CONMED CORP
Form 10-K
February 27, 2017

United States
Securities and Exchange Commission
Washington, D.C.
20549

Form 10-K
Annual Report Pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2016	Commission file number 0-16093

CONMED CORPORATION
(Exact name of registrant as specified in its charter)

New York (State or other jurisdiction of incorporation or organization)	16-0977505 (I.R.S. Employer Identification No.)
525 French Road, Utica, New York (Address of principal executive offices)	13502 (Zip Code)

(315) 797-8375
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.01 par value per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act).
Yes ý No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§232.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer ý Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

As of June 30, 2016, the last business day of the registrant’s most recently completed second fiscal quarter, the aggregate market value of the shares of voting common stock held by non-affiliates of the registrant was approximately $1,327,544,000 based upon the closing price of the Company’s common stock on the NASDAQ Stock Market.

The number of shares of the registrant's $0.01 par value common stock outstanding as of February 21, 2017 was 27,836,532.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Definitive Proxy Statement and any other informational filings for the 2017 Annual Meeting of Shareholders are incorporated by reference into Part III of this report.

CONMED CORPORATION
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CONMED CORPORATION

Item 1. Business

Forward Looking Statements

This Annual Report on Form 10-K for the Fiscal Year Ended December 31, 2016 ("Form 10-K") contains certain forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995) and information relating to CONMED Corporation ("CONMED", the "Company", "we" or "us" — references to "CONMED", the "Company", "we" or "us" shall be deemed to include our direct and indirect subsidiaries unless the context otherwise requires) which are based on the beliefs of our management, as well as assumptions made by and information currently available to our management.

When used in this Form 10-K, the words "estimate", "project", "believe", "anticipate", "intend", "expect" and similar expressi are intended to identify forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors, including those identified under the caption "Item 1A-Risk Factors" and elsewhere in this Form 10-K which may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following:

- general economic and business conditions;
- changes in foreign exchange and interest rates;
- cyclical customer purchasing patterns due to budgetary and other constraints;
- changes in customer preferences;
- competition;
- changes in technology;
- the introduction and acceptance of new products;
- the ability to evaluate, finance and integrate acquired businesses, products and companies;
- changes in business strategy;
- the availability and cost of materials;
- the possibility that United States or foreign regulatory and/or administrative agencies may initiate enforcement actions against us or our distributors;
- future levels of indebtedness and capital spending;
- quality of our management and business abilities and the judgment of our personnel;
- the availability, terms and deployment of capital;
- the risk of litigation, especially patent litigation as well as the cost associated with patent and other litigation;
- the risk of a lack of allograft tissues due to reduced donations of such tissues or due to tissues not meeting the appropriate high standards for screening and/or processing of such tissues;
- compliance with and changes in regulatory requirements; and
- various other factors referenced in this Form 10-K.

See "Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations", "Item 1-Business" and "Item 1A-Risk Factors" for a further discussion of these factors. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this Form 10-K or to reflect the occurrence of unanticipated events.

General

CONMED Corporation was incorporated under the laws of the State of New York in 1970. CONMED is a medical technology company that provides surgical devices and equipment for minimally invasive procedures. The Company's products are used by surgeons and physicians in a variety of specialties including orthopedics, general surgery, gynecology, neurosurgery and gastroenterology. Headquartered in Utica, New York, the Company's 3,300 employees distribute its products worldwide from several manufacturing locations.

We have historically used strategic business acquisitions, internal product development activities and exclusive distribution relationships to diversify our product offerings, increase our market share in certain product lines, realize economies of scale and take advantage of growth opportunities in the healthcare field.

We are committed to offering products with the highest standards of quality, technological excellence and customer service. Substantially all of our facilities have attained certification under the ISO international quality standards and other domestic and international quality accreditations.

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports are accessible free of charge through the Investor Relations section of our website (http://www.conmed.com) as soon as practicable after such materials have been electronically filed with, or furnished to, the United States Securities and Exchange Commission (the "SEC"). Our SEC filings are also available for reading and copying at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (http:/www.sec.gov) containing reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

Business Strategy

Our principal objectives are to improve the quality of surgical outcomes and patient care through the development of innovative medical devices, the refinement of existing products and the development of new technologies which reduce risk, trauma, cost and procedure time. We believe that by meeting these objectives we will enhance our ability to anticipate and adapt to customer needs and market opportunities and provide shareholders with superior investment returns. We intend to achieve future growth in revenues and earnings through the following initiatives:

- Introduction of New Products and Product Enhancements. We continually pursue organic growth through the development of new products and enhancements to existing products. We seek to develop new technologies which improve the durability, performance and usability of existing products. In addition to our internal research and development efforts, we receive new ideas for products and technologies, particularly in procedure-specific areas, from surgeons, inventors and other healthcare professionals.

- Pursue Strategic Acquisitions. We pursue strategic acquisitions, distribution and similar arrangements in existing and new growth markets to achieve increased operating efficiencies, geographic diversification and market penetration. Targeted companies have historically included those with proven technologies and established brand names which provide potential sales, marketing and manufacturing synergies. This includes the January 4, 2016 acquisition of SurgiQuest, Inc. ("SurgiQuest") as further described in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 2 to the consolidated financial statements.

- Realize Manufacturing and Operating Efficiencies. We continually review our production systems for opportunities to reduce operating costs, consolidate product lines or identical process flows, reduce inventory requirements and optimize existing processes. Our vertically integrated manufacturing facilities allow for further opportunities to reduce overhead and increase operating efficiencies and capacity utilization.

- Geographic Diversification. We believe that significant growth opportunities exist for our surgical products outside the United States. Principal international markets for our products include Europe, Latin America, Canada and Asia/Pacific Rim. Critical elements of our future sales growth in these markets include leveraging our existing relationships with international surgeons, hospitals, third-party payers and foreign distributors (including sub-distributors and sales agents), maintaining an appropriate presence in emerging market countries and continually evaluating our routes-to-market.

- Active Participation in the Medical Community. We believe that excellent working relationships with physicians and others in the medical industry enable us to gain an understanding of new therapeutic and diagnostic alternatives, trends and emerging opportunities. Active participation allows us to quickly respond to the changing needs of physicians and patients. In addition, we are an active sponsor of medical education both in the United States and internationally, offering training on new and innovative surgical techniques as well as other medical education materials for use with our products.

Products

The following table sets forth the percentage of net sales for each of our product lines during each of the three years ended December 31:

	Year Ended December 31,		
	2016	2015	2014
Orthopedic surgery	48 %	54 %	54 %
General surgery	45	38	38
Surgical visualization	7	8	8
Consolidated net sales	100 %	100 %	100 %
Net sales (in thousands)	$763,520	$719,168	$740,055

The increase in the percentage of net sales to General Surgery in 2016 is driven by the acquisition of SurgiQuest, Inc. on January 4, 2016 as further described in Note 2 to the consolidated financial statements.

Orthopedic Surgery

Our orthopedic surgery product offering includes sports medicine, powered surgical instruments, and sports biologics and tissue. These products are marketed under a number of brands, including Hall®, CONMED Linvatec®, Concept® and Shutt®.

We offer a comprehensive range of devices and products to repair injuries which have occurred in the articulating joint areas of the body. Many of these injuries are the result of sports related events or similar traumas. Our sports medicine products include powered resection instruments, arthroscopes, reconstructive systems, tissue repair sets, metal and bioabsorbable implants as well as related disposable products and fluid management systems. It is our standard practice to place some of these products, such as shaver consoles and pumps, with certain customers at no charge in exchange for commitments to purchase disposable products over certain time periods. This capital equipment is loaned and subject to return if certain minimum single-use purchases are not met. Single-use products include products such as shaver blades, burs and pump tubing. In sports medicine, we compete with Smith & Nephew, plc; Arthrex, Inc.; Stryker Corporation; Johnson & Johnson: DePuy Mitek, Inc. and Zimmer Biomet, Inc.

Our powered instruments offering is sold principally under the Hall® Surgical brand name, for use in large and small bone orthopedic, arthroscopic, oral/maxillofacial, podiatric, plastic, ENT, neurological, spinal and cardiothoracic surgeries. Our newest product is the Hall 50™ Powered Instrument System, specifically designed to meet the requirements of most orthopedic applications. The modularity and versatility of the Hall 50™ Powered Instrument System allows a facility to purchase a single power system to perform total joint arthroplasty, trauma, arthroscopy and some small bone procedures. In powered instruments, our competition includes Stryker Corporation; Medtronic plc, (Midas Rex and Xomed divisions); Johnson & Johnson: DePuy Synthes, Inc.; MicroAire Surgical Instruments, LLC and Zimmer Holdings, Inc.

As more fully described in Note 5 to the consolidated financial statements, on January 3, 2012, the Company entered into the Sports Medicine Joint Development and Distribution Agreement (the "JDDA") with Musculoskeletal Transplant Foundation (“MTF”) to obtain MTF's worldwide promotion rights with respect to allograft tissues within the field of sports medicine and related products. Under the terms of this agreement, we are now the exclusive worldwide promoter of these allograft tissues, which includes the reconstruction and/or replacement of tendon, ligament, cartilage or menisci, along with the correction of deformities within the extremities.

General Surgery

Our general surgery product line offers a large range of products in the areas of advanced surgical, endoscopic technologies, and critical care.

Our advanced surgical product offering includes an extensive line of electrosurgical generators, handpieces, smoke management systems and accessories. Our endomechanical instrumentation products offer a full line of instruments including trocars, suction irrigation devices, graspers, scissors and dissectors used in minimally invasive surgery. We offer a unique and premium uterine manipulator called VCARE® for use in increasing the efficiency of laparoscopic hysterectomies and other gynecologic laparoscopic procedures. Our competition includes Medtronic plc (formerly Covidien); Johnson & Johnson: Ethicon Endo-Surgery, Inc.; ERBE Elektromedizin GmbH; Megadyne and Applied Medical Resources Corporation.

On January 4, 2016, we acquired SurgiQuest for $265 million in cash (on a cash-free, debt-free basis). SurgiQuest developed, manufactured and marketed the AirSeal® System, the first integrated access management technology for use in laparoscopic and robotic procedures. This proprietary and differentiated access system is complementary to our general surgery offering.

Our endoscopic technologies offering includes a comprehensive line of minimally invasive diagnostic and therapeutic products used in conjunction with procedures which require flexible endoscopy. This offering includes mucosal management devices, forceps, scope management accessories, bronchoscopy devices, dilatation, stricture management devices, hemostasis, biliary devices and polypectomy. Our competition includes Boston Scientific Corporation - Endoscopy; Cook Medical, Inc.; Merit Medical Endotek; Olympus, Inc.; STERIS Corporation - U.S. Endoscopy and Cantel Medical- Medivators, Inc.

Our critical care offering includes a line of vital signs, cardiac monitoring and patient care products including ECG electrodes & accessories and cardiac defibrillation & pacing pads. We also offer a complete line of suction instruments and tubing that are used throughout all areas of the hospital as well as in Ambulatory Surgery Centers and the emergency medical market. Finally, we offer a physician's office electrosurgical product mainly used by dermatologists. This offering's main competition includes Medtronic plc (formerly Covidien) and 3M Company.

Surgical Visualization

Our surgical visualization product line offers imaging systems for use in minimally invasive orthopedic and general surgery procedures including 2DHD and 3DHD vision technologies. Competition includes Smith & Nephew, plc; Arthrex, Inc.; Stryker Corporation; Olympus, Inc.; Richard Wolf and Karl Storz GmbH.

International

Expanding our international presence is an important component of our long-term growth plan. Our products are sold in over 100 foreign countries. International sales efforts are coordinated through local country dealers (including sub-distributors or sales agents) or through direct in-country sales. We distribute our products through sales subsidiaries and branches with offices located in Australia, Austria, Belgium, Canada, China, Denmark, Finland, France, Germany, Italy, Korea, the Netherlands, Poland, Spain, Sweden and the United Kingdom. In these countries, our sales are denominated in the local currency and amounted to approximately 30% of our total net sales in 2016. In the remaining countries where our products are sold through independent distributors, sales are denominated in United States dollars.

Competition

We compete in orthopedic, surgical visualization and general surgery medical device markets across the world. Our competitors range from large manufacturers with multiple business units to smaller manufacturers with limited product offerings. We believe we have appropriate product offerings and adequate market share to compete effectively in these markets. The global markets are constantly changing due to technological advances. We seek to closely align our research and development with our key business objectives, namely developing and improving products and processes, applying innovative technology to the manufacture of products for new global markets and reducing the cost of producing core products.

The breadth of our product lines in our key product areas enables us to meet a wide range of customer requirements and preferences. This has enhanced our ability to market our products to surgeons, hospitals, surgery centers, group purchasing organizations ("GPOs"), integrated delivery networks ("IDNs") and other customers, particularly as institutions seek to reduce costs and minimize the number of suppliers.

Marketing

A significant portion of our products are distributed domestically directly to more than 6,000 hospitals, surgery centers and other healthcare institutions as well as through medical specialty distributors. We are not dependent on any single customer and no single customer accounted for more than 10% of our net sales in 2016, 2015 and 2014.

A significant portion of our U.S. sales are to customers affiliated with GPOs, IDNs and other large national or regional accounts, as well as to the Veterans Administration and other hospitals operated by the Federal government. For hospital inventory management purposes, some of our customers prefer to purchase our products through independent third-party medical product distributors.

Our employee sales representatives are specially trained in our various product offerings. Each employee sales representative is assigned a defined geographic area and compensated on a commission basis or through a combination of salary and commission. The sales force is supervised and supported by either area directors or district managers. In certain geographies, sales agent groups are used in the United States to sell our orthopedic products. These sales agent groups are paid a commission for sales made to customers while home office sales and marketing management provide the overall direction for marketing and positioning of our products. Our sales professionals provide surgeons and medical personnel with information relating to the technical features and benefits of our products.

Our health systems organization is responsible for interacting with large regional and national accounts (e.g. GPOs, IDNs, etc.). We have contracts with many such organizations and believe that the loss of any individual group purchasing contract will not materially impact our business. In addition, all of our sales professionals are required to work closely with distributors where applicable and maintain close relationships with end-users.

We sell to a diversified base of customers around the world and, therefore, believe there is no material concentration of credit risk.

Manufacturing

Raw material costs constitute a substantial portion of our cost of production. Substantially all of our raw materials and select components used in the manufacturing process are procured from external suppliers. We work closely with multiple suppliers to ensure continuity of supply while maintaining high quality and reliability. As a consequence of supply chain best practices, new product development and acquisitions, we often form strategic partnerships with key suppliers. As a consequence of these supplier partnerships, components and raw materials may be sole sourced. Due to the strength of these suppliers and the variety of products we provide, we do not believe the risk of supplier interruption poses an overall material adverse effect on our financial and operational performance. We schedule production and maintain adequate levels of safety stock based on a number of factors, including experience, knowledge of customer ordering patterns, demand, manufacturing lead times and optimal quantities required to maintain the highest possible service levels. Customer orders are generally processed for immediate shipment and backlog of firm orders is therefore not considered material to an understanding of our business.

Research and Development

New and improved products play a critical role in our continued sales growth. Internal research and development efforts focus on the development of new products and product technological and design improvements aimed at complementing and expanding existing product lines. We continually seek to leverage new technologies which improve the durability, performance and usability of existing products. In addition, we maintain close working relationships with surgeons, inventors and operating room personnel who often make new product and technology disclosures, principally in procedure-specific areas. In certain cases, we seek to obtain rights to these ideas through negotiated agreements. Such agreements typically compensate the originator through payments based upon a percentage of licensed product net sales. Annual royalty expense approximated $2.3 million, $2.3 million and $2.6 million in 2016, 2015 and 2014, respectively.

Amounts expended for Company research and development were approximately $32.3 million, $27.4 million and $27.8 million during 2016, 2015 and 2014, respectively. In 2016, the Company increased its efforts on new product development and innovation.

Intellectual Property

Patents and other proprietary rights, in general, are important to our business. We have rights to intellectual property, including United States patents and foreign equivalent patents which cover a wide range of our products. We own a majority of these patents and have exclusive and non-exclusive licensing rights to the remainder. In addition, certain of these patents have currently been licensed to third parties on a non-exclusive basis. We believe that the development of new products and technological and design improvements to existing products will continue to be of primary importance in maintaining our competitive position.

Government Regulation and Quality Systems

The development, manufacture, sale and distribution of our products are subject to regulation by numerous agencies and legislative bodies, including the U.S. Food and Drug Administration ("FDA") and comparable foreign counterparts. In the United States, these regulations were enacted under the Medical Device Amendments of 1976 to the Federal Food, Drug and Cosmetic Act and its subsequent amendments, and the regulations issued or proposed thereunder.

