2005, and 2004 totaled \$7 million, \$7 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 license extensions, amounts previously contributed to the external trust funds for Plants Hatch and Farley are currently projected to be adequate to meet the decommissioning obligations.

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

In accordance with regulatory treatment, the traditional operating companies record AFUDC, which 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 traditional operating companies' regulated rates is capitalized in accordance with standard interest capitalization requirements.

Cash payments for interest totaled \$875 million, \$661 million, and \$551 million in 2006, 2005, and 2004, respectively, net of amounts capitalized of \$27 million, \$21 million, and \$36 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 loss is required. Until the assets are disposed of, their estimated fair value is re-evaluated when circumstances or events change.

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Storm Damage Reserves

Each traditional 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 traditional operating companies accrued \$26 million in 2006 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 2006, 2005, and 2004, such additional accruals totaled \$3 million, \$6 million, and \$25 million, respectively. In October 2006, the Mississippi PSC ordered Mississippi Power to suspend all accruals to its retail property damage reserve pending the establishment of a new reserve limit. Mississippi Power made no discretionary accruals in 2006 as a result of the order. See Note 3 under "Storm Damage Cost 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 have been or may be approved by the respective state PSCs to replenish these reserves.

Environmental Remediation 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 for environmental remediation. 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.

Gulf Power's environmental remediation liability includes estimated costs of environmental remediation projects of approximately \$57.2 million as of December 31, 2006. These estimated costs relate to new regulations and more stringent site closure criteria by the Florida Department of Environmental Protection (FDEP) for impacts to 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 estimates.

For Southern Company, the undiscounted environmental remediation liabilities balances as of December 31, 2006 and 2005 totaled \$63 million and \$62 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 depreciation and amortization, as well as interest on long-term debt related to these investments. The Company reviews all important lease assumptions at least annually, or more frequently if events or changes in circumstances indicate that a change in assumptions has occurred or may occur. These assumptions include the effective tax rate, the residual value, and the credit quality of the lessees.

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

(in millions)	2006	2005
Net rentals receivable	\$ 497	\$ 509
Unearned income	(261)	(280)
Investment in leveraged leases	236	229
Deferred taxes arising from leveraged leases	(133)	(59)
Net investment in leveraged leases	\$ 103	\$ 170

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

(in millions)	2006	2005	2004
Pretax leveraged lease income	\$20	\$ 23	\$17
Income tax expense	(9)	(11)	(8)
Net leveraged lease income	\$11	\$ 12	\$ 9

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

(in millions)	2006	2005
Net rentals receivable	\$1,299	\$1,298
Unearned income	(396)	(445)
Investment in leveraged leases	903	853
Deferred taxes arising from leveraged leases	(492)	(351)
Net investment in leveraged leases	\$ 411	\$ 502

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

(in millions)	2006	2005	2004
Pretax leveraged lease income	\$49	\$ 51	\$ 53
Income tax expense	(17)	(18)	(19)
Net leveraged lease income	\$32	\$ 33	\$ 34

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See Note 3 under “Income Tax Matters” for additional information regarding the leveraged lease transactions.

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 and recovered by the traditional operating companies through fuel cost recovery rates approved by each state PSC. Emission allowances granted by the Environmental Protection Agency (EPA) are included in inventory at zero cost.

Stock Options

Prior to January 1, 2006, Southern Company accounted for options granted in accordance with Accounting Principles Board Opinion No. 25; thus, no compensation expense was recognized because the exercise price of all options granted equaled the fair market value on the date of the grant.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), “Share-Based Payment” (SFAS No. 123(R)), using the modified prospective method. Under that method, compensation cost for the year ended December 31, 2006 is recognized as the requisite service is rendered and includes: (a) compensation cost for the portion of share-based awards granted prior to and that are outstanding as of January 1, 2006, for which the requisite service had not been rendered, based on the grant-date fair value of those awards as calculated in accordance with the original provisions of FASB Statement No. 123, “Accounting for Stock-based Compensation” (SFAS No. 123), and (b) compensation cost for all share-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

For Southern Company, the adoption of SFAS No. 123(R) has resulted in a reduction in earnings from continuing operations before income taxes and net income of \$28 million and \$17 million, respectively, for the year ended December 31, 2006. Additionally, SFAS No. 123(R) requires the gross excess tax benefit from stock option exercises to be reclassified as a financing cash flow as opposed to an operating cash flow; the reduction in operating cash flows and increase in financing cash flows for the year ended December 31, 2006 was \$10 million.

The adoption of SFAS No. 123(R) has also resulted in a reduction in basic and diluted earnings per share from continuing operations of \$0.02 and \$0.03, respectively, for the year ended December 31, 2006.

For the years prior to the adoption of SFAS No. 123(R), the pro forma impact of fair-value accounting for options granted on earnings from continuing operations and basic and diluted earnings per share from continuing operations is as follows:

	AS REPORTED	OPTIONS IMPACT AFTER TAX	PRO FORMA
2005			
Net income (in millions):	\$1,591	\$(17)	\$1,574
Earnings per share (dollars):			
Basic	\$ 2.14		\$ 2.12
Diluted	\$ 2.13		\$ 2.10
2004			
Net income (in millions):	\$1,529	\$(16)	\$1,513
Earnings per share (dollars):			
Basic	\$ 2.07		\$ 2.05
Diluted	\$ 2.06		\$ 2.04

Because historical forfeitures have been insignificant and are expected to remain insignificant, no forfeitures are assumed in the calculation of compensation expense; rather they are recognized when they occur.

The estimated fair values of stock options granted in 2006, 2005, and 2004 were derived using the Black-Scholes stock option pricing model. Expected volatility is based on historical volatility of the Company’s stock over a period equal to the expected term. Southern Company uses historical exercise data to estimate the expected term that represents the period of time that options granted to employees are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant that covers the expected term of the stock options. The following table shows the assumptions used in the pricing model and the weighted average grant-date fair value of stock options granted:

Period ended December 31	2006	2005	2004
Expected volatility	16.9%	17.9%	19.6%
Expected term (in years)	5.0	5.0	5.0
Interest rate	4.6%	3.9%	3.1%
Dividend yield	4.4%	4.4%	4.8%
Weighted average grant date fair value	\$4.15	\$3.90	\$3.29

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 (categorized in “Other”) 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

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are accounted for under the accrual method. Other derivative contracts qualify as cash flow hedges of anticipated transactions or are recoverable through the traditional 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, including derivatives related to synthetic fuel investments, 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 did not equal fair value at December 31 were as follows:

(in millions)	CARRYING AMOUNT	FAIR VALUE
Long-term debt:		
2006	\$13,824	\$13,702
2005	13,623	13,633

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

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 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 traditional operating companies are not considered

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 \$46 million, of which \$43 million has been funded. Southern Company's investment in the fund at December 31, 2006 totaled \$25.6 million.

NOTE TWO:

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). No contributions to the plan are expected for the year ending December 31, 2007. Southern Company also provides certain defined benefit pension 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 through other postretirement benefit plans. The traditional operating companies fund related trusts to the extent required by their respective regulatory commissions. For the year ending December 31, 2007, postretirement trust contributions are expected to total approximately \$41 million.

On December 31, 2006, Southern Company adopted FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158), which requires recognition of the funded status of its defined benefit postretirement plans in its balance sheet. Prior to the adoption of SFAS No. 158, Southern Company generally recognized only the difference between the benefit expense recognized and employer contributions to the plan as either a prepaid asset or as a liability. With respect to each of its underfunded non-qualified pension plans, Southern Company recognized an additional minimum liability representing the difference between each plan's accumulated benefit obligation and its assets.