The FDA's Quality System Regulations set forth requirements for our product design and manufacturing processes, require the maintenance of certain records, provide for on-site inspection of our facilities and continuing review by the FDA. Many of our products are also subject to industry-defined standards. Authorization to commercially market our products in the U.S. is granted by the FDA under a procedure referred to as a 510(k) pre-market notification. This process requires us to notify the FDA

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of the new product and obtain FDA clearance before marketing the device. We believe that our products and processes presently meet applicable standards in all material respects.

Medical device regulations continue to evolve world-wide. Products marketed in the European Union and other countries require preparation of technical files and design dossiers which demonstrate compliance with applicable international regulations. As government regulations continue to change, there is a risk that the distribution of some of our products may be interrupted or discontinued if they do not meet the country specific requirements.

We market our products in numerous foreign countries and therefore are subject to regulations affecting, among other things, product standards, sterilization, packaging requirements, labeling requirements, import laws and onsite inspection by independent bodies with the authority to issue or not issue certifications we may require to be able to sell products in certain countries. Many of the regulations applicable to our devices and products in these countries are similar to those of the FDA. The member countries of the European Union have adopted the European Medical Device Directives, which create a single set of medical device regulations for all member countries. These regulations require companies that wish to manufacture and distribute medical devices in the European Union to maintain quality system certifications through European Union recognized Notified Bodies. These Notified Bodies authorize the use of the CE Mark allowing free movement of our products throughout the member countries. Requirements pertaining to our products vary widely from country to country, ranging from simple product registrations to detailed submissions such as those required by the FDA. We believe that our products and quality procedures currently meet applicable standards for the countries in which they are marketed.

As noted above, our facilities are subject to periodic inspection by the United States Food and Drug Administration (“FDA”) and foreign regulatory agencies or notified bodies for, among other things, conformance to Quality System Regulation and Current Good Manufacturing Practice (“CGMP”) requirements and foreign or international standards. Refer to Note 11 to the consolidated financial statements for further discussion.

Employees

As of December 31, 2016, we had approximately 3,300 full-time employees, including approximately 2,200 in operations, 160 in research and development and the remaining in sales, marketing and related administrative support. We believe that we have good relations with our employees and have never experienced a strike or similar work stoppage. None of our domestic employees are represented by a labor union.

Item 1A. Risk Factors

An investment in our securities, including our common stock, involves a high degree of risk. Investors should carefully consider the specific factors set forth below as well as the other information included or incorporated by reference in this Form 10-K. See “Forward Looking Statements”.

Our financial performance is dependent on conditions in the healthcare industry and the broader economy.

The results of our business are directly tied to the economic conditions in the healthcare industry and the broader economy as a whole. We will continue to monitor and manage the impact of the overall economic environment on the Company, including proposals for broad reform of the existing United States corporate tax system, including provisions impacting companies that import goods from Mexico or export goods from the United States. These proposals are currently under evaluation by various legislative and administrative bodies. We cannot predict the overall impact that such proposals may have on our business model, financial condition or results of operations.

In addition, approximately 21% of our revenues are derived from the sale of capital products. The sales of such products are negatively impacted if hospitals and other healthcare providers are unable to secure the financing necessary to purchase these products or otherwise defer purchases.

Our significant international operations subject us to foreign currency fluctuations and other risks associated with operating in countries outside the Untied States.

A significant portion of our revenues are derived from international sales. Approximately 48% of our total 2016 consolidated net sales were to customers outside the United States. We have sales subsidiaries in a significant number of countries in Europe as well as Australia, Canada, China and Korea. In those countries in which we have a direct presence, our sales are denominated in the local currency and those sales denominated in local currency amounted to approximately 30% of our total net sales in 2016. The remaining 18% of sales to customers outside the United States was on an export basis and transacted in United States dollars.

Because a significant portion of our operations consist of sales activities in jurisdictions outside the United States, our financial results may be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the markets in which we distribute products. While we have implemented a hedging strategy involving foreign currency forward contracts for 2016, our revenues and earnings are only partially protected from foreign currency translation if the United States dollar strengthens as compared with currencies such as the Euro. Further, as of the date of this Form 10-K, we have not entered into any foreign currency forward contracts beyond 2018. Our international presence exposes us to certain other inherent risks, including:

- imposition of limitations on conversions of foreign currencies into dollars or remittance of dividends and other payments by international subsidiaries;
- imposition or increase of withholding and other taxes on remittances and other payments by international subsidiaries;
- trade barriers;
- political risks, including political instability;
- reliance on third parties to distribute our products;
- hyperinflation in certain countries outside the United States; and
- imposition or increase of investment and other restrictions by foreign governments.

We cannot assure you that such risks will not have a material adverse effect on our business and results of operations.

Our financial performance is subject to the risks inherent in our acquisition strategy, including the effects of increased borrowing and integration of newly acquired businesses or product lines.

A key element of our business strategy has been to expand through acquisitions and we may seek to pursue additional acquisitions in the future. Our success is dependent in part upon our ability to integrate acquired companies or product lines into our existing operations. We may not have sufficient management and other resources to accomplish the integration of our past and future acquisitions and implementing our acquisition strategy may strain our relationship with customers, suppliers, distributors, personnel or others. There can be no assurance that we will be able to identify and make acquisitions on acceptable terms or that we will be able to obtain financing for such acquisitions on acceptable terms. In addition, while we are generally entitled to customary indemnification from sellers of businesses for any difficulties that may have arisen prior to our acquisition of each business, acquisitions may involve exposure to unknown liabilities and the amount and time for claiming under these indemnification provisions is often limited. As a result, our financial performance is now, and will continue to be, subject to various risks associated with the acquisition of businesses, including the financial effects associated with any increased borrowing required to fund such acquisitions or with the integration of such businesses. We incurred substantial additional debt in connection with the SurgiQuest acquisition, and we cannot ensure that we will be able to successfully advance SurgiQuest’s product lines or that risks related to the SurgiQuest acquisition will not negatively impact our financial performance.

Our financial performance may be adversely impacted by healthcare reform legislation.

Provisions of healthcare legislation, including provisions of the Patient Protection and Affordable Care Act ("ACA"), could meaningfully change the way health care is developed and delivered and may adversely affect our business and results of operations. For example, the ACA includes provisions aimed at improving quality and decreasing costs of Medicare, governing comparative effectiveness research, and implementing an independent payment advisory board and pilot programs to evaluate alternative payment methodologies. That legislation also included a 2.3% excise tax imposed upon sales within the U.S. of certain medical device products, which has been delayed until 2018. We also face uncertainties that might result in the modification or repeal of any provisions of the ACA, including as a result of current and future executive orders and legislative actions. The uncertainty associated with modifications or a repeal could generally cause healthcare markets to be unstable and we could be subject to some interruptions, the magnitude of which are impossible to determine, as healthcare providers, both facilities and medical professionals, who have benefited from the ACA determine the paths forward.

As a manufacturer of medical devices that interacts with physicians and health care providers domestically and internationally, we face risks under domestic and foreign regulations, including the Foreign Corrupt Practices Act.

Manufacturers of medical devices have been the subject of various investigations or enforcement actions relating to interactions with health care providers domestically or internationally. The interactions with domestic health care providers are subject to regulations, known as the Anti-Kickback Statute, the Stark Act and the False Claims Act, that generally govern incentives for health care providers, or methods of reimbursement funded in whole or in part by the government. Similarly, the Foreign Corrupt Practices Act (“FCPA”) prohibits certain conduct by manufacturers, generally described as bribery, with respect to interactions, either directly through foreign subsidiaries or indirectly through distributors, with health care providers who may be considered government officials because they are affiliated with public hospitals. The FCPA also imposes obligations on manufacturers listed on U.S. stock exchanges to maintain accurate books and records, and maintain internal accounting controls sufficient to provide assurance that transactions are accurately recorded, lawful and in accordance with management's authorization. The FCPA can pose unique challenges for manufacturers who operate in foreign cultures where conduct prohibited by the FCPA may not be viewed as illegal in local jurisdictions, and because, in some cases, a United States manufacturer may face risks under the FCPA based on the conduct of third parties over whom the manufacturer may not have complete control.

In this regard, from time to time, the Company may receive an information request or subpoena from a government agency, such as the Securities and Exchange Commission, Department of Justice, Equal Employment Opportunity Commission, the Occupational Safety and Health Administration, the Department of Labor, the Treasury Department or other federal and state agencies or foreign governments or government agencies. Alternatively, employees or private parties may provide us with reports of alleged misconduct. These information requests or subpoenas may or may not be routine inquiries, or may begin as informal or routine inquiries and over time develop into investigations or enforcement actions of various types under the FCPA or otherwise. Similarly, the employee and third party reports may prompt us to conduct internal investigations into the alleged misconduct. No inquiry that the Company currently faces or has faced to date, and no report of misconduct that the Company has received to date, has had a material adverse effect on our financial condition, results of operations or cash flows. There can be no assurance, however, that any pending inquiries will become investigations or enforcement actions, or the costs associated with responding to such inquiries, investigations, enforcement actions or investigations relating to reports of misconduct will not have a material adverse effect on our financial condition, results of operations or cash flows.

Failure to comply with regulatory requirements may result in recalls, fines or materially adverse implications.

Substantially all of our products are classified as class II medical devices subject to regulation by numerous agencies and legislative bodies, including the FDA and comparable international counterparts. As a manufacturer of medical devices, our manufacturing processes and facilities are subject to on-site inspection and continuing review by the FDA for compliance with the Quality System Regulations. We may have future inspections at our sites and there can be no assurance that the costs of responding to such inspections will not be material. Refer to Note 11 to the consolidated financial statements for further discussion.

Manufacturing and sales of our products outside the United States are also subject to international regulatory requirements which vary from country to country. Moreover, we are generally required to obtain regulatory clearance or approval prior to marketing a new product. The time required to obtain approvals from foreign countries may be longer or shorter than that required for FDA clearance, and requirements for such approvals may differ from FDA requirements. Failure to comply with applicable domestic and/or foreign regulatory requirements may result in:

- fines or other enforcement actions;
- recall or seizure of products;
- total or partial suspension of production;
- loss of certification;
- withdrawal of existing product approvals or clearances;
- refusal to approve or clear new applications or notices;
- increased quality control costs; or
- criminal prosecution.

Failure to comply with Quality System Regulations and applicable international regulations could result in a material adverse effect on our business, financial condition or results of operations.

If we are not able to manufacture products in compliance with regulatory standards, we may decide to cease manufacturing of those products and may be subject to product recall.

In addition to the Quality System Regulations, many of our products are also subject to industry-defined standards. We may not be able to comply with these regulations and standards due to deficiencies in component parts or our manufacturing processes. If we are not able to comply with the Quality System Regulations or industry-defined standards, we may not be able to fill customer orders and we may decide to cease production of non-compliant products. Failure to produce products could affect our profit margins and could lead to loss of customers.

Our products are subject to product recall and we have conducted product recalls in the past. Although no recall has had a material adverse effect on our business or financial condition, we cannot assure you that regulatory issues will not have a material adverse effect on our business, financial condition or results of operations in the future or that product recalls will not harm our reputation and our customer relationships.

The highly competitive market for our products may create adverse pricing pressures.

The market for our products is highly competitive and our customers have numerous alternatives of supply. Many of our competitors offer a range of products in areas other than those in which we compete, which may make such competitors more attractive to surgeons, hospitals, group purchasing organizations and others. In addition, many of our competitors are large, technically competent firms with substantial assets. Competitive pricing pressures or the introduction of new products by our competitors could have an adverse effect on our revenues. See "Products" in Item 1 - Business for a further discussion of these competitive forces.

Factors which may influence our customers' choice of competitor products include:

- changes in surgeon preferences;
- increases or decreases in healthcare spending related to medical devices;
- our inability to supply products to them as a result of product recall, market withdrawal or back-order;
- the introduction by competitors of new products or new features to existing products;
- the introduction by competitors of alternative surgical technology; and
- advances in surgical procedures, discoveries or developments in the healthcare industry.

We use a variety of raw materials in our businesses, and significant shortages or price increases could increase our operating costs and adversely impact the competitive positions of our products.

Our reliance on certain suppliers and commodity markets to secure raw materials used in our products exposes us to volatility in the prices and availability of raw materials. In some instances, we participate in commodity markets that may be subject to allocations by suppliers. A disruption in deliveries from our suppliers, price increases or decreased availability of raw materials or commodities could have an adverse effect on our ability to meet our commitments to customers or increase our operating costs. We believe that our supply management practices are based on an appropriate balancing of the foreseeable risks and the costs of alternative practices. Nonetheless, price increases or the unavailability of some raw materials may have an adverse effect on our results of operations or financial condition.

Cost reduction efforts in the healthcare industry could put pressures on our prices and margins.

In recent years, the healthcare industry has undergone significant change driven by various efforts to reduce costs. Such efforts include national healthcare reform, trends towards managed care, cuts in Medicare, consolidation of healthcare distribution companies and collective purchasing arrangements by GPOs and IDNs. Demand and prices for our products may be adversely affected by such trends.

We may not be able to keep pace with technological change or to successfully develop new products with wide market acceptance, which could cause us to lose business to competitors.

The market for our products is characterized by rapidly changing technology. Our future financial performance will depend in part on our ability to develop and manufacture new products on a cost-effective basis, to introduce them to the market on a timely basis and to have them accepted by surgeons.

We may not be able to keep pace with technology or to develop viable new products. In addition, many of our competitors are substantially larger with greater financial resources which may allow them to more rapidly develop new products. Factors which may result in delays of new product introductions or cancellation of our plans to manufacture and market new products include:

- capital constraints;

- research and development delays;
- delays in securing regulatory approvals; and
- changes in the competitive landscape, including the emergence of alternative products or solutions which reduce or eliminate the markets for pending products.

Our new products may fail to achieve expected levels of market acceptance.

New product introductions may fail to achieve market acceptance. The degree of market acceptance for any of our products will depend upon a number of factors, including:

- our ability to develop and introduce new products and product enhancements in the time frames we currently estimate;

- our ability to successfully implement new technologies;
- the market's readiness to accept new products;
- having adequate financial and technological resources for future product development and promotion;
- the efficacy of our products; and
- the prices of our products compared to the prices of our competitors' products.

If our new products do not achieve market acceptance, we may be unable to recover our investments and may lose business to competitors.

In addition, some of the companies with which we now compete, or may compete in the future, have or may have more extensive research, marketing and manufacturing capabilities and significantly greater technical and personnel resources than we do, and may be better positioned to continue to improve their technology in order to compete in an evolving industry. See "Products" in Item 1 - Business for a further discussion of these competitive forces.

Our senior credit agreement contains covenants which may limit our flexibility or prevent us from taking actions.

Our senior credit agreement contains, and future credit facilities are expected to contain, certain restrictive covenants which will affect, and in many respects significantly limit or prohibit, among other things, our ability to:

- incur indebtedness;
- make investments;
- engage in transactions with affiliates;
- pay dividends or make other distributions on, or redeem or repurchase, capital stock;
- sell assets; and
- pursue acquisitions.

These covenants, unless waived, may prevent us from pursuing acquisitions, significantly limit our operating and financial flexibility and limit our ability to respond to changes in our business or competitive activities. Our ability to comply with such provisions may be affected by events beyond our control. In the event of any default under our credit agreement, the credit agreement lenders may elect to declare all amounts borrowed under our credit agreement, together with accrued interest, to be due and payable. If we were unable to repay such borrowings, the credit agreement lenders could proceed against collateral securing the credit agreement which consists of substantially all of our property and assets. Our credit agreement also contains a material adverse effect clause which may limit our ability to access additional funding under our credit agreement should a material adverse change in our business occur.

Our leverage and debt service requirements may require us to adopt alternative business strategies.

As of December 31, 2016, we had $499.1 million of debt outstanding, representing 45% of total capitalization. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" and Note 6 to our consolidated financial statements.

The degree to which we are leveraged could have important consequences to investors, including but not limited to the following:

- a portion of our cash flow from operations must be dedicated to debt service and will not be available for operations, capital expenditures, acquisitions, dividends and other purposes;
- our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or general corporate purposes may be limited or impaired or may be at higher interest rates;

- we may be at a competitive disadvantage when compared to competitors that are less leveraged;
- we may be hindered in our ability to adjust rapidly to market conditions;
- our degree of leverage could make us more vulnerable in the event of a downturn in general economic conditions or other adverse circumstances applicable to us; and
- our interest expense could increase if interest rates in general increase because a portion of our borrowings, including our borrowings under our credit agreement, are and will continue to be at variable rates of interest.

We may not be able to generate sufficient cash to service our indebtedness, which could require us to reduce our expenditures, sell assets, restructure our indebtedness or seek additional equity capital.

Our ability to satisfy our obligations will depend upon our future operating performance, which will be affected by prevailing economic conditions and financial, business and other factors, many of which are beyond our control. We may not have sufficient cash flow available to enable us to meet our obligations. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as foregoing acquisitions, reducing or delaying capital expenditures, selling assets, restructuring or refinancing our indebtedness or seeking additional equity capital. We cannot assure you that any of these strategies could be implemented on terms acceptable to us, if at all. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources” for a discussion of our indebtedness and its implications.

We rely on a third party to obtain, process and distribute sports medicine allograft tissue. If such tissue cannot be obtained, is not accepted by the market or is not accepted under numerous government regulations, our results of operations could be negatively impacted.

A portion of our orthopedic revenues relate to our share of the service fees from the MTF allograft tissues for which we have exclusive promotion rights, as further described in our revenue recognition policy in Note 1 to the consolidated financial statements. Our primary costs related to these revenues come from our commission expense and certain marketing costs. Our ability to increase the service fees may be constrained by certain factors which are outside of our control, such as the limited supply of donors and donated tissue that meets the quality standards of MTF. Similarly, under the terms of the Joint Development and Distribution Agreement (“JDDA”), MTF remains responsible for tissue procurement and processing, shipment of tissues and invoicing of service fees to customers. To the extent MTF’s performance does not meet customer expectations or otherwise fails, CONMED may be unable to increase the allograft service fees or to find a suitable replacement for MTF on terms that are acceptable.

The FDA and several states have statutory authority to regulate allograft processing and allograft-based materials. The FDA could identify deficiencies in future inspections of MTF or MTF's suppliers or promulgate future regulatory rulings that could disrupt our business, reducing profitability.

If the Company or our business partners are unable to adequately protect our information assets from cyber-based attacks or other security incidents, our operations could be disrupted.

We are increasingly dependent on information technology, including the internet, for the storage, processing, and transmission of our electronic, business-related, information assets. We leverage our internal information technology infrastructures, and those of our business partners, to enable, sustain, and support our global business interests. In the event that the Company or our business partners are unable to prevent, detect, and remediate cyber-based attacks or other security incidents in a timely manner, our operations could be disrupted or we may incur financial or reputational losses arising from the theft, alteration, misuse, unauthorized disclosure, or destruction of our information assets.

If we infringe third parties’ patents, or if we lose our patents or they are held to be invalid, we could become subject to liability and our competitive position could be harmed.

Much of the technology used in the markets in which we compete is covered by patents. We have numerous U.S. patents and corresponding international patents on products expiring at various dates from 2017 through 2038 and have additional patent applications pending. See Item 1 Business “Research and Development” and “Intellectual Property” for a further description of our patents. The loss of our patents could reduce the value of the related products and any related competitive advantage. Competitors may also be able to design around our patents and to compete effectively with our products. In addition, the cost of enforcing our patents against third parties and defending our products against patent infringement actions by others could be substantial. We cannot assure you that:

- pending patent applications will result in issued patents;
- patents issued to or licensed by us will not be challenged by competitors;

- our patents will be found to be valid or sufficiently broad to protect our technology or provide us with a competitive advantage; or
- we will be successful in defending against pending or future patent infringement claims asserted against our products.

Ordering patterns of our customers may change resulting in reductions in sales.

Our hospital and surgery center customers purchase our products in quantities sufficient to meet their anticipated demand. Likewise, our healthcare distributor customers purchase our products for ultimate resale to healthcare providers in quantities sufficient to meet the anticipated requirements of the distributors' customers. Should inventories of our products owned by our hospital, surgery center and distributor customers grow to levels higher than their requirements, our customers may reduce the ordering of products from us. This could result in reduced sales during a financial accounting period.

We can be sued for producing defective products and our insurance coverage may be insufficient to cover the nature and amount of any product liability claims.

The nature of our products as medical devices and today's litigious environment should be regarded as potential risks which could significantly and adversely affect our financial condition and results of operations. The insurance we maintain to protect against claims associated with the use of our products has deductibles and may not adequately cover the amount or nature of any claim asserted against us. We are also exposed to the risk that our insurers may become insolvent or that premiums may increase substantially. See "Item 3 - Legal Proceedings" for a further discussion of the risk of product liability actions and our insurance coverage.

Damage to our physical properties as a result of windstorm, earthquake, fire or other natural or man-made disaster may cause a financial loss and a loss of customers.

Although we maintain insurance coverage for physical damage to our property and the resultant losses that could occur during a business interruption, we are required to pay deductibles and our insurance coverage is limited to certain caps. For example, our deductible for windstorm damage to our Florida property amounts to 2% of any loss.

Further, while insurance reimburses us for our lost gross earnings during a business interruption, if we are unable to supply our customers with our products for an extended period of time, there can be no assurance that we will regain the customers' business once the product supply is returned to normal.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Facilities

The following table sets forth certain information with respect to our principal operating facilities. We believe that our facilities are generally well maintained, are suitable to support our business and adequate for present and anticipated needs.

Location	Square Feet	Own or Lease	Lease Expiration
Utica, NY	500,000	Own	—
Largo, FL	278,000	Own	—
Chihuahua, Mexico	207,720	Lease	September 2019
Lithia Springs, GA	188,400	Lease	December 2019
Brussels, Belgium	45,531	Lease	June 2024
Milford, CT	40,542	Lease	November 2020
Mississauga, Canada	22,378	Lease	December 2018
Westborough, MA	19,515	Lease	June 2020
Frenchs Forest, Australia	16,912	Lease	July 2020
Seoul, Korea	15,585	Lease	January 2020
Anaheim, CA	14,037	Lease	August 2018
Frankfurt, Germany	13,606	Lease	March 2023
Milan, Italy	13,024	Lease	March 2023
Barcelona, Spain	12,820	Lease	December 2023
Swindon, Wiltshire, UK	8,562	Lease	December 2020
Greenwood Village, CO	8,541	Lease	January 2020
Askim, Sweden	8,353	Lease	May 2019
Lyon, France	7,438	Lease	December 2026
Beijing, China	6,799	Lease	June 2017
Copenhagen, Denmark	5,899	Lease	October 2018
New York, NY	3,473	Lease	September 2022
Beijing, China	3,456	Lease	September 2019
Warsaw, Poland	3,222	Lease	February 2018
Espoo, Finland	3,078	Lease	Open Ended
Shanghai, China	2,269	Lease	February 2018
Innsbruck, Austria	1,820	Lease	June 2020

Our principal manufacturing facilities are located in Utica, NY, Largo, FL, Anaheim, CA and Chihuahua, Mexico. Lithia Springs, GA and Brussels, Belgium are our principal distribution centers. The remaining facilities are sales and administrative offices with certain offices also including smaller distribution centers.

Item 3. Legal Proceedings

We are involved in various proceedings, legal actions and claims arising in the normal course of business, including proceedings related to product, labor and intellectual property and other matters that are more fully described in Note 11 to the consolidated financial statements. We are not a party to any pending legal proceedings other than ordinary routine litigation incidental to our business.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock, par value $.01 per share, is traded on the NASDAQ Stock Market under the symbol “CNMD”. At January 31, 2017, there were 597 registered holders of our common stock and approximately 5,353 accounts held in “street name”.

The following table sets forth quarterly high and low closing sales prices for the years ended December 31, 2016 and 2015, as reported by the NASDAQ Stock Market.

	2016	
Period	High	Low
First Quarter	$42.61	$36.16
Second Quarter	47.73	38.97
Third Quarter	50.00	38.48
Fourth Quarter	46.45	37.75

Generating Station	Location	Nameplate Capacity (1) (Kilowatts)
Watson	Gulfport, MS	39,360
Mississippi Power Total		226,052
Dahlberg	Jackson County, GA	756,000
DeSoto	Arcadia, FL	343,760
Oleander	Cocoa, FL	791,301
Rowan	Salisbury, NC	455,250
Southern Power Total		2,346,311
Gaston **(SEGCO)**	Wilsonville, AL	19,680(7)
Total Combustion Turbines		5,392,132
COGENERATION		
Washington County	Washington County, AL	123,428
GE Plastics Project	Burkeville, AL	104,800
Theodore	Theodore, AL	236,418
Total Cogeneration		464,646

COMBINED CYCLE		
Barry	Mobile, AL	
Alabama Power Total		1,070,424
McIntosh Units 10&11	Effingham County, GA	
Georgia Power Total		1,318,920
Smith	Lynn Haven, FL	
Gulf Power Total		545,500
Daniel (Leased)	Pascagoula, MS	
Mississippi Power Total		1,070,424
Franklin	Smiths, AL	1,198,360
Harris	Autaugaville, AL	1,318,920
Rowan	Salisbury, NC	530,550
Stanton Unit A	Orlando, FL	428,649(12)
Wansley	Carrollton, GA	1,073,000
Southern Power Total		4,549,479
Total Combined Cycle		8,554,747
HYDROELECTRIC FACILITIES		
Bankhead	Holt, AL	53,985
Bouldin	Wetumpka, AL	225,000
Harris	Wedowee, AL	132,000
Henry	Ohatchee, AL	72,900
Holt	Holt, AL	46,944
Jordan	Wetumpka, AL	100,000
Lay	Clanton, AL	177,000
Lewis Smith	Jasper, AL	157,500
Logan Martin	Vincent, AL	135,000
Martin	Dadeville, AL	182,000
Mitchell	Verbena, AL	170,000
Thurlow	Tallassee, AL	81,000
Weiss	Leesburg, AL	87,750
Yates	Tallassee, AL	47,000
Alabama Power Total		1,668,079
Barnett Shoals (Leased)	Athens, GA	2,800
Bartletts Ferry	Columbus, GA	173,000
Goat Rock	Columbus, GA	38,600
Lloyd Shoals	Jackson, GA	14,400
Morgan Falls	Atlanta, GA	16,800
North Highlands	Columbus, GA	29,600
Oliver Dam	Columbus, GA	60,000
Rocky Mountain	Rome, GA	215,256(13)

Sinclair Dam	Milledgeville, GA	45,000
Tallulah Falls	Clayton, GA	72,000
Terrora	Clayton, GA	16,000
Tugalo	Clayton, GA	45,000
Wallace Dam	Eatonton, GA	321,300
Yonah	Toccoa, GA	22,500
6 Other Plants		18,080
Georgia Power Total		1,090,336
Total Hydroelectric Facilities		2,758,415
Total Generating Capacity		41,947,757

Notes:

(1) See Jointly-Owned Facilities herein for additional information.

(2) Owned by Alabama Power and Mississippi Power as tenants in common in the proportions of 60% and 40%, respectively.

(3) Capacity shown is Alabama Power s portion (91.84%) of total plant capacity.

(4) Capacity shown for Georgia Power is 8.4% of Units 1 and 2 and 75% of Unit 3. Capacity shown for Gulf Power is 25% of Unit 3.

(5) Capacity shown is Georgia Power s portion (53.5%) of total plant capacity.

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(6) Represents 50% of the plant which is owned as tenants in common by Gulf Power and Mississippi Power.

(7) SEGCO is jointly-owned by Alabama Power and Georgia Power. See BUSINESS in Item 1 herein for additional information.

(8) Capacity shown is Georgia Power s portion (50.1%) of total plant capacity.

(9) Capacity shown is Georgia Power s portion (45.7%) of total plant capacity.

(10) Capacity shown represents 33 1/3% of total plant capacity. Georgia Power owns a 1/3 interest in the unit with 100% use of the unit from June through September. Progress Energy Florida operates the unit.

(11) Generation is dedicated to a

single industrial customer.

(12) Capacity shown is Southern Power s portion (65%) of total plant capacity.

(13) Capacity shown is Georgia Power s portion (25.4%) of total plant capacity. OPC operates the plant.

Except as discussed below under Titles to Property, the principal plants and other important units of the traditional operating companies, Southern Power, and SEGCO are owned in fee by the respective companies. It is the opinion of management of each such company that its operating properties are adequately maintained and are substantially in good operating condition.

Mississippi Power owns a 79-mile length of 500-kilovolt transmission line which is leased to Entergy Gulf States. The line, completed in 1984, extends from Plant Daniel to the Louisiana state line. Entergy Gulf States is paying a use fee over a 40-year period covering all expenses and the amortization of the original $57 million cost of the line. At December 31, 2007, the unamortized portion of this cost was approximately $25 million.

The all-time maximum demand on the traditional operating companies, Southern Power, and SEGCO was 38,777,000 kilowatts and occurred on August 22, 2007. This amount excludes demand served by capacity retained by MEAG, OPC, and SEPA. The reserve margin for the traditional operating companies, Southern Power, and SEGCO at that time was 11.2%. See SELECTED FINANCIAL DATA in Item 6 herein for additional information on peak demands.

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Jointly-Owned Facilities

Alabama Power, Georgia Power, and Southern Power have undivided interests in certain generating plants and other related facilities to or from non-affiliated parties. The percentages of ownership are as follows:

		Percentage Ownership										
	Total Capacity (Megawatts)	Alabama Power	Power South	Georgia Power	OPC	MEAG	Dalton	Progress Energy Florida	Southern Power	OUC	FMPA	KUA
Plant Miller Units 1 and 2	1,320	91.8%	8.2%	%	%	%	%	%	%	%	%	%
Plant Hatch	1,796			50.1	30.0	17.7	2.2					
Plant Vogtle	2,320			45.7	30.0	22.7	1.6					
Plant Scherer Units 1 and 2	1,636			8.4	60.0	30.2	1.4					
Plant Wansley	1,779			53.5	30.0	15.1	1.4					
Rocky Mountain	848			25.4	74.6							
Intercession City, FL	143			33.3				66.7				
Plant Stanton A	660								65%	28%	3.5%	3.5%

Alabama Power and Georgia Power have contracted to operate and maintain the respective units in which each has an interest (other than Rocky Mountain and Intercession City) as agent for the joint owners. SCS provides operation and maintenance services for Plant Stanton A.

In addition, Georgia Power has commitments regarding a portion of a five percent interest in Plant Vogtle owned by MEAG that are in effect until the later of retirement of the plant or the latest stated maturity date of MEAG s bonds issued to finance such ownership interest. The payments for capacity are required whether any capacity is available. The energy cost is a function of each unit s variable operating costs. Except for the portion of the capacity payments related to the Georgia PSC s disallowances of Plant Vogtle costs, the cost of such capacity and energy is included in purchased power from non-affiliates in Georgia Power s statements of income in Item 8 herein.

Titles to Property

The traditional operating companies , Southern Power s, and SEGCO s interests in the principal plants (other than certain pollution control facilities, one small hydroelectric generating station leased by Georgia Power, combined cycle units at Plant Daniel leased by Mississippi Power and the land on which five combustion turbine generators of Mississippi Power are located, which is held by easement) and other important units of the respective companies are owned in fee by such companies, subject only to the liens pursuant to pollution control bonds of Alabama Power and Gulf Power on specific pollution control facilities. As of January 26, 2007, Gulf Power s mortgage indenture and the lien on its principal property were discharged. See Note 6 to the financial statements of Southern Company, Alabama Power, and Gulf Power under Assets Subject to Lien and Note 7 to the financial statements of Mississippi Power under Operating Leases Plant Daniel Combined Cycle Generating Units in Item 8 herein for additional information. The traditional operating companies own the fee interests in certain of their principal plants as tenants in common. See Jointly-Owned Facilities herein for additional information. Properties such as electric transmission and distribution lines and steam heating mains are constructed principally on rights-of-way which are maintained under franchise or are held by easement only. A substantial portion of lands submerged by reservoirs is held under flood right easements.

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Item 3. LEGAL PROCEEDINGS

(1) United States of America v. Alabama Power (United States District Court for the Northern District of Alabama)
United States of America v. Georgia Power and Savannah Electric (United States District Court for the Northern District of Georgia)

See Environmental Matters New Source Review Actions in Note 3 to Southern Company s and each traditional operating company s financial statements in Item 8 herein for information.

(2) Environmental Remediation

See Environmental Matters Environmental Remediation in Note 3 to the financial statements of Southern Company, Georgia Power, Gulf Power, and Mississippi Power and Retail Regulatory Matters Environmental Compliance Overview Plan in Note 3 to the financial statements of Mississippi Power in Item 8 herein for information related to environmental remediation.

(3) In re: Mirant Corporation, et al. (United States Bankruptcy Court for the Northern District of Texas)

See Mirant Matters Mirant Bankruptcy in Note 3 to Southern Company s financial statements in Item 8 herein for information.

(4) MC Asset Recovery, LLC v. Southern Company (United States District Court for the Northern District of Georgia) (formerly styled *In re: Mirant Corporation, et al.* in the United States Bankruptcy Court for the Northern District of Texas)

See Mirant Matters MC Asset Recovery Litigation in Note 3 to Southern Company s financial statements in Item 8 herein for information.

(5) In re: Mirant Corporation Securities Litigation (United States District Court for the Northern District of Georgia)

See Mirant Matters Mirant Securities Litigation in Note 3 to Southern Company s financial statements in Item 8 herein for information.

(6) Right of Way Litigation

See Right of Way Litigation in Note 3 to Southern Company s, Georgia Power s, Gulf Power s, and Mississippi Power s financial statements in Item 8 herein for information.