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With the adoption of SFAS No. 158, Southern Company was required to recognize on its balance sheet previously unrecognized assets and liabilities related to unrecognized prior service cost, unrecognized gains or losses (from changes in actuarial assumptions and the difference between actual and expected returns on plan assets), and any unrecognized transition amounts (resulting from the change from cash-basis accounting to accrual accounting). These amounts will continue to be amortized as a component of expense over the employees' remaining average service life as SFAS No. 158 did not change the recognition of pension and other postretirement benefit expense in the statements of income. With the adoption of SFAS No. 158, Southern Company recorded an additional prepaid pension asset of \$520 million with respect to its overfunded defined benefit plan and additional liabilities of \$45 million and \$553 million, respectively, related to its underfunded non-qualified pension plans and retiree benefit plans. The incremental effect of applying SFAS No. 158 on individual line items in the consolidated balance sheet at December 31, 2006 follows:

(in millions)	BEFORE	ADJUSTMENTS	AFTER
Prepaid pension costs	\$ 1,029	\$ 520	\$ 1,549
Other regulatory assets	239	697	936
Other property and investments	2,523	(30)	2,493
Total assets	41,671	1,187	42,858
Accumulated deferred income taxes	(5,959)	(30)	(5,989)
Other regulatory liabilities	(287)	(507)	(794)
Employee benefit obligations	(969)	(598)	(1,567)
Total liabilities	(29,608)	(1,135)	(30,743)
Accumulated other comprehensive income	109	(52)	57
Total stockholders' equity	(12,063)	(52)	(12,115)

Because the recovery of postretirement benefit expense through rates is considered probable, Southern Company recorded offsetting regulatory assets or regulatory liabilities under the provisions of SFAS No. 71 with respect to the prepaid assets and the liabilities associated with the Company's traditional operating companies. With respect to its unregulated subsidiaries, Southern Company recorded the resulting offset as a component of accumulated other comprehensive income, net of tax.

The measurement date for plan assets and obligations is September 30 for each year presented. Pursuant to SFAS No. 158, Southern Company will be required to change the measurement date for its defined benefit postretirement plans from September 30 to December 31 beginning with the year ending December 31, 2008.

Pension Plans

The total accumulated benefit obligation for the pension plans was \$5.1 billion in 2006 and \$5.2 billion in 2005. Changes during the year in the projected benefit obligations and fair value of plan assets were as follows:

(in millions)	2006	2005
Change in benefit obligation		
Benefit obligation at beginning of year	\$5,557	\$5,075
Service cost	153	138
Interest cost	300	286
Benefits paid	(230)	(214)
Plan amendments	8	32
Actuarial (gain) loss	(297)	240
Balance at end of year	5,491	5,557
Change in plan assets		
Fair value of plan assets at beginning of year	6,147	5,476
Actual return on plan assets	759	866
Employer contributions	17	19
Benefits paid	(230)	(214)
Fair value of plan assets at end of year	6,693	6,147
Funded status at end of year	1,202	590
Unrecognized transition amount	-	(6)
Unrecognized prior service cost	-	293
Unrecognized net gain	-	(2)
Fourth quarter contributions	5	5
Prepaid pension asset, net	\$1,207	\$ 880

At December 31, 2006, the projected benefit obligations for the qualified and non-qualified pension plans were \$5.1 billion and \$0.3 billion, respectively. All plan assets are related to the qualified pension 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. 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. The actual composition of the

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Company's pension plan assets as of the end of the year, along with the targeted mix of assets, is presented below:

	TARGET	2006	2005
Domestic equity	36%	38%	40%
International equity	24	23	24
Fixed income	15	16	17
Real estate	15	16	13
Private equity	10	7	6
Total	100%	100%	100%

Amounts recognized in the consolidated balance sheets related to the Company's pension plans consist of the following:

(in millions)	2006	2005
Prepaid pension costs	\$ 1,549	\$ 1,022
Other regulatory assets	158	–
Current liabilities, other	(18)	–
Other regulatory liabilities	(507)	–
Employee benefit obligations	(324)	(310)
Other property and investments	–	43
Accumulated other comprehensive income	–	125

Presented below are the amounts included in accumulated other comprehensive income, regulatory assets, and regulatory liabilities at December 31, 2006, related to the defined benefit pension plans that have not yet been recognized in net periodic pension cost along with the estimated amortization of such amounts for the next fiscal year:

(in millions)	PRIOR SERVICE COST	NET (GAIN)/LOSS
Balance at December 31, 2006:		
Accumulated other comprehensive income	\$ 11	\$ (11)
Regulatory assets	27	131
Regulatory liabilities	225	(732)
Total	\$ 263	\$ (612)

Estimated amortization in net periodic pension cost in 2007:

(in millions)	2006	2005
Accumulated other comprehensive income	\$ 1	\$ 1
Regulatory assets	4	10
Regulatory liabilities	27	–
Total	\$ 32	\$ 11

Components of net periodic pension cost (income) were as follows:

(in millions)	2006	2005	2004
Service cost	\$ 153	\$ 138	\$ 128
Interest cost	300	286	269
Expected return on plan assets	(456)	(456)	(452)
Recognized net (gain) loss	16	10	(7)
Net amortization	26	24	18
Net periodic pension cost (income)	\$ 39	\$ 2	\$ (44)

Net periodic pension cost (income) is the sum of service cost, interest cost, and other costs netted against the expected return on plan assets. The expected return on plan assets is determined by multiplying the expected rate of return on plan assets and the market-related value of plan assets. In determining the market-related value of plan assets, the Company has elected to amortize changes in the market value of all plan assets over five years rather than recognize the changes immediately. As a result, the accounting value of plan assets that is used to calculate the expected return on plan assets differs from the current fair value of the plan assets.

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, 2006, estimated benefit payments were as follows:

(in millions)	2007	2008	2009	2010	2011	2012 to 2016
	\$ 241	252	263	277	294	1,786

Other Postretirement Benefits

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

(in millions)	2006	2005
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 1,826	\$ 1,712
Service cost	30	28
Interest cost	98	96
Benefits paid	(79)	(78)
Actuarial (gain) loss	(49)	68
Retiree drug subsidy	4	–
Balance at end of year	1,830	1,826
Change in plan assets		
Fair value of plan assets at beginning of year	684	592
Actual return on plan assets	68	78
Employer contributions	97	92
Benefits paid	(118)	(78)
Fair value of plan assets at end of year	731	684
Funded status at end of year	(1,099)	(1,142)
Unrecognized transition amount	–	114
Unrecognized prior service cost	–	121
Unrecognized net loss	–	428
Fourth quarter contributions	53	40
Accrued liability (recognized in the balance sheet)	\$ (1,046)	\$ (439)

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Other 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. 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. The actual composition of the Company's other postretirement benefit plan assets as of the end of the year, along with the targeted mix of assets, is presented below:

	TARGET	2006	2005
Domestic equity	42%	44%	46%
International equity	19	20	18
Fixed income	29	27	29
Real estate	6	6	5
Private equity	4	3	2
Total	100%	100%	100%

Amounts recognized in the balance sheets related to the Company's other postretirement benefit plans consist of the following:

(in millions)	2006	2005
Other regulatory assets	\$ 538	\$ -
Current liabilities, other	(3)	-
Employee benefit obligations	(1,043)	(439)
Accumulated other comprehensive income	14	-

Presented below are the amounts included in accumulated other comprehensive income and regulatory assets at December 31, 2006, related to the other postretirement benefit plans that have not yet been recognized in net periodic postretirement benefit cost along with the estimated amortization of such amounts for the next fiscal year.

(in millions)	PRIOR SERVICE COST	NET (GAIN)/ LOSS	TRANSITION OBLIGATION
Balance at December 31, 2006:			
Accumulated other comprehensive income	\$ 4	\$ 10	\$ -
Regulatory assets	108	332	99
Total	\$ 112	\$ 342	\$ 99

Estimated amortization as net periodic postretirement benefit cost in 2007:

Accumulated other comprehensive income	\$ -	\$ -	\$ -
Regulatory assets	9	14	15
Total	\$ 9	\$ 14	\$ 15

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

(in millions)	2006	2005	2004
Service cost	\$ 30	\$ 28	\$ 28
Interest cost	98	97	93
Expected return on plan assets	(49)	(45)	(50)
Net amortization	43	38	35
Net postretirement cost	\$ 122	\$ 118	\$ 106

In the third quarter 2004, Southern Company prospectively adopted FASB Staff Position 106-2, "Accounting and Disclosure Requirements" (FSP 106-2), 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 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 years ended December 31, 2005 and 2006 by approximately \$11 million, \$26 million, and \$39 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 APBO 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
2007	\$ 82	\$ (6)	\$ 76
2008	91	(7)	84
2009	99	(9)	90
2010	107	(10)	97
2011	115	(11)	104
2012 to 2016	667	(81)	586

Actuarial Assumptions

The weighted average rates assumed in the actuarial calculations used to determine both the benefit obligations as of the measurement date and the net periodic costs for the pension and other postretirement benefit plans for the following year are presented below. Net periodic benefit costs for 2004 were calculated using a discount rate of 6.00 percent.

	2006	2005	2004
Discount	6.00%	5.50%	5.75%
Annual salary increase	3.50	3.00	3.50
Long-term return on plan assets	8.50	8.50	8.50

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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 9.56 percent for 2007, decreasing gradually to 5.00 percent through the year 2015 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 APBO and the service and interest cost components at December 31, 2006 as follows:

(in millions)	1 PERCENT INCREASE	1 PERCENT DECREASE
Benefit obligation	\$138	\$118
Service and interest costs	9	8

Employee Savings Plan

Southern Company also sponsors a 401(k) defined contribution plan covering substantially all employees. The Company provides an 85 percent matching contribution up to 6 percent of an employee's base salary. Prior to November 2006, the Company matched employee contributions at a rate of 75 percent up to 6 percent of the employee's base salary. Total matching contributions made to the plan for 2006, 2005, and 2004 were \$62 million, \$58 million, and \$56 million, respectively.

NOTE THREE:

CONTINGENCIES AND REGULATORY MATTERS

General Litigation Matters

Southern Company is subject to certain claims and legal actions arising in the ordinary course of business. In addition, Southern Company's business activities are subject to extensive governmental regulation related to public health and the environment. Litigation over environmental issues and claims of various types, including property damage, personal injury, and citizen enforcement of environmental requirements 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) was an energy company with businesses that included 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 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 the \$39 million receivable, Southern Company has reserved approximately \$13.7 million. In December 2006, Southern Company received approximately \$23 million in tax refunds from the IRS related to Mirant tax items. Additional refunds are expected. The amount of any unsecured claim ultimately allowed with respect to Mirant tax items is expected to be reduced dollar-for-dollar by the amount of all refunds received from the IRS by Southern Company.

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. As part of a complaint filed against Southern Company in June 2005 and amended thereafter, 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. MC Asset Recovery, a special purpose subsidiary of Reorganized Mirant, has been substituted as plaintiff in the complaint. 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 final outcome of this matter cannot now be determined.

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MC Asset Recovery 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, February 2006, and May 2006. The third amended complaint (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 plaintiff asserts is valued at over \$200 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 breached its fiduciary duties to Mirant and its creditors, caused Mirant to breach its fiduciary duties to creditors, and aided and abetted breaches of fiduciary duties by Mirant's directors and officers. The complaint also seeks recoveries under the theories of restitution and unjust enrichment. The complaint seeks monetary damages in excess of \$2 billion plus interest, punitive damages, attorneys' fees, and costs. Finally, the complaint includes an objection to Southern Company's pending 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 complaint in June 2006.

On December 29, 2005, the Bankruptcy Court entered an order authorizing the transfer of this proceeding, along with certain other actions, to MC Asset Recovery, a special purpose subsidiary of Reorganized Mirant. Under that 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 certain unsecured creditors and the original equity holders. In January 2006, the U.S. District Court for the Northern District of Texas substituted MC Asset Recovery as plaintiff.

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. On May 19, 2006, Southern Company filed a motion for summary judgment seeking entry of judgment against the plaintiff as to all counts of the complaint. On December 11, 2006, the U.S. District Court for the Northern District of Georgia granted in part and denied in part the motion. As a result, certain breach of fiduciary duty claims are barred; all other claims in the complaint may proceed. 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 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. On March 24, 2006, the plaintiffs filed a motion for reconsideration requesting that the court vacate that portion of its July 14, 2003 order dismissing the plaintiffs' claims based upon Mirant's alleged improper energy trading and marketing activities involving the California energy market. Southern Company and the other defendants have opposed the plaintiffs' motion. The plaintiffs have also stated that they intend to request that the court grant leave for them to amend the complaint to add allegations based upon claims asserted against Southern Company in the MC Asset Recovery litigation.

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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. In April 2006, the U.S. District Court for the Northern District of Georgia granted summary judgment in favor of Southern Company and all other defendants in the case. The plaintiff filed an appeal of the ruling. On December 19, 2006, the parties executed a written settlement term sheet, to be followed by a formal settlement agreement. On the same day, the parties waived oral argument in the U.S. Court of Appeals for the Eleventh Circuit, where the case was pending, and moved to remand the matter to the district court. The motion was granted on December 20, 2006.

The settlement term sheet admits no liability and provides for a payment of \$15 million, to be made by the Company's insurance carrier, to the Plan, after deduction of any award for plaintiff's attorneys fees and certain other expenses if approved by the district court. Because the case is a putative class action, the settlement requires court approval. The district court will consider all matters related to the settlement. Pending the settlement approval, 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 filed a separate action in January 2001 against Alabama Power in the U.S. District Court for the Northern District of Alabama after Alabama Power was dismissed from the original action. In these lawsuits, the EPA alleged that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power and Georgia Power (including a facility formerly owned by 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 19, 2006, the U.S. District Court for the Northern District of Alabama entered a consent decree between Alabama Power and the EPA, resolving the alleged NSR violations at Plant Miller. The consent decree required Alabama Power to pay \$100,000 to resolve the government's claim for a civil penalty and to donate \$4.9 million of sulfur dioxide emission allowances to a nonprofit charitable organization and formalized specific emissions reductions to be accomplished by Alabama Power, consistent with other Clean Air Act programs that require emissions reductions. On August 14, 2006, the district court in Alabama granted Alabama Power's motion for summary judgment and entered final judgment in favor of Alabama Power on the EPA's claims related to Plants Barry, Gaston, Gorgas, and Greene County. The plaintiffs have appealed this decision to the U.S. Court of Appeals for the Eleventh Circuit, and on November 14, 2006, the Eleventh Circuit granted plaintiffs' request to stay the appeal, pending the U.S. Supreme Court's ruling in a similar NSR case filed by the EPA against Duke Energy. The action against Georgia Power 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 traditional 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

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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. Such expenditures 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 requested injunctive and declaratory relief, civil penalties, a supplemental environmental project, and attorneys' fees. In January 2007, following the March 2006 reversal and remand by the U.S. Court of Appeals for the Eleventh Circuit, the district court ruled for Georgia Power on all remaining allegations in this case. The only issue remaining for resolution by the district court is the appropriate remedy for two isolated, short-term, technical violations of the plant's Clean Air Act operating permit. The court has asked the parties to submit a joint proposed remedy or individual proposals in the event the parties cannot agree. Although the ultimate outcome of this matter cannot currently be determined, the resulting liability associated with the two events is not expected to have a material impact on the Company's financial statements.

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, 2006, 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, 2006 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 traditional operating companies and Southern Power has authorization from the FERC to sell power to non-affiliates, including short-term opportunity sales, at market-based prices. 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. Any new market-based rate sales by any subsidiary of Southern Company in Southern Company's retail service territory entered into during a 15-month refund period beginning February 27, 2005 could be subject to refund to the level of the default cost-based rates, pending the outcome of the proceeding. Such sales through May 27, 2006, the end of the refund period, were approximately \$19.7 million for the Southern Company system. In the event that the FERC's default mitigation measures for entities that are found to have market power are ultimately applied, the traditional 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 15-month refund period related to this expanded investigation. Any new market-based rate sales involving any Southern Company subsidiary could be subject to refund to the extent the FERC orders lower rates as a result of this new investigation. Such sales through October 19, 2006, the end of the refund period, were approximately \$55.4 million for the Southern Company system, of which \$15.5 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. On January 3, 2007, the FERC issued an order noting settlement of the IIC proceeding and seeking comment identifying any remaining issues and the proper procedure for addressing any such issues.