See Note 3 to each registrant s financial statements in Item 8 herein for descriptions of additional legal and administrative proceedings discussed therein.

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Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Southern Company, Alabama Power, Gulf Power, Mississippi Power, and Southern Power

None.

Georgia Power

By written consent, in lieu of a special meeting of the sole common shareholder of Georgia Power, effective October 8, 2007, the sole shareholder approved an amendment to the Charter of Georgia Power to establish a new series of preference stock designated as the 6.50% Series 2007A Preference Stock, Non-Cumulative, Par Value $100 Per Share (Amendment).

All of the 9,261,500 outstanding shares of Georgia Power s common stock were owned by Southern Company and were voted in favor of the Amendment.

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EXECUTIVE OFFICERS OF SOUTHERN COMPANY

(Identification of executive officers of Southern Company is inserted in Part I in accordance with Regulation S-K, Item 401(b), Instruction 3.) The ages of the officers set forth below are as of December 31, 2007.

David M. Ratcliffe

Chairman, President, Chief Executive Officer, and Director

Age 59

Elected in 1999. President since April 2004; Chairman and Chief Executive Officer since July 2004. Previously served as Chief Executive Officer of Georgia Power from June 1999 to April 2004; and President of Georgia Power from June 1999 to December 2003.

W. Paul Bowers

Executive Vice President and Chief Financial Officer

Age 51

Elected in 2001. Executive Vice President and Chief Financial Officer since February 1, 2008 and Executive Vice President since May 2007. Previously served as President of Southern Company Generation, a business unit of Southern Company, and Executive Vice President of SCS since May 2001; and President and Chief Executive Officer of Southern Power from May 2001 through March 2005.

Thomas A. Fanning

Executive Vice President and Chief Operating Officer

Age 50

Elected in 2003. Executive Vice President and Chief Operating Officer since February 1, 2008. Previously served as Executive Vice President and Chief Financial Officer from May 2007 through January 2008; Executive Vice President, Chief Financial Officer, and Treasurer from April 2003 to May 2007; and President, Chief Executive Officer, and Director of Gulf Power from 2002 to April 2003.

Michael D. Garrett

Executive Vice President

Age 58

Elected in 2004. Executive Vice President since January 1, 2004. He also serves as President and Director of Georgia Power since January 1, 2004 and Chief Executive Officer of Georgia Power since April 2004. Previously served as President, Chief Executive Officer, and Director of Mississippi Power from 2001 to 2003.

G. Edison Holland, Jr.

Executive Vice President, General Counsel, and Secretary

Age 55

Elected in 2001. Executive Vice President and General Counsel since 2001.

C. Alan Martin

President and Chief Executive Officer of SCS

Age 59

Elected in 2008. President and Chief Executive Officer of SCS since February 1, 2008. Previously served as Executive Vice President of the Customer Service Organization at Alabama Power from May 2001 through January 2008.

Charles D. McCrary

Executive Vice President

Age 56

Elected in 1998. Executive Vice President of Southern Company since February 2002; President, Chief Executive Officer, and Director of Alabama Power since October 2001.

J. Barnie Beasley
President and Chief Executive Officer of Southern Nuclear
Age 56
Elected in 2004. President and Chief Executive Officer of Southern Nuclear since September 2004. Previously served as Executive Vice President of Southern Nuclear from January 2004 to September 2004; and Vice President from July 1998 through December 2003.

The officers of Southern Company were elected for a term running from the first meeting of the directors following the last annual meeting (May 23, 2007) for one year until the first board meeting after the next annual meeting or until their successors are elected and have qualified, except for Mr. Martin whose election was effective on February 1, 2008.

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EXECUTIVE OFFICERS OF ALABAMA POWER

(Identification of executive officers of Alabama Power is inserted in Part I in accordance with Regulation S-K, Item 401(b), Instruction 3.) The ages of the officers set forth below are as of December 31, 2007.

Charles D. McCrary
President, Chief Executive Officer, and Director
Age 56
Elected in 2001. President, Chief Executive Officer, and Director since October 2001; Executive Vice President of Southern Company since February 2002.

Art P. Beattie
Executive Vice President, Chief Financial Officer, and Treasurer
Age 53
Elected in 2004. Executive Vice President, Chief Financial Officer, and Treasurer since February 2005. Previously served as Vice President and Comptroller of Alabama Power from 1998 through January 2005.

Mark A. Crosswhite
Executive Vice President
Age 45
Elected in 2008. Executive Vice President of External Affairs since February 1, 2008. Previously served as Senior Vice President and Counsel of Alabama Power from July 2006 through January 2008; Senior Vice President, General Counsel, and Assistant Secretary of Southern Power from March 2004 through January 2005; and Vice President of SCS from March 2004 through January 2008. Prior to March 2004, Mr. Crosswhite was a partner at the law firm of Balch & Bingham LLP.

Steven R. Spencer
Executive Vice President
Age 52
Elected in 2001. Executive Vice President of the Customer Service Organization since February 1, 2008. Previously served as Executive Vice President of External Affairs from 2001 through January 2008.

Jerry L. Stewart
Senior Vice President
Age 58
Elected in 1999. Senior Vice President of Fossil and Hydro Generation since 1999.

The officers of Alabama Power were elected for a term running from the last annual organizational meeting of the directors (July 27, 2007) for one year until the next annual meeting or until their successors are elected and have qualified, except for Mr. Crosswhite whose election was effective February 1, 2008.

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EXECUTIVE OFFICERS OF GEORGIA POWER

(Identification of executive officers of Georgia Power is inserted in Part I in accordance with Regulation S-K, Item 401(b), Instruction 3.) The ages of the officers set forth below are as of December 31, 2007.

Michael D. Garrett
President, Chief Executive Officer, and Director
Age 58
Elected in 2003. President, Chief Executive Officer, and Director of Georgia Power since April 2004. Previously served as President and Director of Georgia Power from January 2004 to April 2004; President, Chief Executive Officer, and Director of Mississippi Power from May 2001 through December 2003.

Mickey A. Brown
Executive Vice President
Age 60
Elected in 2001. Executive Vice President of the Customer Service Organization since January 2005. Previously served as Senior Vice President of Distribution from May 2001 through December 2004.

Cliff S. Thrasher
Executive Vice President, Chief Financial Officer, and Treasurer
Age 57
Elected in 2005. Executive Vice President, Chief Financial Officer, and Treasurer since March 2005. Previously served as Senior Vice President, Comptroller, and Chief Financial Officer of Southern Power from November 2002 to March 2005 and Vice President of SCS from June 2002 to March 2005.

Christopher C. Womack
Executive Vice President
Age 49
Elected in 2001. Executive Vice President of External Affairs since March 2006. Previously served as Senior Vice President of Fossil and Hydro Generation and Senior Production Officer from December 2001 to February 2006.

Judy M. Anderson
Senior Vice President
Age 59
Elected in 2001. Senior Vice President of Charitable Giving since 2001.

Douglas E. Jones
Senior Vice President
Age 49
Elected in 2005. Senior Vice President of Fossil and Hydro Generation since March 2006. Previously served as Senior Vice President of Customer Service and Sales from January 2005 to February 2006; Executive Vice President of Southern Power from January 2004 to January 2005; Senior Vice President of SCS from December 2001 to January 2004.

James H. Miller, III
Senior Vice President and General Counsel
Age 58
Elected in 2004. Senior Vice President and General Counsel since March 2004. Previously served as Vice President and Associate General Counsel for SCS and Senior Vice President, General Counsel, and Assistant Secretary of Southern Power from August 2001 through February 2004.

Each of the above is currently an executive officer of Georgia Power, serving a term running from the last annual organizational meeting of the directors (May 16, 2007) for one year until the next annual meeting or until their successors are elected and qualified.

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EXECUTIVE OFFICERS OF MISSISSIPPI POWER

(Identification of executive officers of Mississippi Power is inserted in Part I in accordance with Regulation S-K, Item 401(b), Instruction 3.) The ages of the officers set forth below are as of December 31, 2007.

Anthony J. Topazi
President, Chief Executive Officer, and Director
Age 57
Elected in 2003. President, Chief Executive Officer, and Director since January 1, 2004. Previously served as Executive Vice President of Southern Company Generation and Energy Marketing from November 2000 to December 2003; and Senior Vice President of Southern Power from November 2002 to December 2003.

John W. Atherton
Vice President
Age 47
Elected in 2004. Vice President of External Affairs since January 2005. Previously served as the Director of Economic Development from September 2003 to January 2005; and Manager, Sales and Marketing Services from April 2002 to August 2003.

Kimberly D. Flowers
Vice President
Age 44
Elected in 2005. Vice President and Senior Production Officer since March 2005. Previously served as Plant Manager, Plant Bowen, Georgia Power from November 2000 until March 2005.

Donald R. Horsley
Vice President
Age 53
Elected in 2006. Vice President of Customer Services and Retail Marketing since April 2006. Previously served as Vice President of Transmission at Alabama Power from March 2005 to March 2006 and Manager, Transmission Lines at Alabama Power from February 2001 to March 2005.

Frances V. Turnage
Vice President, Treasurer, and
Chief Financial Officer
Age 59
Elected in 2005. Vice President, Treasurer, and Chief Financial Officer since March 2005. Previously served as Comptroller from 1993 to March 2005.

The officers of Mississippi Power were elected for a term running from the last annual organizational meeting of the directors (April 11, 2007) for one year until the next annual meeting or until their successors are elected and have qualified.

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PART II

Item 5. MARKET FOR REGISTRANTS COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

(a)(1) The common stock of Southern Company is listed and traded on the New York Stock Exchange. The common stock is also traded on regional exchanges across the United States. The high and low stock prices for each quarter of the past two years were as follows:

	High	Low
2007		
First Quarter	$37.25	$34.85
Second Quarter	38.90	33.50
Third Quarter	37.70	33.16
Fourth Quarter	39.35	35.15
2006		
First Quarter	$35.89	$32.34
Second Quarter	33.25	30.48
Third Quarter	35.00	32.01
Fourth Quarter	37.40	34.49

There is no market for the other registrants common stock, all of which is owned by Southern Company.
(a)(2) Number of Southern Company s common stockholders of record at December 31, 2007: 102,903
Each of the other registrants have one common stockholder, Southern Company.
(a)(3) Dividends on each registrant s common stock are payable at the discretion of their respective board of directors. The dividends on common stock declared by Southern Company and the traditional operating companies to their stockholder(s) for the past two years were as follows:

Registrant	**Quarter**	**2007**	**2006**
		(in thousands)	
Southern Company	First	$290,292	$276,442
	Second	303,699	287,704
	Third	304,775	287,845
	Fourth	306,039	288,440
Alabama Power	First	116,250	110,150
	Second	116,250	110,150
	Third	116,250	110,150
	Fourth	116,250	110,150
Georgia Power	First	172,475	157,500
	Second	172,475	157,500
	Third	172,475	157,500
	Fourth	172,475	157,500
Gulf Power	First	18,525	17,575
	Second	18,525	17,575
	Third	18,525	17,575
	Fourth	18,525	17,575

Mississippi Power	First	16,825	16,300
	Second	16,825	16,300
	Third	16,825	16,300
	Fourth	16,825	16,300

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In 2006 and 2007, Southern Power paid dividends to Southern Company as follows:

Registrant	Quarter	2007	2006
		(in millions)	
Southern Power	First	$22.45	$
	Second	22.45	38.9
	Third	22.45	19.4
	Fourth	22.45	19.4

The dividend paid per share of Southern Company s common stock was 37.25¢ in the first quarter of 2006 and 38.75¢ for the remaining quarters of 2006 and the first quarter of 2007. For the second, third, and fourth quarters of 2007, the dividend paid per share of Southern Company s common stock was 40.25¢.

The traditional operating companies and Southern Power can only pay dividends to Southern Company out of retained earnings or paid-in-capital.

Southern Power s credit facility contains potential limitations on the payment of common stock dividends. At December 31, 2007, Southern Power was in compliance with the conditions of this credit facility and thus had no restrictions on its ability to pay common stock dividends. See Note 8 to the financial statements of Southern Company under Common Stock Dividend Restrictions and Note 6 to the financial statements of Southern Power under Dividend Restrictions in Item 8 herein for additional information regarding these restrictions.

(a)(4) Securities authorized for issuance under equity compensation plans.

See Part III, Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters under the heading Equity Compensation Plan Information herein.

(b) Use of Proceeds

Not applicable.

(c) Issuer Purchases of Equity Securities

None.

Item 6. SELECTED FINANCIAL DATA

Southern Company. See SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA, contained herein at pages II-97 and II-98.

Alabama Power. See SELECTED FINANCIAL AND OPERATING DATA, contained herein at pages II-159 and II-160.

Georgia Power. See SELECTED FINANCIAL AND OPERATING DATA, contained herein at pages II-225 and II-226.

Gulf Power. See SELECTED FINANCIAL AND OPERATING DATA, contained herein at pages II-282 and II-283.

Mississippi Power. See SELECTED FINANCIAL AND OPERATING DATA, contained herein at pages II-343 and II-344.

Southern Power. See SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA, contained herein at page II-382.

Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Southern Company. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, contained herein at pages II-12 through II-45.

Alabama Power. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, contained herein at pages II-102 through II-122.
Georgia Power. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, contained herein at pages II-164 through II-185.
Gulf Power. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, contained herein at pages II-230 through II-250.
Mississippi Power. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, contained herein at pages II-287 through II-309.
Southern Power. See MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, contained herein at pages II-348 through II-364.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See MANAGEMENT S DISCUSSION AND ANALYSIS - FINANCIAL CONDITION AND LIQUIDITY Market Price Risk of each of the registrants in Item 7 herein and Note 1 of each of the registrant s financial statements under Financial Instruments in Item 8 herein. See also Note 6 to the financial statements of Southern Company, each traditional operating company, and Southern Power under Financial Instruments in Item 8 herein.

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Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
INDEX TO 2007 FINANCIAL STATEMENTS

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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Item 9A. CONTROLS AND PROCEDURES

Disclosure Controls And Procedures.

As of the end of the period covered by this annual report, Southern Company conducted an evaluation under the supervision and with the participation of Southern Company s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures (as defined in Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based upon this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures are effective in alerting them in a timely manner to material information relating to Southern Company (including its consolidated subsidiaries) required to be included in periodic filings with the SEC.

Internal Control Over Financial Reporting.

(a) Management s Annual Report on Internal Control Over Financial Reporting.

Southern Company s Management s Report on Internal Control Over Financial Reporting is included on page II-9 of this Form 10-K.

(b) Attestation Report of the Registered Public Accounting Firm.

The report of Deloitte & Touche LLP, Southern Company s independent registered public accounting firm, regarding Southern Company s internal control over financial reporting is included on page II-10 of this Form 10-K.

(c) Changes in internal controls.

There have been no changes in Southern Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fourth quarter 2007 that have materially affected or are reasonably likely to materially affect Southern Company s internal control over financial reporting.

Item 9A(T). CONTROLS AND PROCEDURES

Disclosure Controls And Procedures.

As of the end of the period covered by this annual report, Alabama Power, Georgia Power, Gulf Power, Mississippi Power, and Southern Power conducted separate evaluations under the supervision and with the participation of each company s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures (as defined in Sections 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934). Based upon these evaluations, the Chief Executive Officer and the Chief Financial Officer, in each case, concluded that the disclosure controls and procedures are effective in alerting them in a timely manner to material information relating to their company (including its consolidated subsidiaries, if any) required to be included in periodic filings with the SEC.

Internal Control Over Financial Reporting.

(a) Management s Annual Report on Internal Control Over Financial Reporting.

Alabama Power s Management s Report on Internal Control Over Financial Reporting is included on page II-100 of this Form 10-K.

Georgia Power s Management s Report on Internal Control Over Financial Reporting is included on page II-162 of this Form 10-K.

Gulf Power s Management s Report on Internal Control Over Financial Reporting is included on page II-228 of this Form 10-K.

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Mississippi Power s Management s Report on Internal Control Over Financial Reporting is included on page II-285 of this Form 10-K.

Southern Power s Management s Report on Internal Control Over Financial Reporting is included on page II-346 of this Form 10-K.

(b) Changes in internal controls.

There have been no changes in Alabama Power s, Georgia Power s, Gulf Power s, Mississippi Power s, or Southern Power s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fourth quarter 2007 that have materially affected or are reasonably likely to materially affect Alabama Power s, Georgia Power s, Gulf Power s, Mississippi Power s, or Southern Power s internal control over financial reporting.

Item 9B. OTHER INFORMATION

None.

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MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
Southern Company and Subsidiary Companies 2007 Annual Report

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. Based on this evaluation, management concluded that Southern Company s internal control over financial reporting was effective as of December 31, 2007.

Deloitte & Touche LLP, an independent registered public accounting firm, as auditors of Southern Company s financial statements, has issued an attestation report on the effectiveness of Southern Company s internal control over financial reporting as of December 31, 2007. Deloitte & Touche LLP s report on Southern Company s internal control over financial reporting is included herein.