Southern Company and its subsidiaries believe that there is no meritorious basis for these proceedings 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 these proceedings, cannot now be determined.

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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.

On October 5, 2006, the FERC issued an order accepting a settlement resolving the proceeding subject to Southern Company's agreement to accept certain modifications to the settlement's terms. On October 20, 2006, Southern Company notified the FERC that it accepted the modifications. The modifications largely involve functional separation and information restrictions related to marketing activities conducted on behalf of Southern Power. Southern Company filed with the FERC on November 6, 2006 an implementation plan to comply with the modifications set forth in the order. The impact of the modifications is not expected to have a material impact on Southern Company's 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 new generating facilities interconnecting to a transmission system. Order 2003 was affirmed by the U.S. Court of Appeals for the District of Columbia Circuit on January 12, 2007. The cost impact resulting from Order 2003 will vary on a case-by-case basis for each new generator interconnecting to the transmission system.

On November 22, 2004, generator company subsidiaries of Tenaska, Inc. (Tenaska), as counterparties to three previously executed interconnection agreements with subsidiaries of Southern Company, filed complaints at the FERC requesting that the FERC modify the agreements and that those Southern Company subsidiaries refund a total of \$19 million previously paid for interconnection facilities, with interest. Southern Company has also received requests for similar modifications from other entities, though no other complaints are pending

with the FERC. On January 19, 2007, the FERC issued an order granting Tenaska's requested relief. Although the FERC's order requires the modification of Tenaska's interconnection agreements, the order reduces the amount of the refund that had been requested by Tenaska. As a result, Southern Company estimates indicate that no refund is due Tenaska. Southern Company has requested rehearing of the FERC's order. The final outcome of this matter cannot now be determined.

Right of Way Litigation

Southern Company and certain of its subsidiaries, including Georgia Power, Gulf Power, Mississippi Power, and Southern Telecom, 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 in December 2005. On October 26, 2006, the Florida First District Court of Appeal issued an order dismissing Gulf Power's December 2005 appeal on the basis that the trial court's order was a non-final order and therefore not subject to review on appeal at this time. The case is once again pending in the trial court for further proceedings. The final outcome of this matter cannot now be determined. In the event of an adverse verdict in this case, Gulf Power could appeal the issues of both liability and damages or other relief granted.

In January 2005, the Superior Court of Decatur County, Georgia granted partial summary judgment in another such lawsuit brought by

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landowners against Georgia Power based on the plaintiffs' declaratory judgment claim that the easements do not permit general telecommunications use. The court also dismissed Southern Telecom from this case. Georgia Power appealed this ruling to the Georgia Court of Appeals. The Georgia Court of Appeals reversed, in part, the trial 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 was denied. On October 10, 2006, the Superior Court of Decatur County, Georgia granted Georgia Power's motion for summary judgment. The period during which the plaintiff could have appealed has expired. This matter is now concluded.

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.

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 2003. 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 1997 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 now final.

In connection with its audits of tax years 2000–2001 and 2002–2003 the IRS also challenged Southern Company's deductions related to three other international lease (sale-in-lease-out, or SILO) transactions. In the third quarter 2006, Southern Company paid the full amount of the disputed tax and the applicable interest on the SILO issue for tax years 2000–2001 and filed a claim for refund which has now been denied by the IRS. The disputed tax amount is \$79 million and the related interest is approximately \$24 million for these tax years. This payment, and the subsequent IRS disallowance of the refund claim, closed the issue with the IRS and Southern Company plans to proceed with litigation. The IRS has also raised the SILO issues for tax years 2002 and 2003. The estimated amount of disputed tax and interest for these years is approximately \$83 million and \$15 million, respectively. The tax and interest for these tax years was paid to the IRS in the fourth quarter 2006. Southern Company has accounted for both payments in 2006 as deposits, as management believes no additional tax or interest liabilities have been incurred. For tax years 2000 through 2006, Southern Company has claimed \$284 million in tax benefits related to these SILO transactions challenged by the IRS. The ultimate outcome of this matter cannot now be determined. 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 are 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 remain unchanged when the projected return on common equity (ROE) ranges 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 made its initial submission of projected data for calendar year 2007 on December 1, 2006. The Rate RSE increase for 2007 is 4.76 percent, or \$193 million annually, and was effective in January 2007. The ratemaking procedures will remain in effect until the Alabama PSC votes to modify or discontinue them.

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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). An increase of 0.8 percent in retail rates, or \$25 million annually, was effective July 2004 under Rate CNP for new certificated power purchase agreements. In April 2005, an adjustment to Rate CNP decreased retail rates by approximately 0.5 percent, or \$19 million annually. The annual true-up adjustment effective in April 2006 increased retail rates by 0.5 percent, or \$19 million annually. The request filed in February 2007 did not require any adjustment beginning in April 2007.

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 1.0 percent in January 2005, 1.2 percent in January 2006, and 0.6 percent in January 2007.

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. In 2007, Georgia Power will refund 2005 retail earnings in excess of a 12.25 percent retail ROE. The refund amount is not expected to be material. No refund is anticipated for 2006. 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.

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

cent 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 ended December 31, 2004.

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

On June 15, 2006, the Georgia PSC ruled on the request and approved an increase in Georgia Power's total annual fuel billings of approximately \$400 million. The Georgia PSC order provided for a combined ongoing fuel forecast but reduced the requested increase related to such forecast by \$200 million. The order also required Georgia Power to file for a new fuel cost recovery rate on a semi-annual basis, beginning in September 2006. Accordingly, on September 15, 2006, Georgia Power filed a request to recover fuel costs incurred through August 2006 by increasing the fuel cost recovery rate.

On November 13, 2006, under an agreement with the Georgia PSC staff, Georgia Power filed a supplementary request reflecting a forecast of annual fuel costs, as well as updated information for previously incurred fuel costs. On February 6, 2007, the Georgia PSC ruled on the request and approved an increase in Georgia Power's total annual billings of approximately \$383 million. The Georgia PSC order reduced Georgia Power's requested increase in the forecast of annual fuel costs by \$40 million and disallowed \$4 million of previously incurred fuel costs. The order also requires Georgia Power to file for a new fuel cost recovery rate no later than March 1, 2008. The new rates will become effective on March 1, 2007. Estimated under recovered fuel costs are to be recovered through May 2009 for customers in the former Georgia Power territory

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and through November 2009 for customers in the former Savannah Electric territory. As of December 31, 2006, Georgia Power had an under recovered fuel balance of approximately \$898 million.

Storm Damage Cost Recovery

Each traditional 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 traditional 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, 2006, the under recovered balance in Southern Company's storm damage reserve accounts totaled approximately \$89 million, of which approximately \$57 million and \$32 million, respectively, is included in the balance sheets herein under "Other Current Assets" and "Other Regulatory Assets." Approximately \$63 million of the under recovered 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.

In June 2006, the Mississippi PSC issued an order based upon a stipulation between Mississippi Power and the Mississippi Public Utilities Staff. The stipulation and the associated order certified actual storm restoration costs relating to Hurricane Katrina through April 30, 2006 of \$267.9 million and affirmed estimated additional costs through December 31, 2007 of \$34.5 million, for total storm restoration costs of \$302.4 million which was net of insurance proceeds of approximately \$77 million, without offset for the property damage reserve of \$3.0 million. Of the total amount, \$292.8 million applies to Mississippi Power's retail jurisdiction. The order directed Mississippi Power to file an application with the Mississippi Development Authority (MDA) for a Community Development Block Grant (CDBG). Mississippi Power filed the CDBG application with the MDA in September 2006. On October 30, 2006, Mississippi Power received from the MDA a CDBG in the amount of \$276.4 million. Mississippi Power has appropriately allocated and applied these CDBG proceeds to both retail and wholesale storm restoration cost recovery.

Mississippi Power filed an application for a financing order with the Mississippi PSC on July 3, 2006 for restoration costs under the state bond program. On October 27, 2006, the Mississippi PSC issued a financing order that authorizes the issuance of \$121.2 million of system restoration bonds. This amount includes \$25.2 million for the retail storm recovery costs not covered by the CDBG, \$60 million for a property damage reserve, and \$36 million for the retail portion of the construction of the storm operations facility. The bonds will be

issued by the Mississippi Development Bank on behalf of the State of Mississippi and will be reported as liabilities by the State of Mississippi. Periodic true-up mechanisms will be structured to comply with terms and requirements of the legislation. Details regarding the issuance of the bonds have not been finalized. The final outcome of this matter cannot now be determined.

As of December 31, 2006, Mississippi Power's under recovered balance in the property damage reserve account totaled approximately \$4.7 million which is included in the balance sheets herein under "Current Assets."

In July 2006, the Florida PSC issued its order approving a stipulation and settlement between Gulf Power and several consumer groups that resolved all matters relating to Gulf Power's request for recovery of incurred costs for storm-recovery activities and the replenishment of Gulf Power's property damage reserve. The order provides for an extension of the storm-recovery surcharge currently being collected by Gulf Power for an additional 27 months, expiring in June 2009. According to the stipulation, the funds resulting from the extension of the current surcharge will first be credited to the unrecovered balance of storm-recovery costs associated with Hurricane Ivan until these costs have been fully recovered. The funds will then be credited to the property reserve for recovery of the storm-recovery costs of \$52.6 million associated with Hurricanes Dennis and Katrina that were previously charged to the reserve. Should revenues collected by Gulf Power through the extension of the storm-recovery surcharge exceed the storm-recovery costs associated with Hurricanes Dennis and Katrina, the excess revenues will be credited to the reserve. The annual accrual to the reserve of \$3.5 million and Gulf Power's limited discretionary authority to make additional accruals to the reserve will continue as previously approved by the Florida PSC. Gulf Power made discretionary accruals to the reserve of \$3 million, \$6 million, and \$15 million in 2006, 2005, and 2004, respectively. As part of the March 2005 agreement regarding Hurricane Ivan costs that established the existing surcharge, Gulf Power agreed that it would not seek any additional increase in its base rates and charges to become effective on or before March 1, 2007. The terms of the stipulation do not alter or affect that portion of the prior agreement. According to the order, in the case of future storms, if Gulf Power incurs cumulative costs for storm-recovery activities in excess of \$10 million during any calendar year, Gulf Power will be permitted to file a streamlined formal request for an interim surcharge. Any interim surcharge would provide for the recovery, subject to refund, of up to 80 percent of the claimed costs for storm-recovery activities. Gulf Power would then petition the Florida PSC for full recovery through an additional surcharge or other cost recovery mechanism.

As of December 31, 2006, Gulf Power's unrecovered balance in the property damage reserve totaled approximately \$45.7 million, of which approximately \$28.8 million and \$16.9 million, respectively, are included in the balance sheets herein under "Current Assets" and "Deferred Charges and Other Assets."

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At Alabama Power, operation and maintenance expenses associated with Hurricane Ivan were \$57.8 million. In 2005, Alabama Power received Alabama PSC approvals to 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 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.

As of December 31, 2006, Alabama Power had recovered \$49.5 million of the costs allowed for storm-recovery activities, of which \$34.5 million was a reduction in the deficit balance in the property damage reserve account related to costs deferred from previous storms. The remaining under recovered balance in the property damage reserve account totaled approximately \$16.8 million at December 31, 2006 and is included in the balance sheets herein under "Current Assets." The remaining \$15.0 million of the recovered amount was used to establish the target reserve for future storms. The balance in the target reserve for future storms was \$13.2 million at December 31, 2006, and is included in the balance sheets herein under "Other Regulatory Liabilities."

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. The gross proceeds from the sale were approximately \$126 million. This sale had no material impact on Southern Company's net income. As a result of the sale, Southern Company's financial statements and related information reflect Southern Company Gas as discontinued operations for all periods presented.

NOTE FOUR:

JOINT OWNERSHIP AGREEMENTS

Alabama Power owns an undivided interest in units 1 and 2 of Plant Miller and related facilities jointly with Alabama Electric Cooperative, Inc. Georgia Power owns undivided interests in Plants Vogtle, Hatch, Scherer, and Wansley in varying amounts jointly with Oglethorpe Power Corporation (OPC), the Municipal Electric Authority of Georgia, the city of Dalton, Georgia, Florida Power & Light Company, and Jacksonville Electric Authority. In addition, Georgia Power has joint ownership agreements with OPC for the Rocky Mountain facilities and with Florida Power Corporation for a combustion turbine unit at Intercession City, Florida. Southern Power owns an undivided interest in Plant Stanton Unit A and related facilities jointly with the Orlando Utilities Commission, Kissimmee Utility Authority, and Florida Municipal Power Agency.

At December 31, 2006, 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:

	PERCENT OWNERSHIP	(in millions)	
		AMOUNT OF INVESTMENT	ACCUMULATED DEPRECIATION
Plant Vogtle (nuclear)	45.7%	\$3,289	\$1,857
Plant Hatch (nuclear)	50.1	925	502
Plant Miller (coal)			
Units 1 and 2	91.8	958	396
Plant Scherer (coal)			
Units 1 and 2	8.4	116	60
Plant Wansley (coal)	53.5	396	179
Rocky Mountain (pumped storage)	25.4	170	95
Intercession City (combustion turbine)	33.3	12	2
Plant Stanton (combined cycle)			
Unit A	65.0	155	13

At December 31, 2006, the portion of total construction work in progress related to Plants Miller, Scherer, and Wansley was \$14.9 million, \$1.7 million, and \$53.1 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.

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NOTE FIVE: 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. Based on management's assessment of the collectibility of this \$39 million receivable, Southern Company has reserved approximately \$13.7 million. In December 2006, Southern Company received approximately \$23 million in tax refunds from the IRS related to Mirant tax items. For additional information, see Note 3 under "Mirant Matters—Mirant Bankruptcy."

At December 31, 2006, the tax-related regulatory assets and liabilities were \$896 million and \$293 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)	2006	2005	2004
Total provision for income taxes:			
Federal—			
Current	\$466	\$ 61	\$ 14
Deferred	207	419	482
	673	480	496
State—			
Current	110	35	15
Deferred	(2)	80	76
	108	115	91
Total	\$781	\$ 595	\$587

Net cash payments for income taxes in 2006, 2005, and 2004 were \$649 million, \$100 million, and \$78 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)	2006	2005
Deferred tax liabilities:		
Accelerated depreciation	\$4,675	\$4,613
Property basis differences	962	994
Leveraged lease basis differences	625	519
Employee benefit obligations	530	333
Under recovered fuel clause	543	528
Premium on reacquired debt	120	126
Regulatory assets associated with employee benefit obligations	362	—
Regulatory assets associated with asset retirement obligations	453	444
Storm reserve	33	68
Other	126	156
Total	8,429	7,781
Deferred tax assets:		
Federal effect of state deferred taxes	267	263
State effect of federal deferred taxes	63	88
Employee benefit obligations	615	210
Other property basis differences	156	148
Deferred costs	131	126
Unbilled revenue	76	58
Other comprehensive losses	60	96
Alternative minimum tax carryforward	—	202
Regulatory liabilities associated with employee benefit obligations	196	—
Asset retirement obligations	453	444
Other	272	247
Total	2,289	1,882
Total deferred tax liabilities, net	6,140	5,899
Portion included in prepaid expenses (accrued income taxes), net	(175)	(180)
Deferred state tax assets	24	17
Accumulated deferred income taxes in the balance sheets	\$5,989	\$5,736

The alternative minimum tax credits do not expire.

At December 31, 2006, 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 2007 and 2021. During 2006, Southern Company utilized \$10 million in available net operating losses, which resulted in a \$0.6 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.