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

/s/ W. Paul Bowers
W. Paul Bowers
Executive Vice President and Chief Financial Officer

February 25, 2008

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Internal Control Over Financial Reporting
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
To the Board of Directors and Stockholders of
Southern Company

We have audited the internal control over financial reporting of Southern Company and Subsidiary Companies (the Company) as of December 31, 2007, 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 (page II-9). Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, 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, 2007 of the Company and our report dated February 25, 2008 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding changes in the method of accounting for uncertainty in income taxes and the method of accounting for the impact of changes in the timing of income tax cash flows generated by leveraged leases in 2007 and a change in the method of accounting for the funded status of defined benefit pension and other postretirement plans in 2006.

/s/ Deloitte & Touche LLP
Atlanta, Georgia
February 25, 2008

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Consolidated Financial Statements
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
To the Board of Directors and Stockholders of
Southern Company

We have audited the accompanying consolidated balance sheets and consolidated statements of capitalization of Southern Company and Subsidiary Companies (the Company) as of December 31, 2007 and 2006, 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, 2007. 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 II-46 to II-95) present fairly, in all material respects, the financial position of Southern Company and Subsidiary Companies at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 3 and 5 to the financial statements, in 2007 the Company changed its method of accounting for uncertainty in income taxes and its method of accounting for the impact of changes in the timing of income tax cash flows generated by leveraged leases. 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 Company s internal control over financial reporting as of December 31, 2007, 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 25, 2008 expressed an unqualified opinion on the Company s internal control over financial reporting.

/s/ Deloitte & Touche LLP
Atlanta, Georgia
February 25, 2008

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Southern Company and Subsidiary Companies 2007 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. The four traditional operating companies 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.

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. Each of the traditional operating companies has various regulatory mechanisms that operate to address cost recovery. Since 2005, the traditional operating companies have completed a number of regulatory proceedings that provide for the timely recovery of costs. Appropriately balancing required costs and capital 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 continues to execute its regional strategy through a combination of acquiring and constructing new power plants and by entering into power purchase agreements (PPAs) with investor owned utilities, independent power producers, municipalities, and electric cooperatives. 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 leveraged lease projects, telecommunications, energy-related services, and an investment in a synthetic fuel producing entity which claimed federal income tax credits designed to offset its operating losses. The availability of synthetic fuel tax credits and the Company s investment in these activities ended on December 31, 2007. Management continues to evaluate the contribution of each of these remaining activities to total shareholder return and may pursue acquisitions and dispositions accordingly.

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 fossil/hydro 2007 Peak Season EFOR of 1.60% was better than the target. The nuclear generating fleet also uses Peak Season EFOR as an indicator of availability and efficient generation fleet operations during the peak season. The nuclear 2007 Peak Season EFOR of 0.94% was also better than target. 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 2007 was better than target for these reliability measures.

MANAGEMENT S DISCUSSION AND ANALYSIS (continued)
Southern Company and Subsidiary Companies 2007 Annual Report

Southern Company s synthetic fuel investments have generated tax credits as a result of synthetic fuel production. Due to higher oil prices in 2006 and 2007, these tax credits were partially phased out and one synthetic fuel investment was terminated in 2006. These tax credits were no longer available after December 31, 2007. Southern Company management uses EPS, excluding earnings from synthetic fuel investments, 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 2007 results compared with its targets for some of these key indicators are reflected in the following chart:

Key Performance Indicator	2007 Target Performance	2007 Actual Performance
Customer Satisfaction	Top quartile in customer surveys	Top quartile
Peak Season EFOR fossil/hydro	2.75% or less	1.60%
Peak Season EFOR nuclear	2.00% or less	0.94%
Basic EPS	$ 2.18 $2.25	$ 2.29
EPS, excluding earnings from synthetic fuel investments	$ 2.13 $2.18	$ 2.21

See RESULTS OF OPERATIONS herein for additional information on the Company s financial performance. The financial performance achieved in 2007 reflects the continued emphasis that management places on these indicators as well as the commitment shown by employees in achieving or exceeding management s expectations.

Earnings

Southern Company s net income was $1.73 billion in 2007, an increase of 10.2% from the prior year. The higher earnings compared with the prior year were primarily the result of a warm summer and state regulatory actions. These positive factors were offset in part by higher non-fuel operations and maintenance expenses, higher interest expense, and higher asset depreciation primarily associated with increased investment in environmental equipment at generating plants and transmission and distribution related to maintaining reliability. Net income was $1.57 billion in 2006 and $1.59 billion in 2005, reflecting a 1.1% decrease and a 3.8% increase over the prior year, respectively. Basic EPS was $2.29 in 2007, $2.12 in 2006, and $2.14 in 2005. Diluted EPS, which factors in additional shares related to stock options, was $2.28 for 2007, $2.10 for 2006, and $2.13 for 2005.

Dividends

Southern Company has paid dividends on its common stock since 1948. Dividends paid per share of common stock were $1.595 in 2007, $1.535 in 2006, and $1.475 in 2005. In January 2008, Southern Company declared a quarterly dividend of 40.25 cents per share. This is the 241st 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% of net income, excluding earnings from synthetic fuel investments. For 2007, the actual payout ratio was 72%, excluding earnings from synthetic fuel investments, and 69.5% overall.

RESULTS OF OPERATIONS

Electricity Business

Southern Company s electric utilities generate and sell electricity to retail and wholesale customers in the Southeast.

MANAGEMENT S DISCUSSION AND ANALYSIS (continued)
Southern Company and Subsidiary Companies 2007 Annual Report
A condensed income statement for the electricity business follows:

	Amount	Increase (Decrease) from Prior Year		
	2007	**2007**	2006	2005
		(in millions)		
Electric operating revenues	**$15,140**	**$1,052**	$ 810	$1,813
Fuel	**5,844**	**701**	655	1,089
Purchased power	**515**	**(28)**	(188)	88
Other operations and maintenance	**3,473**	**183**	70	215
Depreciation and amortization	**1,215**	**51**	27	229
Taxes other than income taxes	**738**	**23**	39	52
Total electric operating expenses	**11,785**	**930**	603	1,673
Operating income	**3,355**	**122**	207	140
Other income, net	**121**	**68**	(9)	38
Interest expense and dividends	**812**	**61**	75	62
Income taxes	**950**	**1**	50	24
Net income	**$ 1,714**	**$ 128**	$ 73	$ 92

Electric Operating Revenues
Details of electric operating revenues were as follows:

	Amount		
	2007	2006	2005
		(in millions)	
Retail prior year	**$ 11,800.6**	$ 11,164.9	$ 9,732.1
Estimated change in			
Rates and pricing	**161.3**	9.0	309.0
Sales growth	**59.6**	114.4	105.0
Weather	**54.0**	34.9	33.8
Fuel and other cost recovery	**563.0**	477.4	985.0
Retail current year	**12,638.5**	11,800.6	11,164.9
Wholesale revenues	**1,988.3**	1,821.7	1,667.0
Other electric operating revenues	**513.7**	465.7	446.2
Electric operating revenues	**$ 15,140.5**	$ 14,088.0	$ 13,278.1
Percent change	**7.5%**	6.1%	15.8%

Retail revenues increased $838 million, $636 million, and $1.4 billion in 2007, 2006, and 2005, respectively. The significant factors driving these changes are shown in the preceding table. The increase in rates and pricing in 2007 was primarily due to Alabama Power s increase under its Rate Stabilization and Equalization Plan (Rate RSE), as ordered by the Alabama Public Service Commission (PSC). See Note 3 to the financial statements under Alabama Power Retail Regulatory Matters for additional information. Partially offsetting the 2007 increase was a decrease in contributions from market-based rates to large commercial and industrial customers at Georgia Power. The 2006 increase in rates and pricing when compared to the prior year was not material. The increase in rates and pricing in 2005 was primarily due to approval by the Georgia PSC of a retail base rate increase at Georgia Power. See Energy Sales below for a discussion of changes in the volume of energy sold, including changes related to sales growth and weather.

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

MANAGEMENT S DISCUSSION AND ANALYSIS (continued)
Southern Company and Subsidiary Companies 2007 Annual Report

equal fuel expenses, including the fuel component of purchased power, and do not affect net income. The traditional operating companies may also have one or more regulatory mechanisms to recover other costs such as environmental, storm damage, new plants, and PPAs.

Wholesale 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 11 years and, as a result, the Company has significantly limited its remarketing risk.

In 2007, wholesale revenues increased $166 million primarily as a result of a 9.5% increase in the average cost of fuel per net kilowatt-hour (KWH) generated. Excluding fuel, wholesale revenues were flat when compared to the prior year.

In 2006, wholesale revenues increased $155 million primarily as a result of a 10.5% 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 short-term opportunity sales.

In 2005, wholesale revenues increased $326 million primarily due to a 26.5% 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.

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:

	2007	2006	2005
		(in millions)	
Other power sales			
Capacity and other	**$ 533**	$ 499	$ 430
Energy	**989**	841	799
Total	**$1,522**	$1,340	$1,229

Capacity revenues under unit power sales contracts, principally sales to Florida utilities, reflect the recovery of fixed costs and a return on investment. Unit power KWH sales decreased 0.8% in 2007 and increased 0.2% and 1.7% in 2006 and 2005, respectively. Fluctuations in oil and natural gas prices, which are the primary fuel sources for unit power sales customers, influence changes in these sales. However, because the energy is generally sold at variable cost, these fluctuations have a minimal effect on earnings. The capacity and energy components of the unit power sales contracts were as follows:

	2007	2006	2005
		(in millions)	
Unit power sales			
Capacity	**$202**	$208	$201
Energy	**264**	274	237
Total	**$466**	$482	$438

Energy Sales

Changes in revenues are influenced heavily by the change in the volume of energy sold from year to year. KWH sales for 2007 and the percent change by year were as follows:

MANAGEMENT S DISCUSSION AND ANALYSIS (continued)
Southern Company and Subsidiary Companies 2007 Annual Report

	KWHs	Percent Change		
	2007	**2007**	2006	2005
	(in billions)			
Residential	**53.3**	**1.8%**	2.5%	2.8%
Commercial	**54.7**	**3.2**	2.2	3.6
Industrial	**54.7**	**(0.7)**	(0.2)	(2.2)
Other	**0.9**	**4.4**	(7.6)	(0.9)
Total retail	**163.6**	**1.4**	1.4	1.2
Wholesale	**40.8**	**5.9**	3.7	7.2
Total energy sales	**204.4**	**2.3**	1.9	2.3

Retail energy sales in 2007 increased 2.3 billion KWHs as a result of 1.3% customer growth and favorable weather in 2007 when compared to 2006. The 2007 decrease in industrial sales primarily resulted from reduced demand and closures within the textile industry, as well as decreased demand in the primary metals sector and the stone, clay, and glass sector. Retail energy sales in 2006 increased 2.3 billion KWHs as a result of customer growth of 1.7%, sustained economic growth primarily in the residential and commercial customer classes, and favorable weather in 2006 when compared to 2005. Retail energy sales in 2005 increased 1.9 billion KWHs as a result of sustained economic growth and customer growth of 1.2%. 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. Wholesale energy sales increased by 2.3 billion KWHs, 1.4 billion KWHs, and 2.5 billion KWHs in 2007, 2006, and 2005, respectively. The increase in wholesale energy sales in 2007 was primarily related to new PPAs acquired by Southern Company through the acquisition of Plant Rowan in September 2006, as well as new contracts with EnergyUnited Electric Membership Corporation that commenced in September 2006 and January 2007. An increase in KWH sales under existing PPAs also contributed to the 2007 increase. The increases in wholesale energy sales in 2006 and 2005 were related primarily to the new PPAs discussed previously under Electric Operating Revenues.

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. Additionally, the electric utilities purchase a portion of their electricity needs from the wholesale market. Details of Southern Company s electricity generated and purchased were as follows:

	2007	2006	2005
Total generation *(billions of KWHs)*	**206**	201	195
Total purchased power *(billions of KWHs)*	**8**	8	9
Sources of generation *(percent)*			
Coal	**70**	70	71
Nuclear	**14**	15	15
Gas	**15**	13	11
Hydro	**1**	2	3

Cost of fuel, generated *(cents per net KWH)*			
Coal	**2.61**	2.40	1.93
Nuclear	**0.50**	0.47	0.47
Gas	**6.64**	6.63	8.52
Average cost of fuel, generated *(cents per net KWH)*	**2.89**	2.64	2.39
Average cost of purchased power *(cents per net KWH)*	**7.20**	6.82	8.04

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In 2007, fuel and purchased power expenses were $6.4 billion, an increase of $673 million or 11.8% above 2006 costs. This increase was primarily the result of a $543 million net increase in the average cost of fuel and purchased power partially resulting from a 51.4% decrease in hydro generation as a result of a severe drought. Also contributing to this increase was a $130 million increase related to an increase in net KWHs generated and purchased.

Fuel and purchased power expenses were $5.7 billion in 2006, an increase of $467 million or 8.9% above the prior year costs. This increase was primarily the result of a $367 million net increase in the average cost of fuel and purchased power and a $100 million increase related to an increase in net KWHs generated and purchased.

In 2005, fuel and purchased power expenses were $5.2 billion, an increase of $1.2 billion or 29.1% above 2004 costs. This increase was the result of a $1.3 billion net increase in the average cost of fuel and purchased power, partially offset by $67 million related to a decrease in net KWHs generated and purchased.

While there has been a significant upward trend in the cost of coal and natural gas since 2003, prices moderated somewhat in 2006 and 2007. Coal prices have been influenced by a worldwide increase in demand from developing countries, as well as increases in mining and fuel transportation costs. While demand for natural gas in the United States continued to increase in 2007, natural gas supplies have also risen due to increased production and higher storage levels. During 2007, uranium prices were volatile and increased over the course of the year due to increasing long-term demand with primary production levels at approximately 55% to 60% of demand. Secondary supplies and inventories were sufficient to fill the primary production shortfall.

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 $3.5 billion, $3.3 billion, and $3.2 billion, increasing $183 million, $70 million, and $215 million in 2007, 2006, and 2005, respectively. Discussion of significant variances for components of other operations and maintenance expenses follows.

Other production expenses at fossil, hydro, and nuclear plants increased $128 million, $3 million, and $58 million in 2007, 2006, and 2005, respectively. Production expenses fluctuate from year to year due to variations in outage schedules and normal increases in costs. Other production expenses increased in 2007 primarily due to a $40 million increase related to expenses incurred for maintenance outages at generating units and a $29 million increase related to new facilities, mainly costs associated with the write-off of Southern Power s integrated coal gasification combined cycle (IGCC) project and the acquisitions of Plants DeSoto and Rowan by Southern Power in June and September 2006, respectively. A $25 million increase related to labor and materials expenses and a $22 million increase in nuclear refueling costs also contributed to the 2007 increase. See FUTURE EARNINGS POTENTIAL Construction Projects Integrated Coal Gasification Combined Cycle herein for additional information regarding the write-off of Southern Power s IGCC project and Note 1 to the financial statements under Property, Plant, and Equipment for additional information regarding the amortization of nuclear refueling costs. The 2006 increase in other production expenses when compared to the prior year was not material. Other production expenses increased in 2005 due to a $50 million increase related primarily to expenses incurred for maintenance outages at generating units.

Administrative and general expenses increased $28 million, $29 million, and $73 million in 2007, 2006, and 2005, respectively. Administrative and general expenses increased in 2007 primarily as a result of a $16 million increase in legal costs and expenses associated with an increase in employees. Also contributing to the 2007 increase was a

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$14 million increase in accrued expenses for the litigation and workers compensation reserve, partially offset by an $8 million decrease in property damage expense. Administrative and general expenses increased in 2006 primarily 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 in 2005 primarily related to a $33 million increase in employee benefits; a $22 million increase in Sarbanes-Oxley Act compliance costs, legal costs, and other corporate expenses; and a $9 million increase in property damage expense.

Transmission and distribution expenses increased $21 million, $30 million, and $60 million in 2007, 2006, and 2005, respectively. Transmission and distribution expenses fluctuate from year to year due to variations in maintenance schedules and normal increases in costs. Transmission and distribution expenses increased in 2007 primarily as a result of increases in labor and materials costs and maintenance associated with additional investment to meet customer growth. 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 maintenance associated with 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.

Depreciation and Amortization

Depreciation and amortization increased $51 million in 2007 primarily as a result of additional investments in environmental equipment at generating plants and transmission and distribution projects mainly at Alabama Power and Georgia Power and an increase in the amortization expense of a regulatory liability recorded in 2003 in connection with the Mississippi PSC s accounting order on Plant Daniel capacity. Partially offsetting the 2007 increase was a reduction in amortization expense due to 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 1 to the financial statements under Depreciation and Amortization for additional information.

Depreciation and amortization increased $27 million in 2006 primarily as a result of the acquisitions of Plants DeSoto, Rowan, and Oleander in June 2006, September 2006, and June 2005, respectively, and an increase in the amortization expense of the Mississippi Power regulatory liability related to Plant Daniel capacity. 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 a reduction in the amortization expense of a Georgia Power regulatory liability related to the levelization of certain purchased power capacity costs.

Depreciation and amortization increased $229 million in 2005 primarily as a result of additional plant in service and from the expiration in 2004 of certain provisions related to the amortization of regulatory liabilities associated with purchased power capacity costs in Georgia Power s retail rate plan for the three years ended December 31, 2004.

Taxes Other than Income Taxes

Taxes other than income taxes increased $23 million in 2007 primarily as a result of increases in franchise and municipal gross receipts taxes associated with increases in revenues from energy sales, partially offset by a decrease in property taxes resulting from the resolution of a dispute with Monroe County, Georgia. Taxes other than income taxes increased $39 million in 2006 primarily as a result of increases in franchise and municipal gross receipts taxes associated with increases in revenues from energy sales, as well as increases in property taxes associated with

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additional plant in service. Taxes other than income taxes increased $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.

Other Income, Net

Other income, net increased $68 million in 2007 primarily as a result of a $56 million increase in allowance for equity funds used during construction related to additional investments in environmental equipment at generating plants and transmission and distribution projects mainly at Alabama Power and Georgia Power. The 2006 decrease in other income, net when compared to the prior year was not material. Other income, net increased $38 million in 2005 primarily as a result of a $19 million reduction largely related to the disallowance of certain Plant McIntosh costs by the Georgia PSC in 2004, a $10 million increase related primarily to changes in the value of derivative transactions, and a $6 million increase in interest income.

Interest Expense and Dividends

Total interest charges and other financing costs increased by $61 million in 2007 primarily as a result of a $72 million increase associated with $1.2 billion in additional debt and preference stock outstanding at December 31, 2007 compared to December 31, 2006 and higher interest rates associated with the issuance of new long-term debt. Also contributing to the 2007 increase was $7 million related to higher average interest rates on existing variable rate debt and $19 million in other interest costs. These increases were partially offset by $38 million more capitalized interest as compared to 2006.

Total interest charges and other financing costs increased by $75 million in 2006 primarily due to a $78 million increase associated with $708 million in additional debt outstanding at December 31, 2006 compared to December 31, 2005 and higher interest rates associated with the issuance of new long-term debt. Also contributing to the 2006 increase was $7 million associated with higher average interest rates on existing variable rate debt, partially offset by $6 million more capitalized interest associated with construction projects and $3 million in lower 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 Securities Industry and Financial Markets Association Municipal Swap Index, which averaged 2.5% in 2005 and 1.2% in 2004. Variable rates on commercial paper and senior notes are highly correlated with the one-month London Interbank Offer Rate, which averaged 3.4% in 2005 and 1.5% 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.

Income Taxes

Income taxes were relatively flat in 2007 as higher pre-tax earnings were largely offset due to a deduction for a Georgia Power land donation, the tax benefit associated with an increase in allowance for equity funds used during construction, and an increase in the Internal Revenue Code of 1986, as amended (Internal Revenue Code), Section 199 production activities deduction. See Note 5 to the financial statements under Effective Tax Rate for additional information.

Income taxes increased $50 million in 2006 primarily due to higher pre-tax earnings and the impact of the accounting order approved by the Alabama PSC discussed previously under Other Operations and Maintenance Expenses. See Note 3 to the financial statements under Storm Damage Cost Recovery for additional information.

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Income taxes increased $24 million in 2005 primarily as a result of higher pre-tax earnings, partially offset by the impact of the accounting order approved by the Alabama PSC discussed above.

Other Business Activities

Southern Company s other business activities include the parent company (which does not allocate operating expenses to business units), investments in leveraged lease and synthetic fuel 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 leveraged lease and synthetic fuel projects that receive tax benefits, which contribute significantly to the economic results of these investments; SouthernLINC Wireless provides digital wireless communications to the traditional operating companies and also markets these services to the public and provides fiber cable services within the Southeast. Southern Company s investment in the synthetic fuel projects ended at December 31, 2007. A condensed income statement for Southern Company s other business activities follows:

	Amount	Increase (Decrease) from Prior Year		
	2007	**2007**	2006	2005
		(in millions)		
Operating revenues	**$ 213**	**$(55)**	$ (8)	$ 12
Other operations and maintenance	**209**	**(29)**	(59)	12
Depreciation and amortization	**30**	**(6)**	(3)	(2)
Taxes other than income taxes	**3**		(1)	1
Total operating expenses	**242**	**(35)**	(63)	11
Operating income/(loss)	**(29)**	**(20)**	55	1
Equity in losses of unconsolidated subsidiaries	**(25)**	**35**	62	(25)
Leveraged lease income	**40**	**(29)**	(5)	4
Other income, net	**41**	**73**	(19)	(9)
Interest expense	**122**	**(27)**	48	18
Income taxes	**(115)**	**53**	136	(14)
Net income/(loss)	**$ 20**	**$ 33**	$ (91)	$(33)

Operating Revenues

Southern Company s non-electric operating revenues from these other businesses decreased $55 million in 2007 primarily as a result of a $13 million decrease in revenues at SouthernLINC Wireless related to lower average revenue per subscriber and fewer subscribers due to increased competition in the industry. Also contributing to the 2007 decrease was a $14 million decrease in fuel procurement service revenues following a contract termination and an $11 million decrease in revenues from Southern Company s energy-related services business. The $8 million decrease in 2006 primarily resulted from 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.

Other Operations and Maintenance Expenses

Other operations and maintenance expenses for these other businesses decreased $29 million in 2007 primarily as a result of $11 million of lower production expenses related to the termination of Southern Company s membership interest in one of the synthetic fuel entities and $8 million attributed to the wind-down of one of the Company s

MANAGEMENT S DISCUSSION AND ANALYSIS (continued)
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energy-related services businesses. Other operations and maintenance expenses decreased $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 primarily 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 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.

Equity in Losses of Unconsolidated Subsidiaries

Southern Company made investments in two synthetic fuel production facilities that generated operating losses. These investments allowed Southern Company to claim federal income tax credits that offset these operating losses and made the projects profitable. The 2007 decrease in equity in losses of unconsolidated subsidiaries was the result of terminating Southern Company s membership interest in one of the synthetic fuel entities which reduced the amount of the Company s share of the losses and, therefore, the funding obligation for the year. Also contributing to the 2007 decrease were adjustments related the phase-out of the related federal income tax credits, partially offset by higher operating expenses due to idled production in 2006 and decreased production in 2007 in anticipation of exiting the business. The 2006 decrease in equity in losses of unconsolidated subsidiaries was the result of terminating Southern Company s membership interest in one of the synthetic fuel entities which reduced the amount of the Company s share of the losses and, therefore, the funding obligation for the year. The 2006 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 resulted from additional production expenses at the synthetic fuel production facilities. The net synthetic fuel tax credits resulting from these investments totaled $36 million in 2007, $65 million in 2006, and $177 million in 2005.

Leveraged Lease Income

Southern Company has several leveraged lease agreements 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. Leveraged lease income decreased $29 million in 2007 as a result of the adoption of Financial Accounting Standards Board (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), as well as an expected decline in leveraged lease income over the terms of the leases. See FUTURE EARNINGS POTENTIAL Income Tax Matters Leveraged Lease Transactions herein for further information. The 2006 and 2005 changes in leveraged lease income when compared to the prior year were not material.

Other Income, Net

Other income, net for these other businesses increased $73 million in 2007 primarily as a result of a $60 million increase related to changes in the value of derivative transactions in the synthetic fuel business and a $16 million increase related to the 2006 impairment of investments in the synthetic fuel entities, partially offset by the release of $6 million in certain contractual obligations associated with these investments in 2006. The $19 million decrease in other income, net in 2006 as compared with 2005 primarily resulted from a $25 million decrease related to changes in the value of derivative transactions in the synthetic fuel business and the previously mentioned impairment and

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release of contractual obligations. The 2005 decrease in other income, net when compared to the prior year was not material.

Interest Expense

Total interest charges and other financing costs for these other businesses decreased by $27 million in 2007 primarily as a result of $16 million of losses on debt that was reacquired in 2006. Also contributing to the 2007 decrease was $97 million less debt outstanding at December 31, 2007 compared to December 31, 2006, lower interest rates associated with the issuance of new long-term debt, and a $4 million decrease in other interest costs. Total interest charges and other financing costs increased by $48 million in 2006 primarily due to a $19 million increase associated with $149 million in additional debt outstanding at December 31, 2006 as compared to December 31, 2005 and higher interest rates associated with the issuance of new long-term debt. Also contributing to the increase were $12 million associated with higher average interest rates on existing 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 was partially offset by $4 million in lower 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.

Income Taxes

Income taxes for these other businesses increased $53 million in 2007 primarily as a result of a $30 million decrease in net synthetic fuel tax credits as a result of terminating Southern Company s membership interest in one of the synthetic fuel entities in 2006 and increasing the synthetic fuel tax credit reserves due to an anticipated phase-out of synthetic fuel tax credits due to higher oil prices. The $136 million increase in income taxes in 2006 as compared with 2005 primarily resulted from a $111 million decrease in net synthetic fuel tax credits as a result of terminating Southern Company s membership interest in one of the synthetic fuel entities, curtailing production at the other synthetic fuel entity from May to September 2006, and increasing the synthetic fuel tax credit reserves due to an anticipated phase-out of synthetic fuel tax credits due to higher oil prices. See Note 5 to the financial statements under Effective Tax Rate for further information. The 2005 decrease in income taxes when compared to the prior year was not material.

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 or in market-based prices, 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, preferred securities, preferred stock, and preference stock. Any recognition of inflation by regulatory authorities is reflected in the rate of return allowed in the traditional operating companies approved electric rates.

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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. Prices for wholesale electricity sales, interconnecting transmission lines, and the exchange of electric power are regulated by the Federal Energy Regulatory Commission (FERC). 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. 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.

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. Other major factors include the profitability of the competitive wholesale supply business and federal regulatory policy (including the FERC s market-based rate proceeding), 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. In addition, the level of future earnings for the wholesale supply business also depends on numerous factors including creditworthiness of customers, total generating capacity available in the Southeast, and the successful remarketing of capacity as current contracts expire.

Southern Company system generating capacity increased 163 megawatts due to Southern Power s completion of Plant Oleander Unit 5 in December 2007. 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, disposition of certain assets, internal restructuring, 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, risks, and financial condition of Southern Company.

Environmental Matters

Compliance costs related to the Clean Air Act and other environmental statutes and regulations could affect earnings if such costs cannot continue to 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 statutes and regulations are adopted or modified. See Note 3 to the financial statements under Environmental Matters for additional information.

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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. The civil actions request penalties and injunctive relief, including an order requiring the installation of the best available control technology at the affected units. The action against Georgia Power has been administratively closed since the spring of 2001, and the case has not been reopened.
In June 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. In August 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 all of the remaining plants: Plants Barry, Gaston, Gorgas, and Greene County.
The plaintiffs appealed the district court s decision to the U.S. Court of Appeals for the Eleventh Circuit, and the appeal was stayed by the Appeals Court pending the U.S. Supreme Court s decision in a similar case against Duke Energy. The Supreme Court issued its decision in the Duke Energy case in April 2007. On October 5, 2007, the U.S. District Court for the Northern District of Alabama issued an order in the Alabama Power case indicating a willingness to re-evaluate its previous decision in light of the Supreme Court s Duke Energy opinion. On December 21, 2007, the Eleventh Circuit vacated the district court s decision in the Alabama Power case and remanded the case back to the district court for consideration of the legal issues in light of the Supreme Court s decision in the Duke Energy case. The final outcome of these matters cannot be determined at this time.
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 either of these cases could require substantial capital expenditures or affect the timing of currently budgeted 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. In June 2005, the 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. In March 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. The EPA has 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.

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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, and no decision has been issued. The ultimate outcome of these matters cannot be determined at this time.

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 2007, Southern Company had invested approximately $4.7 billion in capital projects to comply with these requirements, with annual totals of $1.5 billion, $661 million, and $423 million for 2007, 2006, and 2005, respectively. The Company expects that capital expenditures to assure compliance with existing and new statutes and regulations will be an additional $1.8 billion, $1.5 billion, and $0.6 billion for 2008, 2009, and 2010, respectively. The Company s compliance strategy is impacted by changes to existing environmental laws, statutes, and regulations, the cost, availability, and existing inventory of emission allowances, and the Company s fuel mix. 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 2007, the Company had spent approximately $3.8 billion in reducing sulfur dioxide (SO_2) 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 SO_2, NO_x, and mercury emissions, maintain compliance with existing regulations, and meet new requirements.

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In 2004, the EPA designated nonattainment areas under an 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. The Macon area was redesignated by the EPA as an attainment area on September 19, 2007. The Birmingham area was redesignated to attainment by the EPA in June 2006, and the EPA subsequently approved a maintenance plan for the area to address future exceedances of the standard. In December 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. On June 20, 2007, the EPA proposed additional revisions to the current eight-hour ozone standard which, if enacted, could result in designation of new nonattainment areas within Southern Company s service territory. The EPA has requested comment and is expected to publish final revisions to the standard in 2008. The impact of this decision, if any, cannot be determined at this time and will depend on subsequent legal action and/or future nonattainment designations and state regulatory plans.

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. State plans for addressing the nonattainment designations under the existing standard are required by April 2008 and could require further reductions in SO_2 and NO_x emissions from power plants. In September 2006, the EPA published a final rule which increased the stringency of the 24-hour average fine particulate matter air quality standard. In December 2007, state agencies recommended to the EPA that Jefferson County (Birmingham) and Etowah County (Gadsden) in Alabama and an area encompassing all or parts of 22 counties within metropolitan Atlanta in Georgia be designated as nonattainment for this standard. The EPA plans to designate nonattainment areas based on the new standard by December 2009. The ultimate outcome of this matter depends on the development and submittal of the required state plans and resolution of pending legal challenges and, therefore, 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 SO_2 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 SO_2 to be achieved in two phases, 2009/2010 and 2015. States in the Southern Company service territory have completed plans to implement this program. These reductions will be accomplished by the installation of additional emission controls at Southern Company s coal-fired facilities and/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 by 2018 toward the natural conditions goal. 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 SO_2 and NO_x. Extensive studies were performed for each of the Company s affected units to demonstrate that additional particulate matter controls are not necessary under BART. At the request of the State of Georgia, additional analyses were performed for certain units in Georgia to demonstrate that no additional SO_2 controls were required. Additional analyses will be required for one of the Company s plants in Florida. States are currently completing implementation plans that contain strategies for BART and any other measures required to achieve the first phase of reasonable progress.

The impacts of the eight-hour ozone and the fine particulate matter nonattainment designations and the Clean Air Visibility Rule on the Company will depend on the development and implementation of rules at the state level. For

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example, while it has implemented the Clean Air Interstate Rule, in June 2007 the State of Georgia approved a multi-pollutant rule that will require plant-specific emission controls on all but the smallest generating units in Georgia according to a schedule set forth in the rule. The rule is designed to ensure reductions in emissions of SO_2, NO_x, and mercury in Georgia. Therefore, the full effects of these regulations on the Company cannot be determined at this time. The Company has developed and continually updates a comprehensive environmental compliance strategy to comply with the continuing and new environmental requirements discussed above. As part of this strategy, the Company plans to install additional SO_2 and NO_x emission controls within the next several years to assure continued compliance with applicable air quality requirements.

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 final Clean Air Mercury Rule was challenged in the U.S. Court of Appeals for the District of Columbia Circuit. The petitioners alleged that the EPA was not authorized to establish a cap-and-trade program for mercury emissions and instead the EPA must establish maximum achievable control technology standards for coal-fired electric utility steam generating units. On February 8, 2008, the court issued its ruling and vacated the Clean Air Mercury Rule. The Company s overall environmental compliance strategy relies primarily on a combination of SO_2 and NOx controls to reduce mercury emissions. Any significant changes in the strategy will depend on the outcome of any appeals and/or future federal and state rulemakings. Future rulemakings could require emission reductions more stringent than required by the Clean Air Mercury Rule.

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 be determined at this time.