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In September 2006, Georgia Power filed its 2005 income tax returns, which included certain state income tax credits that resulted in a lower effective income tax rate for the year ended December 31, 2006 when compared to 2005. Georgia Power has also filed similar claims for the years 2001 through 2004. Amounts recorded in Southern Company's financial statements for the year ended December 31, 2006 related to these claims are not material. The Georgia Department of Revenue is currently reviewing these claims. If approved as filed, such claims could have a significant, and possibly material, effect on Southern Company's net income. The ultimate outcome of this matter cannot now be determined.

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 \$23 million in 2006, \$25 million in 2005, and \$27 million in 2004. At December 31, 2006, 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:

	2006	2005	2004
Federal statutory rate	35.0%	35.0%	35.0%
State income tax, net of federal deduction	2.9	3.4	2.8
Synthetic fuel tax credits	(2.7)	(8.0)	(8.5)
Employee stock plans dividend deduction	(1.4)	(1.5)	(1.5)
Non-deductible book depreciation	1.0	1.1	1.1
Difference in prior years' deferred and current tax rate	(0.3)	(1.8)	(0.7)
Other	(1.8)	(1.4)	(0.9)
Effective income tax rate	32.7%	26.8%	27.3%

NOTE SIX: FINANCING

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

Southern Company and the traditional 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 or the applicable traditional operating company through the issuance of junior subordinated notes totaling \$1.6 billion, which constitute substantially all of the 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 traditional 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, 2006, preferred securities of \$1.5 billion were outstanding. Southern Company guarantees \$206 million of notes related to these securities issued on its behalf. 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)	2006	2005
Capitalized leases	\$ 13	\$ 13
First mortgage bonds	-	45
Pollution control bonds	-	12
Senior notes	1,369	697
Long-term debt payable to affiliated trusts	-	72
Other long-term debt	36	47
Preferred stock	-	15
Total	\$1,418	\$901

Debt and preferred stock redemptions, and/or serial maturities through 2011 applicable to total long-term debt are as follows: \$1.4 billion in 2007; \$499 million in 2008; \$604 million in 2009; \$286 million in 2010, and \$329 million in 2011. On February 1, 2007, \$400 million of the 2007 long-term debt principal amount matured. The maturity was funded with short-term borrowings.

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. At January 1, 2006, Alabama Power and Gulf Power had mortgages that secured first mortgage bonds they had issued and constituted a direct first lien on substantially all of their respective fixed property and franchises. Alabama Power discharged its remaining outstanding first mortgage bond obligations and the first mortgage lien was removed in May 2006. Following the maturity of Gulf Power's remaining outstanding first mortgage bonds in November 2006, the first mortgage lien was removed on January 26, 2007. The Mississippi Power and Georgia Power first mortgage liens were removed in 2005 and 2002, respectively. Alabama Power and Gulf Power have granted one or more liens on certain of their respective property in connection with the issuance of certain pollution control bonds with an outstanding principal amount of \$194 million. 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.

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Bank Credit Arrangements

At the beginning of 2007, unused credit arrangements with banks totaled \$3.35 billion, of which \$656 million expires during 2007 and \$2.7 billion expires in 2008 and beyond. Of the \$2.7 billion expiring in 2008 and beyond, \$2.4 billion does not expire until 2011. The following table outlines the credit arrangements by company:

(in millions)	TOTAL	UNUSED	EXPIRES	
			2007	2008 & BEYOND
COMPANY:				
Alabama Power	\$ 965	\$ 965	\$365	\$ 600
Georgia Power	910	904	40	870
Gulf Power	120	120	120	–
Mississippi Power	181	181	101	80
Southern Company	750	750	–	750
Southern Power	400	400	–	400
Other	30	30	30	–
Total	\$3,356	\$3,350	\$656	\$2,700

Approximately \$79 million of the credit facilities expiring in 2007 allow the execution of term loans for an additional two-year period, and \$343 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 traditional operating companies, and Southern Power. Compensating balances are not legally restricted from withdrawal.

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, 2006, Southern Company, Southern Power, and the traditional 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. In the event of a material adverse change, as defined in Gulf Power's credit agreements, Gulf Power would be prohibited from borrowing against unused credit arrangements totaling \$10 million.

A portion of the \$3.35 billion unused credit with banks is allocated to provide liquidity support to the traditional operating companies' variable rate pollution control bonds. The amount of variable rate pollution control bonds requiring liquidity support as of December 31, 2006 was \$719 million.

Southern Company, the traditional 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 traditional 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, 2006 and December 31, 2005 was \$1.8 billion and \$944 million, respectively. In addition, the Company and the traditional operating companies had \$30 million of extendible commercial notes and \$140 million of short-term bank loans outstanding at December 31, 2006.

During 2006, the peak amount outstanding for short-term debt was \$2.1 billion, and the average amount outstanding was \$1.6 billion. The average annual interest rate on short-term debt was 5.2 percent for 2006 and 3.5 percent for 2005.

Financial Instruments

The traditional 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 traditional 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 generally shift substantially all fuel cost responsibility to the purchaser. Each of the traditional operating companies has implemented fuel-hedging programs at the instruction of their respective state PSCs. Together with Southern Power, the traditional operating companies may enter into hedges of forward electricity sales.

At December 31, 2006, the fair value gains/(losses) of energy-related derivative contracts was reflected in the financial statements as follows:

(in millions)	AMOUNT
Regulatory assets, net	\$(85)
Accumulated other comprehensive income	3
Net income	–
Total fair value	\$(82)

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 other hedges qualifying as cash flow hedges, including those of Southern Power, the fair value gains or losses are recorded in other comprehensive income and are reclassified into earnings at the same time the hedged items affect earnings. For 2006, 2005, and 2004, the pre-tax gains (losses) reclassified from other comprehensive income from continuing operations to fuel expense or revenues was not material. For the year 2007, approximately \$3 million of gains are expected to be reclassified from other comprehensive income to revenues. There

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was no significant ineffectiveness recorded in earnings for any period presented. Southern Company has energy-related hedges in place up to and including 2009.

During 2006, Southern Company entered into derivative transactions with net initial premiums paid of \$20 million to reduce its exposure to a potential phase-out of certain income tax credits in 2006 and 2007. In accordance with Section 45K of the Internal Revenue Code, these tax credits are subject to limitation as the annual average price of oil increases. At December 31, 2006, the fair value of the derivatives was a \$12 million net liability. For 2006 and 2005, the fair value loss recognized in other income (expense) to mark the transactions to market was \$32 million and \$7 million, respectively.

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. The derivatives employed as hedging instruments are structured to minimize ineffectiveness. As such, no material ineffectiveness has been recorded in earnings.

At December 31, 2006, Southern Company had \$2.4 billion notional amount of interest rate swaps and options outstanding with net fair value losses of \$2 million as follows:

Fair Value Hedges

(in millions)	HEDGE MATURITY	VARIABLE RATE PAID	NOTIONAL AMOUNT	FAIR VALUE (LOSS)
COMPANY:				
Southern Company	2007	6-month LIBOR-0.10%*	\$400	\$(0.1)

Cash Flow Hedges

(in millions)	HEDGE MATURITY	WEIGHTED AVERAGE FIXED RATE PAID	NOTIONAL AMOUNT	FAIR VALUE GAIN/(LOSS)
COMPANY:				
Alabama Power	2007	2.01%**	\$536	\$0.8
	2017	6.15%***	100	(1.9)
Georgia Power	2017	6.15%***	100	(1.9)
	2007	3.85%***	400	0.1
	2037	5.75%***	300	1.4
	2017	5.29%	225	(2.0)
	2007	2.68%	300	1.4
	2007	2.50%**	14	0.2

* London Interbank Offer Rate (LIBOR).

** Hedged using the Bond Market Association Municipal Swap Index.

*** Interest rate collar (showing only the rate cap percentage).

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 2006, 2005, and 2004, the Company incurred net losses of \$1 million, \$19 million, and \$7 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 2006, 2005, and 2004, approximately \$1 million, \$10 million, and \$23 million, respectively, of pre-tax losses were reclassified from other comprehensive income to interest expense. For 2007, pre-tax losses of approximately \$15 million are expected to be reclassified from other comprehensive income to interest expense.