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

Federal legislative proposals that would impose mandatory requirements related to greenhouse gas emissions continue to be considered in Congress. The ultimate outcome of these proposals cannot be determined at this time; however, mandatory restrictions on the Company s greenhouse gas emissions could result in significant additional

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compliance costs that could affect future unit retirement and replacement decisions and results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

In April 2007, the U.S. Supreme Court ruled that the EPA has authority under the Clean Air Act to regulate greenhouse gas emissions from new motor vehicles. The EPA is currently developing its response to this decision. Regulatory decisions that will follow from this response may have implications for both new and existing stationary sources, such as power plants. The ultimate outcome of these rulemaking activities cannot be determined at this time; however, as with the current legislative proposals, mandatory restrictions on the Company s greenhouse gas emissions could result in significant additional compliance costs that could affect future unit retirement and replacement decisions and results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

In addition, some states are considering or have undertaken actions to regulate and reduce greenhouse gas emissions. For example, on July 13, 2007, the Governor of the State of Florida signed three executive orders addressing reduction of greenhouse gas emissions within the state, including statewide emission reduction targets beginning in 2017. Included in the orders is a directive to the Florida Secretary of Environmental Protection to develop rules adopting maximum allowable emissions levels of greenhouse gases for electric utilities, consistent with the statewide emission reduction targets, and a request to the Florida PSC to initiate rulemaking requiring utilities to produce at least 20% of their electricity from renewable sources. The impact of these orders on Southern Company will depend on the development, adoption, and implementation of any rules governing greenhouse gas emissions, and the ultimate outcome cannot be determined at this time.

International climate change negotiations under the United Nations Framework Convention on Climate Change also continue. Current efforts focus on a potential successor to the Kyoto Protocol for the post 2008 through 2012 timeframe. The outcome and impact of the international negotiations cannot be determined at this time.

The Company continues to evaluate its future energy and emission profiles and is participating in voluntary programs to reduce greenhouse gas emissions and to help develop and advance technology to reduce emissions.

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 the 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 that ended in May 2006 could be subject to refund to a cost-based rate level.

In late June and July 2007, hearings were held in this proceeding and the presiding administrative law judge issued an initial decision on November 9, 2007 regarding the methodology to be used in the generation dominance tests. The proceedings are ongoing. The ultimate outcome of this generation dominance proceeding cannot now be determined, but an adverse decision by the FERC in a final order could require the traditional operating companies and Southern Power 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, and could also result in refunds of up to $19.7

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million, plus interest. Southern Company and its subsidiaries believe that there is no meritorious basis for this proceeding and are vigorously defending themselves in this matter.

On June 21, 2007, the FERC issued its final rule regarding market-based rate authority. The FERC generally retained its current market-based rate standards. The impact of this order and its effect on the generation dominance proceeding cannot now be determined.

Intercompany Interchange Contract

The Company s generation fleet in its retail service territory is operated under the Intercompany Interchange Contract (IIC), as approved by the FERC. In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among the traditional operating companies, Southern Power, and Southern Company Services, Inc. (SCS), as agent, under the terms of which the power pool of Southern Company is operated, (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.

In October 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 and 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 in November 2006 a compliance plan in connection with the order. On April 19, 2007, the FERC approved, with certain modifications, the plan submitted by Southern Company. Implementation of the plan is not expected to have a material impact on the Company s financial statements. On November 19, 2007, Southern Company notified the FERC that the plan had been implemented and the FERC division of audits subsequently began an audit pertaining to compliance implementation and related matters, which is ongoing.

Generation Interconnection Agreements

In November 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. No other similar 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 required the modification of Tenaska s interconnection agreements, under the provisions of the order, Southern Company determined that no refund was payable to Tenaska. Southern Company requested rehearing asserting that the FERC retroactively applied a new principle to existing interconnection agreements. Tenaska requested rehearing of FERC s methodology for determining the amount of refunds. The requested rehearings were denied, and Southern Company and Tenaska have appealed the orders to the U.S. Circuit Court for the District of Columbia. The final outcome of this matter cannot now be determined.

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

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information for the applicable upcoming calendar year. Rate adjustments for any two-year period, when averaged together, cannot exceed 4% per year and any annual adjustment is limited to 5%. Rates remain unchanged when the retail return on common equity (ROE) is projected to be between 13% and 14.5%. 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 ROE fall below the allowed equity return range. The Rate RSE increase for 2008 is 3.24%, or $147 million annually, and was effective in January 2008. Under the terms of Rate RSE, the maximum increase for 2009 cannot exceed 4.76%. See Note 3 to the financial statements under Alabama Power Retail Regulatory Matters for further information.

Georgia Power

In December 2007, the Georgia PSC approved the retail rate plan for the years 2008 through 2010 (2007 Retail Rate Plan). Under the 2007 Retail Rate Plan, Georgia Power s earnings will continue to be evaluated against a retail ROE range of 10.25% to 12.25%. Two-thirds of any earnings above 12.25% will be applied to rate refunds with the remaining one-third applied to an environmental compliance cost recovery (ECCR) tariff. Georgia Power has agreed that it will not file for a general base rate increase during this period unless its projected retail ROE falls below 10.25%. Retail base rates increased by approximately $99.7 million effective January 1, 2008 to provide for cost recovery of transmission, distribution, generation, and other investments, as well as increased operating costs. In addition, the ECCR tariff was implemented to allow for the recovery of costs for required environmental projects mandated by state and federal regulations. The ECCR tariff increased rates by approximately $222 million effective January 1, 2008. Georgia Power is required to file a general rate case by July 1, 2010, in response to which the Georgia PSC would be expected to determine whether the 2007 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.

Fuel Cost Recovery

The traditional operating companies each have established fuel cost recovery rates approved by their respective state PSCs. Over the past several years, the traditional operating companies have continued to experience higher than expected fuel costs for coal, natural gas, and uranium. 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 2006 and/or 2007 to increase its fuel cost recovery factor to recover existing under recovered amounts as well as projected future costs. At December 31, 2007, the amount of under recovered fuel costs included in the balance sheets was $1.1 billion compared to $1.3 billion at December 31, 2006.

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 sheets. See Note 1 to the financial statements under Revenues and Note 3 to the financial statements under Alabama Power Retail Regulatory Matters and Georgia Power Retail Regulatory Matters for additional information.

Storm Damage Cost Recovery

Each traditional operating company maintains a reserve to cover the cost of damages from major storms to its transmission and distribution lines and generally the cost of uninsured damages to its generation facilities and other property. In addition, each of the traditional operating companies has been authorized by its state PSC to defer the portion of the major storm restoration costs that exceeded the balance in its storm damage reserve account. As of December 31, 2007, the under recovered balance in Southern Company s storm damage reserve accounts totaled

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approximately $43 million, of which approximately $40 million and $3 million, respectively, are included in the balance sheets herein under Other Current Assets and Other Regulatory Assets.

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 Internal Revenue Service (IRS) audit for the tax years 2000 and 2001, Southern Company paid approximately $39 million in additional tax and interest related to Mirant tax items and filed a claim in Mirant s bankruptcy case for that amount. Through December 2007, Southern Company received from the IRS approximately $36 million in refunds related to Mirant. Southern Company believes it has a right to recoup the $39 million tax payment owed by Mirant from such tax refunds. As a result, Southern Company intends to retain the tax refunds and reduce its claim against Mirant for the payment of Mirant taxes by the amount of such refunds. MC Asset Recovery, a special purpose subsidiary of Reorganized Mirant, has objected to and sought to equitably subordinate the Southern Company tax claim in its fraudulent transfer litigation against Southern Company. Southern Company has reserved the approximately $3 million amount remaining with respect to its Mirant tax claim.

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 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, May 2006, and March 2007. In January 2006, MC Asset Recovery was substituted as plaintiff. The fourth 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. In addition, the complaint alleges a claim under the Federal Debt Collection Procedure Act (FDCPA) to void certain transfers from Mirant to Southern Company. MC Asset

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Recovery claims to have standing to assert violations of the FDCPA and to recover property on behalf of the Mirant debtors estates. 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 April 2007.

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. In May 2006, Southern Company filed a motion for summary judgment seeking entry of judgment against the plaintiff as to all counts in the complaint. In December 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 alleged in earlier versions of the complaint were barred; all other claims 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.

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 other 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. In March 2006, the plaintiffs filed a motion for reconsideration requesting that the court vacate that portion of its July 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. On March 6, 2007, the court granted plaintiffs motion for reconsideration, reinstated the California energy market claims, and granted in part and denied in part defendants motion to compel certain class certification discovery. On March 21, 2007, defendants filed renewed motions to dismiss the California energy claims on grounds originally set forth in their 2003 motions to dismiss, but which were not addressed by the court. On July 27, 2007, certain defendants, including Southern Company, filed motions for reconsideration of the court s denial of a motion seeking dismissal of certain federal securities laws claims based upon, among other things, certain alleged errors included in financial statements issued by Mirant. The ultimate outcome of this matter cannot be determined at this time.

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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.

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.

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 prior to 2004. The IRS challenged Southern Company s deductions related to three international lease transactions (SILO or sale-in-lease-out transactions), in connection with its audits of Southern Company s 2000 through 2003 tax returns. 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 and 2001 and filed a claim for refund which was denied by the IRS. The disputed tax amount was $79 million and the related interest 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 initiated litigation in the U.S. District Court for the Northern District of Georgia for a complete refund of tax and interest paid for the 2000 and 2001 tax years. The IRS also challenged the SILO deductions for the tax years 2002 and 2003. The estimated amount of disputed tax and interest for these tax years was 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. For tax years 2000 through 2007, Southern Company has claimed approximately $330 million in tax benefits related to these SILO transactions challenged by the IRS. These tax benefits relate to timing differences and do not impact total net income. Southern Company believes these transactions are valid leases for U.S. tax purposes and the related deductions are allowable. Southern Company is continuing to pursue resolution of these matters; however, the ultimate outcome cannot now be determined. In addition, the U.S. Senate is currently considering legislation that would disallow tax benefits after December 31, 2007 for SILO losses and other international leveraged lease transactions (such as lease-in-lease-out transactions). The ultimate impact on Southern Company s net income and cash flow will be dependent on the outcome of the pending litigation and proposed legislation, but could be significant, and potentially material.

FSP 13-2 amended 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. The initial adoption required Southern Company to recognize a cumulative effect through retained earnings. Any future changes in the underlying lease assumptions that will change the projected or actual income tax cash flows will result in an additional recalculation of the net investment in the leases and will be recorded currently in income. See ACCOUNTING POLICIES New Accounting Standards Leveraged Lease Transactions herein and Note 3 to the financial statements under Income Tax Matters herein for further details.

Bonus Depreciation

On February 13, 2008, President Bush signed the Economic Stimulus Act of 2008 (Stimulus Act) into law. The Stimulus Act includes a provision that allows 50% bonus depreciation for certain property acquired in 2008 and placed in service in 2008 or, in certain limited cases, 2009. Southern Company is currently assessing the financial implications of the Stimulus Act; however, the ultimate impact cannot be determined at this time.

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Georgia State Income Tax Credits

Georgia Power s 2005 through 2007 income tax filings for the State of Georgia include state income tax credits for increased activity through Georgia ports. Georgia Power has also filed similar claims for the years 2002 through 2004. The Georgia Department of Revenue has not responded to these claims. On July 24, 2007, Georgia Power filed a complaint in the Superior Court of Fulton County to recover the credits claimed for the years 2002 through 2004. If allowed, these claims could have a significant, possibly material, positive effect on Southern Company s net income. If Georgia Power is not successful, payment of the related state tax could have a significant, possibly material, negative effect on Southern Company s cash flow. The ultimate outcome of this matter cannot now be determined.

Internal Revenue Code Section 199 Domestic Production Deduction

The American Jobs Creation Act of 2004 created a tax deduction for a portion of income attributable to U.S. production activities as defined in the Internal Revenue Code Section 199 (production activities deduction). The deduction is equal to a stated percentage of qualified production activities net income. The percentage is phased in over the years 2005 through 2010 with a 3% rate applicable to the years 2005 and 2006, a 6% rate applicable for years 2007 through 2009, and a 9% rate applicable for all years after 2009. See Note 5 to the financial statements under Effective Tax Rate for additional information.

Construction Projects

Integrated Coal Gasification Combined Cycle

In December 2005, Southern Power and the Orlando Utilities Commission (OUC) executed definitive agreements for development of a 285-megawatt IGCC project in Orlando, Florida. The definitive agreements provided that Southern Power would own at least 65% of the gasifier portion of the IGCC project. OUC would own the remainder of the gasifier portion and 100% of the combined cycle portion of the IGCC project. Southern Power signed cooperative agreements with the DOE that provided up to $293.8 million in grant funding for the gasification portion of this project. The IGCC project was expected to begin commercial operation in 2010. Due to continuing uncertainty surrounding potential state regulations relating to greenhouse gas emissions, Southern Power and OUC mutually agreed to terminate the construction of the gasifier portion of the IGCC project in November 2007. Southern Power will continue construction of the gas-fired combined cycle generating facility under a fixed price, long-term contract for engineering, procurement, and construction services. The Company recorded an after-tax loss of approximately $10.7 million in the fourth quarter of 2007 related to the cancellation of the gasifier portion of the IGCC project.

In June 2006, Mississippi Power filed an application with the United States Department of Energy (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 is expected to require an approximate investment of $1.5 billion, excluding the mine costs, and is expected to be completed in 2013. The DOE subsequently certified the project and in November 2006 the IRS allocated Internal Revenue Code 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 undertaking 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 Mississippi PSC has authorized Mississippi Power to create a regulatory asset for the approved retail portion of the costs associated with the generation resource planning, evaluation, and screening

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activities up to approximately $23.8 million ($16 million for the retail portion). The retail portion of these costs will be charged to and remain as a regulatory asset until the Mississippi PSC determines the prudence and ultimate recovery, which decision is expected in January 2009.

The final outcome of these matters cannot now be determined.

Nuclear

In August 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 information on these co-owners. In June 2006, the Georgia PSC approved 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. At December 31, 2007, approximately $28.4 million is included in deferred charges and other assets. No final decision has been made regarding actual construction. Any new generation resource must be certified by the Georgia PSC in a separate proceeding.

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 was organized to complete detailed engineering design work and to prepare COL applications for two advanced reactor designs. COLs for the two reactor designs were submitted to the NRC during the fourth quarter of 2007. The COLs ultimately are 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.

Nuclear Relicensing

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. Georgia Power filed an application with the NRC in June 2007 to extend the licenses for Plant Vogtle Units 1 and 2 for an additional 20 years. Georgia Power anticipates the NRC may make a decision regarding the license extension for Plant Vogtle as early as 2009.

Other Matters

Southern Company is involved in various other matters being litigated, regulatory matters, and certain tax-related issues that could affect future earnings. In addition, Southern Company is subject to certain claims and legal actions arising in the ordinary course of business. 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, common law nuisance, and citizen enforcement of environmental requirements such as opacity and air and water 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

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proceedings would have a material adverse effect on Southern Company s financial statements. See Note 3 to the financial statements for information regarding material issues.

ACCOUNTING POLICIES

Application of Critical Accounting Policies and Estimates

Southern Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States. Significant accounting policies are described in Note 1 to the financial statements. In the application of these 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 91% of Southern Company s total earnings for 2007, 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 of such matters could materially affect Southern Company s financial statements. These events or conditions include the following:

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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, the FERC, 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.

Leveraged Leases

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) amended 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. The initial adoption required Southern Company to record a cumulative effect to retained earnings. Any future changes in the underlying lease assumptions, such as the expected resolution date of the ongoing SILO litigation, which will change the projected or actual income tax cash flows will result in an additional recalculation of the net investment in the leases and will be recorded currently in income. 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.

New Accounting Standards

Income Taxes

On January 1, 2007, Southern Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest and penalties. The provisions of FIN 48 were applied to all tax positions beginning January 1, 2007. The impact on Southern Company s financial

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statements was a reduction to beginning 2007 retained earnings of approximately $15 million related to Southern Company s SILO transactions. See Note 5 to the financial statements for additional information.

Leveraged Leases

Effective January 1, 2007, Southern Company adopted FSP 13-2. The cumulative effect of initially adopting FSP 13-2 was recorded as a reduction to beginning retained earnings. For the LILO (lease-in-lease-out) transaction settled with the IRS in February 2005, the cumulative effect of adopting FSP 13-2 was a $17 million reduction in retained earnings. With respect to Southern Company s SILO transactions, the adoption of FSP 13-2 reduced retained earnings by $108 million. The adjustments to retained earnings are non-cash charges and will be recognized as income over the remaining terms of the affected leases. The adoption of FSP 13-2 also resulted in a reduction to net income of approximately $15 million during 2007. Any future changes in the projected or actual income tax cash flows will result in an additional recalculation of the net investment in the leases and will be recorded currently in income.

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 the balance sheets. 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.

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 adopted SFAS No. 157 in its entirety on January 1, 2008, with no material effect on its financial condition or results of operations.

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 adopted SFAS No. 159 on January 1, 2008, with no material effect on its financial condition or results of operations.

Business Combinations

In December 2007, the FASB issued FASB Statement No. 141 (revised 2007), Business Combinations (SFAS No. 141R). SFAS No. 141R, when adopted, will significantly change the accounting for business combinations, specifically the accounting for contingent consideration, contingencies, acquisition costs, and restructuring costs. Southern Company plans to adopt SFAS No. 141R on January 1, 2009. It is likely that the adoption of SFAS No. 141R will have a significant impact on the accounting for any business combinations completed by Southern Company after January 1, 2009.