NOTE SEVEN:

COMMITMENTS

Construction Program

Southern Company is engaged in continuous construction programs, currently estimated to total \$3.9 billion in 2007, \$4.5 billion in 2008, and \$4.8 billion in 2009. These amounts include \$120 million, \$109 million, and \$122 million in 2007, 2008, and 2009, 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, 2006, significant purchase commitments were outstanding in connection with the ongoing construction program, which includes new facilities and capital improvements to transmission, distribution, and generation facilities, including those to meet environmental standards.

Long-Term Service Agreements

The traditional operating companies and Southern Power have entered into 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, with the exception of newly acquired Plants DeSoto and Rowan. 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.

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.

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Scheduled payments to GE are made at various intervals based on actual operating hours of the respective units. Total remaining payments to GE under these agreements for facilities owned are currently estimated at \$1.6 billion over the remaining life of the agreements, which are currently estimated to 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 neutron monitoring system parts and electronics at Plant Hatch. Total remaining payments to GE under this agreement are currently estimated at \$12.2 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 fixed 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, 2006. Also, Southern Company has entered into various long-term commitments for the purchase of electricity. Total estimated minimum long-term obligations at December 31, 2006 were as follows:

(in millions)	COMMITMENTS			
	NATURAL GAS	COAL	NUCLEAR FUEL	PURCHASED POWER
2007	\$ 1,347	\$ 3,294	\$ 120	\$ 173
2008	1,174	2,609	109	175
2009	728	1,720	122	199
2010	454	1,024	160	185
2011	355	620	145	166
2012 and thereafter	2,740	2,221	236	890
Total	\$ 6,798	\$ 11,488	\$ 892	\$ 1,788

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. 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 \$9 million for the fair market value of this residual value guarantee is included in the balance sheet as of December 31, 2006.

Southern Company also has other operating lease agreements with various terms and expiration dates. Total operating lease expenses were \$161 million, \$150 million, and \$156 million for 2006, 2005, and 2004, 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, 2006, estimated minimum lease payments for noncancelable operating leases were as follows:

(in millions)	MINIMUM LEASE PAYMENTS			
	PLANT DANIEL	BARGES & RAIL CARS	OTHER	TOTAL
2007	\$ 29	\$ 53	\$ 53	\$ 135
2008	29	48	43	120
2009	29	39	36	104
2010	28	30	29	87
2011	28	22	23	73
2012 and thereafter	—	62	124	186
Total	\$ 143	\$ 254	\$ 308	\$ 705

For the traditional operating companies, the barge and 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 2009, 2010, and 2011, and the maximum obligations are \$20 million, \$62 million, and

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\$64 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, 2006 is less than \$20 million, all of which will expire by 2009.

As discussed earlier in this Note under "Operating Leases," Alabama Power, Georgia Power, and Mississippi Power have entered into certain residual value guarantees.

NOTE EIGHT:

COMMON STOCK

Stock Issued

In 2006, Southern Company raised \$1 million (53,000 shares) from the issuance of new common shares and \$136 million (5 million shares) from the issuance of treasury stock under the Company's various stock programs. In 2005, the Company raised \$213 million (10 million shares) from the issuance of new common shares under the Company's various stock programs.

Stock Repurchased

In early January 2006, Southern Company discontinued the common stock repurchase program begun in 2005 which was designed primarily to offset the shares of common stock issued under the Company's various stock programs. In January 2006, prior to the discontinuance of the program, Southern Company repurchased approximately 3,000 shares of common stock at a total cost of \$0.1 million. During 2005, Southern Company repurchased 10 million shares of common stock at a total cost of \$352 million.

Shares Reserved

At December 31, 2006, a total of 88.9 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, 2006, 6,509 current and former employees participated in the stock option plan. The maximum number of shares of common stock that may be issued under these programs may not exceed 57 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. Southern Company generally recognizes stock option expense on a straight-line basis over the vesting period which equates to the requisite service period; however, for employees who are eligible for retirement the total cost is expensed at the grant date. 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. For certain stock option awards, a change in control will provide accelerated vesting. As part of the adoption of SFAS No. 123(R), as discussed in Note 1 under "Stock Options," Southern Company has not modified its stock option plan or outstanding stock options, nor has it changed the underlying valuation assumptions used in valuing the stock options that were used under SFAS No. 123.

Southern Company's activity in the stock option plan for 2006 is summarized below:

	SHARES SUBJECT TO OPTION	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at Dec. 31, 2005	31,347,355	\$27.13
Granted	6,656,788	33.81
Exercised	(3,239,698)	23.97
Cancelled	(155,202)	31.22
Outstanding at Dec. 31, 2006	34,609,243	\$28.69
Exercisable at Dec. 31, 2006	22,045,449	\$26.37

The number of stock options vested, and expected to vest in the future, as of December 31, 2006 is not significantly different from the number of stock options outstanding at December 31, 2006 as stated above.

As of December 31, 2006, the weighted average remaining contractual term for the options outstanding and options exercisable is 6.4 years and 5.2 years, respectively, and the aggregate intrinsic value for the options outstanding and options exercisable is \$283 million and \$231 million, respectively.

As of December 31, 2006, there was \$10 million of total unrecognized compensation cost related to stock option awards not yet vested. That cost is expected to be recognized over a weighted-average period of approximately 11 months.

The total intrinsic value of options exercised during the years ended December 31, 2006, 2005, and 2004 was \$36 million, \$130 million, and \$81 million, respectively.

The actual tax benefit realized by the Company for the tax deductions from stock option exercises totaled \$14 million, \$50 million, and \$31 million, respectively, for the years ended December 31, 2006, 2005, and 2004.

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Southern Company has a policy of issuing shares to satisfy share option exercises. In January 2006, the Company started reissuing treasury shares that it had previously repurchased. The repurchase program ended in January 2006. Cash received from issuances related to option exercises under the share-based payment arrangements for the years ended December 31, 2006, 2005, and 2004 was \$77 million, \$213 million, and \$119 million, respectively.

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		
	2006	2005	2004
As reported shares	743,146	743,927	738,879
Effect of options	4,739	4,600	4,197
Diluted shares	747,885	748,527	743,076

Common Stock Dividend Restrictions

The income of Southern Company is derived primarily from equity in earnings of its subsidiaries. At December 31, 2006, consolidated retained earnings included \$4.8 billion of undistributed retained earnings of the subsidiaries. Southern Power's credit facility contains potential limitations on the payment of common stock dividends; as of December 31, 2006, Southern Power was in compliance with all such requirements.

NOTE NINE:

NUCLEAR INSURANCE

Under the Price-Anderson Amendments 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 \$38 million and \$49 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

SOUTHERN COMPANY AND SUBSIDIARY COMPANIES 2006 ANNUAL REPORT

NOTE TEN:

SEGMENT AND RELATED INFORMATION

Southern Company's reportable business segment is the sale of electricity in the Southeast by the traditional 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 traditional operating companies were \$492 million, \$557 million, and \$425 million in 2006, 2005, and 2004, 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						
	TRADITIONAL OPERATING COMPANIES	SOUTHERN POWER	ELIMINATIONS	TOTAL	ALL OTHER	ELIMINATIONS	CONSOLIDATED
2006							
Operating revenues	\$13,920	\$ 777	\$ (609)	\$ 14,088	\$ 413	\$(145)	\$ 14,356
Depreciation and amortization	1,098	66	-	1,164	37	(1)	1,200
Interest income	33	2	-	35	7	(1)	41
Interest expense	637	80	-	717	149	-	866
Income taxes	867	82	-	949	(168)	-	781
Segment net income (loss)	1,462	124	-	1,586	(11)	(2)	1,573
Total assets	38,825	2,691	(110)	41,406	1,933	(481)	42,858
Gross property additions	2,561	501	(16)	3,046	26	-	3,072

(in millions)	ELECTRIC UTILITIES						
	TRADITIONAL OPERATING COMPANIES	SOUTHERN POWER	ELIMINATIONS	TOTAL	ALL OTHER	ELIMINATIONS	CONSOLIDATED
2005							
Operating revenues	\$13,157	\$ 781	\$(660)	\$ 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						
	TRADITIONAL 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

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Products and Services

(in millions)	ELECTRIC UTILITIES REVENUES			
	RETAIL	WHOLESALE	OTHER	TOTAL
2006	\$11,801	\$1,822	\$465	\$14,088
2005	11,165	1,667	446	13,278
2004	9,732	1,341	392	11,465

NOTE ELEVEN:

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial data for 2006 and 2005—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	TRADING PRICE RANGE	
						HIGH	LOW
QUARTER ENDED							
March 2006	\$3,063	\$ 590	\$262	\$0.35	\$0.3725	\$35.89	\$32.34
June 2006	3,592	807	385	0.52	0.3875	33.25	30.48
September 2006	4,549	1,358	738	0.99	0.3875	35.00	32.01
December 2006	3,152	469	188	0.25	0.3875	37.40	34.49
March 2005	\$2,787	\$ 560	\$323	\$0.43	\$0.3575	\$34.34	\$31.14
June 2005	3,120	721	387	0.52	0.3725	35.00	31.60
September 2005	4,358	1,277	722	0.97	0.3725	36.47	33.24
December 2005	3,289	404	159	0.21	0.3725	36.33	32.76

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

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

FOR THE PERIODS ENDED DECEMBER 2002 THROUGH 2006

	2006	2005	2004	2003	2002
Operating Revenues (in millions)	\$ 14,356	\$ 13,554	\$ 11,729	\$ 11,018	\$ 10,447
Total Assets (in millions)	\$ 42,858	\$ 39,877	\$ 36,955	\$ 35,175	\$ 33,721
Gross Property Additions (in millions)	\$ 3,072	\$ 2,476	\$ 2,099	\$ 2,014	\$ 2,728
Return on Average Common Equity (percent)	14.26	15.17	15.38	16.05	15.79
Cash Dividends Paid Per Share of Common Stock	\$ 1.535	\$ 1.475	\$ 1.415	\$ 1.385	\$ 1.355
Consolidated Net Income (in millions):					
Continuing Operations	\$ 1,574	\$ 1,591	\$ 1,529	\$ 1,483	\$ 1,315
Discontinued Operations	(1)	-	3	(9)	3
Total	\$ 1,573	\$ 1,591	\$ 1,532	\$ 1,474	\$ 1,318
Earnings Per Share From Continuing Operations—					
Basic	\$ 2.12	\$ 2.14	\$ 2.07	\$ 2.04	\$ 1.86
Diluted	2.10	2.13	2.06	2.03	1.85
Earnings Per Share Including Discontinued Operations—					
Basic	\$ 2.12	\$ 2.14	\$ 2.07	\$ 2.03	\$ 1.86
Diluted	2.10	2.13	2.06	2.02	1.85
Capitalization (in millions):					
Common stock equity	\$ 11,371	\$ 10,689	\$ 10,278	\$ 9,648	\$ 8,710
Preferred and preference stock	744	596	561	423	298
Mandatorily redeemable preferred securities	-	-	-	1,900	2,380
Long-term debt payable to affiliated trusts	1,561	1,888	1,961	-	-
Long-term debt	10,942	10,958	10,488	10,164	8,714
Total (excluding amounts due within one year)	\$ 24,618	\$ 24,131	\$ 23,288	\$ 22,135	\$ 20,102
Capitalization Ratios (percent):					
Common stock equity	46.2	44.3	44.1	43.6	43.3
Preferred and preference stock	3.0	2.5	2.4	1.9	1.5
Mandatorily redeemable preferred securities	-	-	-	8.6	11.8
Long-term debt payable to affiliated trusts	6.3	7.8	8.4	-	-
Long-term debt	44.5	45.4	45.1	45.9	43.4
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	\$ 15.24	\$ 14.42	\$ 13.86	\$ 13.13	\$ 12.16
Market price per share:					
High	37.40	36.47	33.96	32.00	31.14
Low	30.48	31.14	27.44	27.00	23.22
Close (year-end)	36.86	34.53	33.52	30.25	28.39
Market-to-book ratio (year-end) (percent)	241.9	239.5	241.8	230.4	233.5
Price-earnings ratio (year-end) (times)	17.4	16.1	16.2	14.8	15.3
Dividends paid (in millions)	\$ 1,140	\$ 1,098	\$ 1,044	\$ 1,004	\$ 958
Dividend yield (year-end) (percent)	4.2	4.3	4.2	4.6	4.8
Dividend payout ratio (percent)	72.4	69.0	68.3	67.7	72.8
Shares outstanding (in thousands):					
Average	743,146	743,927	738,879	726,702	708,161
Year-end	746,270	741,448	741,495	734,829	716,402
Stockholders of record (year-end)	110,259	118,285	125,975	134,068	141,784
Traditional Operating Company Customers (year-end) (in thousands):					
Residential	3,706	3,642	3,600	3,552	3,496
Commercial	596	586	578	564	553
Industrial	15	15	14	14	14
Other	5	5	5	6	5
Total	4,322	4,248	4,197	4,136	4,068
Employees (year-end)	26,091	25,554	25,642	25,762	26,178

SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

FOR THE PERIODS ENDED DECEMBER 2002 THROUGH 2006

	2006	2005	2004	2003	2002
Operating Revenues (in millions):					
Residential	\$ 4,716	\$ 4,376	\$ 3,848	\$ 3,565	\$ 3,556
Commercial	4,117	3,904	3,346	3,075	3,007
Industrial	2,866	2,785	2,446	2,146	2,078
Other	102	100	92	89	87
Total retail	11,801	11,165	9,732	8,875	8,728
Sales for resale	1,822	1,667	1,341	1,358	1,168
Total revenues from sales of electricity	13,623	12,832	11,073	10,233	9,896
Other revenues	733	722	656	785	551
Total	\$ 14,356	\$ 13,554	\$ 11,729	\$ 11,018	\$ 10,447
Kilowatt-Hour Sales (in millions):					
Residential	52,383	51,082	49,702	47,833	48,784
Commercial	52,987	51,857	50,037	48,372	48,250
Industrial	55,044	55,141	56,399	54,415	53,851
Other	920	996	1,005	998	1,000
Total retail	161,334	159,076	157,143	151,618	151,885
Sales for resale	40,089	37,801	35,239	40,520	32,551
Total	201,423	196,877	192,382	192,138	184,436
Average Revenue Per Kilowatt-Hour (cents):					
Residential	9.00	8.57	7.74	7.45	7.29
Commercial	7.77	7.53	6.69	6.36	6.23
Industrial	5.21	5.05	4.34	3.94	3.86
Total retail	7.31	7.02	6.19	5.85	5.75
Sales for resale	4.54	4.41	3.81	3.35	3.59
Total sales	6.76	6.52	5.76	5.33	5.37
Average Annual Kilowatt-Hour Use Per Residential Customer	14,235	14,084	13,879	13,562	14,036
Average Annual Revenue Per Residential Customer	\$ 1,282	\$ 1,207	\$ 1,074	\$ 1,011	\$ 1,023
Plant Nameplate Capacity Ratings (year-end) (megawatts)	41,785	40,509	38,622	38,679	36,353
Maximum Peak-Hour Demand (megawatts):					
Winter	30,958	30,384	28,467	31,318	25,939
Summer	35,890	35,050	34,414	32,949	32,355
System Reserve Margin (at peak) (percent)	17.1	14.4	20.2	21.4	13.3
Annual Load Factor (percent)	60.8	60.2	61.4	62.0	51.1
Plant Availability (percent):					
Fossil-steam	89.3	89.0	88.5	87.7	84.8
Nuclear	91.5	90.5	92.8	94.4	90.3
Source of Energy Supply (percent):					
Coal	66.7	67.1	64.6	66.4	65.7
Nuclear	13.9	14.0	14.4	14.8	14.7
Hydro	1.9	3.1	2.9	3.8	2.6
Oil and gas	12.7	10.7	10.9	8.8	11.4
Purchased power	4.8	5.1	7.2	6.2	5.6
Total	100.0	100.0	100.0	100.0	100.0