In December 2007, the FASB issued FASB Statement No. 160, Non-controlling Interests in Consolidated Financial Statements (SFAS No. 160). SFAS No. 160 amends Accounting Research Bulletin No. 51, Consolidated

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Financial Statements to establish accounting and reporting standards for the non-controlling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a non-controlling interest in a subsidiary should be reported as equity in the consolidated financial statements and establishes a single method of accounting for changes in a parent s ownership interest in a subsidiary that do not result in deconsolidation. Southern Company plans to adopt SFAS No. 160 on January 1, 2009. Southern Company is currently assessing its impact, if any.

FINANCIAL CONDITION AND LIQUIDITY

Overview

Southern Company s financial condition remained stable at December 31, 2007. Net cash provided from operating activities totaled $3.4 billion, an increase of $575 million as compared to 2006. The increase was primarily due to an increase in net income as previously discussed, an increase in cash collections from previously deferred fuel and storm damage costs, and a reduction in cash outflows compared to the previous year in fossil fuel inventory. In 2006, net cash provided from operating activities increased over the previous year by $290 million primarily as a result of a decrease in under recovered storm restoration costs, a decrease in accounts payable from year-end 2005 amounts that included substantial hurricane-related expenditures, partially offset by an increase in fossil fuel inventory. In 2005, net cash provided from operating activities totaled $2.5 billion, a decrease of $165 million as compared to 2004 primarily due to higher fuel costs at the traditional operating companies, partially offset by increases in base rates and fuel recovery rates.

Net cash used for investing activities in 2007 totaled $3.7 billion primarily due to property additions to utility plant of $3.5 billion. In 2006, net cash used for investing activities was $2.8 billion primarily due to property additions to utility plant of $3.0 billion, partially offset by proceeds from the sale of Southern Company Gas LLC and the receipt by Mississippi Power of capital grant proceeds related to Hurricane Katrina. In 2005, net cash used for investing activities was $2.6 billion primarily due to property additions to utility plant of $2.4 billion.

Net cash provided from financing activities totaled $348 million in 2007 primarily due to replacement of short-term debt with longer term financing and cash raised from common stock programs. In 2006 and 2005, net cash used for financing activities was $21 million and $67 million, respectively.

Significant balance sheet changes in 2007 include an increase in long-term debt of $1.6 billion primarily to replace short-term debt and to provide funds for the Company s continuous construction program. Balance sheet changes also include an increase in property, plant, and equipment of $2.2 billion and an increase in prepaid pension assets of $820 million with a corresponding increase in other regulatory liabilities.

At the end of 2007, the closing price of Southern Company s common stock was $38.75 per share, compared with book value of $16.23 per share. The market-to-book value ratio was 239% at the end of 2007, compared with 242% at year-end 2006.

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 2008, as well as in subsequent years, will be contingent on Southern Company s investment opportunities.

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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. 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 Securities and Exchange Commission (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.

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, 2007, Southern Company and its subsidiaries had approximately $201 million of cash and cash equivalents and $4.1 billion of unused credit arrangements with banks, of which $811 million expire in 2008 and $3.3 billion expire in 2012. Approximately $79 million of the credit facilities expiring in 2008 allow for the execution of term loans for an additional two-year period, and $500 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 2007, Southern Company and its subsidiaries issued $3.4 billion of senior notes, $456 million of obligations related to tax-exempt bonds, and $470 million of preference stock. Interest rate hedges of $1.4 billion notional amount were settled at a gain of $9 million related to the issuances. The security issuances were used to redeem $2.6 billion of long-term debt, to reduce short-term indebtedness, to fund Southern Company s ongoing construction program, and for general corporate purposes.

Subsequent to December 31, 2007, Alabama Power issued $300 million of senior notes. The proceeds from the sale of the senior notes were used to repay a portion of outstanding short-term indebtedness and for other general corporate purposes, including Alabama Power s continuous construction program.

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% of Juniper s assets. Mississippi Power is not required to consolidate the leased assets and

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related liabilities, and the lease with Juniper is considered an operating lease. The lease also provides for a residual value guarantee, approximately 73% 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 and Baa2, or BBB- or Baa3 or below. These contracts are primarily for physical electricity purchases and sales. At December 31, 2007, the maximum potential collateral requirements at a BBB and Baa2 rating were approximately $9 million and at a BBB- or Baa3 rating were approximately $297 million. At December 31, 2007, the maximum potential collateral requirements at a rating below BBB- or Baa3 were approximately $1.0 billion. 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 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, 2007, Southern Company s total exposure to these types of agreements was approximately $15 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 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 a change in interest rates, the Company enters into forward starting interest rate swaps and other derivatives that have been designated as hedges. Derivatives outstanding at December 31, 2007 have a notional amount of $505 million and are related to anticipated debt issuances over the next two years. The weighted average interest rate on $3.4 billion of long-term variable interest rate exposure that has not been hedged at January 1, 2008 was 4.5%. On January 8, 2008, Georgia Power converted $115 million of floating rate pollution control bonds to a fixed interest rate, reducing the Company s exposure to $3.3 billion. Beginning in February 2008, Georgia Power and Alabama Power hedged a total of $601 million and $576 million, respectively, of floating rate exposure, further reducing the Company s long-term variable interest rate exposure to $2.1 billion. 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 $33.7 million at January 1, 2008. Subsequent to the recently completed transactions, a 100 basis point change in interest rates for all unhedged variable rate long-term debt would affect annualized interest expense by approximately $22.2 million. For further information, see Notes 1 and 6 to the financial statements under Financial Instruments.

Of the Company s remaining $2.1 billion of variable interest rate exposure, approximately $1.1 billion relates to tax-exempt auction rate pollution control bonds. Recent weakness in the auction markets has resulted in failed auctions during February 2008 of some of the $1.1 billion auction rate securities which results in significantly higher interest

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rates during the failed auctions period. The Company has sent notice of conversion of $946 million of these auction rate securities to alternative interest rate determination methods and plans to remarket all remaining auction rate securities in a timely manner. None of the securities are insured or backed by letters of credit that would require approval of a guarantor or security provider. It is not expected that the higher rates as a result of the weakness in the auction markets will be material.
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 enter into fixed-price contracts for the purchase and sale of electricity through the wholesale electricity market and, to a lesser extent, into financial hedge 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:

	Changes in Fair Value	
	2007	2006
	(in millions)	
Contracts beginning of year	$**(82)**	$ 101
Contracts realized or settled	**80**	93
New contracts at inception		
Changes in valuation techniques		
Current period changes(a)	**6**	(276)
Contracts end of year	**$ 4**	$ (82)

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

	Source of 2007 Year-End Valuation Prices		
	Total Fair Value	Maturity	
		Year 1	1-3 Years
		(in millions)	
Actively quoted	**$(1)**	**$(11)**	**$10**
External sources	**5**	**5**	
Models and other methods			
Contracts end of year	**$ 4**	**$ (6)**	**$10**

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, 2007, the fair value gains/(losses) of energy-related derivative contracts were reflected in the financial statements as follows:

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	Amounts
	(in millions)
Regulatory assets, net	$
Accumulated other comprehensive income	1
Net income	3
Total fair value	$ 4

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 were impacted by changes in oil prices, the Company 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 2007, the fair value gain recognized in income for mark to market transactions was $27 million. For 2006 and 2005, the fair value losses recognized in income for mark to market transactions were $32 million and $7 million, respectively. 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 $4.5 billion for 2008, $4.8 billion for 2009, and $4.3 billion for 2010. Environmental expenditures included in these estimated amounts are $1.8 billion, $1.5 billion, and $0.6 billion for 2008, 2009, and 2010, respectively. Actual construction costs may vary from these estimates because of changes in such factors as: business conditions; environmental statutes and 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.

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Contractual Obligations

	2008	2009-2010	2011-2012	After 2012	Uncertain Timing[e]	Total
			(in millions)			
Long-term debt[a]						
Principal	$ 1,053	$ 900	$1,909	$11,353	$	$15,215
Interest	805	1,479	1,398	10,985		14,667
Preferred stock[b]	125					125
Preferred and preference stock dividends[c]	71	142	142			355
Other derivative obligations[d]						
Commodity	46					46
Interest	16	4				20
Operating leases	125	199	109	164		597
Unrecognized tax benefits and interest[e]	187				108	295
Purchase commitments[f]						
Capital[g]	4,275	8,779				13,054
Limestone[h]	7	49	69	180		305
Coal	3,413	3,766	1,359	1,683		10,221
Nuclear fuel	176	358	313	167		1,014
Natural gas[i]	1,735	1,773	948	3,530		7,986
Purchased power	177	436	381	1,656		2,650
Long-term service agreements[j]	81	203	205	1,784		2,273
Trusts						
Nuclear decommissioning	7	7	7	56		77
Postretirement benefits[k]	46	84				130
Total	$12,345	$18,179	$6,840	$31,558	$ 108	$69,030

(a) All amounts are reflected based on final maturity dates. Southern Company and its subsidiaries plan to continue to retire higher-cost securities and replace these obligations with lower-cost capital if market conditions permit. Variable rate interest obligations are estimated based on rates as of January 1, 2008, 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) On October 26, 2007, Alabama Power announced the redemption on January 1, 2008 of 1,250 shares of Flexible Money Market Class A Preferred Stock (Series 2003A), Cumulative, Par Value $1 Per Share (Stated Capital $100,000 Per Share).

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

(d)

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

(e) The timing related to the \$108 million in unrecognized tax benefits and interest payments in individual years beyond 12 months cannot be reasonably and reliably estimated due to uncertainties in the timing of the effective settlement of tax positions. Of this \$108 million, \$71 million is expected to represent cash payments. See Notes 3 and 5 to the financial statements for additional information.

(f) Southern Company generally does not enter into non-cancelable commitments for other operations and maintenance expenditures. Total other operations and maintenance expenses for

2007, 2006, and 2005 were $3.7 billion, $3.5 billion, and $3.5 billion, respectively.

(g) 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 nuclear fuel. At December 31, 2007, significant purchase commitments were outstanding in connection with the construction program.

(h) As part of Southern Company s program to reduce sulfur dioxide emissions from certain of its coal plants, the traditional operating companies are constructing certain equipment and have entered into various long-term commitments for the procurement of limestone to be used in such equipment.

(i) 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, 2007.

(j) Long-term service agreements include price escalation based on inflation indices.

(k) 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.

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Cautionary Statement Regarding Forward-Looking Statements

Southern Company s 2007 Annual Report contains forward-looking statements. Forward-looking statements include, among other things, statements concerning the strategic goals for the wholesale business, 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, 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, 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, environmental laws including regulation of water quality and emissions of sulfur, nitrogen, mercury, carbon, soot, or particulate matter and other substances, and also changes in 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, population, and business growth (and declines), and the effects of energy conservation measures;

available sources and costs of fuel;

effects of inflation;

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;

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, droughts, 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.

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CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2007, 2006, and 2005
Southern Company and Subsidiary Companies 2007 Annual Report

	2007	2006	2005
		(in millions)	
Operating Revenues:			
Retail revenues	**$ 12,639**	$ 11,801	$ 11,165
Wholesale revenues	**1,988**	1,822	1,667
Other electric revenues	**513**	465	446
Other revenues	**213**	268	276
Total operating revenues	**15,353**	14,356	13,554
Operating Expenses:			
Fuel	**5,856**	5,152	4,495
Purchased power	**515**	543	731
Other operations	**2,495**	2,423	2,394
Maintenance	**1,175**	1,096	1,116
Depreciation and amortization	**1,245**	1,200	1,176
Taxes other than income taxes	**741**	718	680
Total operating expenses	**12,027**	11,132	10,592
Operating Income	**3,326**	3,224	2,962
Other Income and (Expense):			
Allowance for equity funds used during construction	**106**	50	51
Interest income	**45**	41	36
Equity in losses of unconsolidated subsidiaries	**(24)**	(57)	(119)
Leveraged lease income	**40**	69	74
Impairment loss on equity method investments		(16)	
Interest expense, net of amounts capitalized	**(886)**	(866)	(747)
Preferred and preference dividends of subsidiaries	**(48)**	(34)	(30)
Other income (expense), net	**10**	(58)	(41)
Total other income and (expense)	**(757)**	(871)	(776)
Earnings Before Income Taxes	**2,569**	2,353	2,186
Income taxes	**835**	780	595
Consolidated Net Income	**$ 1,734**	$ 1,573	$ 1,591
Common Stock Data:			
Earnings per share			
Basic	**$ 2.29**	$ 2.12	$ 2.14
Diluted	**2.28**	2.10	2.13

Average number of shares of common stock outstanding (in millions)			
Basic	**756**	743	744
Diluted	**761**	748	749
Cash dividends paid per share of common stock	**$ 1.595**	$ 1.535	$ 1.475

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2007, 2006, and 2005
Southern Company and Subsidiary Companies 2007 Annual Report

	2007	2006	2005
		(in millions)	
Operating Activities:			
Consolidated net income	**$ 1,734**	$ 1,573	$ 1,591
Adjustments to reconcile consolidated net income to net cash provided from operating activities			
Depreciation and amortization	**1,486**	1,421	1,398
Deferred income taxes and investment tax credits	**7**	202	499
Allowance for equity funds used during construction	**(106)**	(50)	(51)
Equity in losses of unconsolidated subsidiaries	**24**	57	119
Leveraged lease income	**(40)**	(69)	(74)
Pension, postretirement, and other employee benefits	**39**	46	(6)
Stock option expense	**28**	28	
Derivative fair value adjustments	**(30)**	32	8
Hedge settlements	**10**	13	(19)
Hurricane Katrina grant proceeds-property reserve	**60**		
Storm damage accounting order			48
Other, net	**58**	50	20
Changes in certain current assets and liabilities			
Receivables	**165**	(69)	(1,045)
Fossil fuel stock	**(39)**	(246)	(110)
Materials and supplies	**(71)**	7	(78)
Other current assets		73	(1)
Accounts payable	**105**	(173)	71
Hurricane Katrina grant proceeds	**14**	120	
Accrued taxes	**(19)**	(103)	28
Accrued compensation	**(40)**	(24)	13
Other current liabilities	**10**	(68)	119
Net cash provided from operating activities	**3,395**	2,820	2,530
Investing Activities:			
Property additions	**(3,545)**	(2,994)	(2,370)
Investment in restricted cash from pollution control bonds	**(157)**		
Distribution of restricted cash from pollution control bonds	**78**		
Nuclear decommissioning trust fund purchases	**(783)**	(751)	(606)
Nuclear decommissioning trust fund sales	**775**	743	596
Proceeds from property sales	**33**	150	10
Hurricane Katrina capital grant proceeds	**35**	153	
Investment in unconsolidated subsidiaries	**(37)**	(64)	(115)
Cost of removal net of salvage	**(108)**	(90)	(128)
Other		19	(16)

Net cash used for investing activities	**(3,709)**	(2,834)	(2,629)
Financing Activities:			
Increase (decrease) in notes payable, net	**(669)**	683	831
Proceeds			
Long-term debt	**3,826**	1,564	1,608
Preferred and preference stock	**470**	150	55
Common stock	**538**	137	213
Redemptions			
Long-term debt	**(2,566)**	(1,366)	(1,285)
Preferred and preference stock		(15)	(4)
Common stock repurchased			(352)
Payment of common stock dividends	**(1,205)**	(1,140)	(1,098)
Other	**(46)**	(34)	(35)
Net cash (used for) provided from financing activities	**348**	(21)	(67)
Net Change in Cash and Cash Equivalents	**34**	(35)	(166)
Cash and Cash Equivalents at Beginning of Year	**167**	202	368
Cash and Cash Equivalents at End of Year	**$ 201**	$ 167	$ 202

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

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CONSOLIDATED BALANCE SHEETS
At December 31, 2007 and 2006
Southern Company and Subsidiary Companies 2007 Annual Report

Assets	**2007**	2006
	(in millions)	
Current Assets:		
Cash and cash equivalents	**$ 201**	$ 167
Restricted cash	**68**	
Receivables		
Customer accounts receivable	**1,000**	943
Unbilled revenues	**294**	283
Under recovered regulatory clause revenues	**716**	517
Other accounts and notes receivable	**348**	330
Accumulated provision for uncollectible accounts	**(22)**	(35)
Fossil fuel stock, at average cost	**710**	675
Materials and supplies, at average cost	**725**	648
Vacation pay	**135**	121
Prepaid expenses	**146**	128
Other	**411**	242
Total current assets	**4,732**	4,019
Property, Plant, and Equipment:		
In service	**47,176**	45,486
Less accumulated depreciation	**17,413**	16,582
	29,763	28,904
Nuclear fuel, at amortized cost	**336**	317
Construction work in progress	**3,228**	1,871
Total property, plant, and equipment	**33,327**	31,092
Other Property and Investments:		
Nuclear decommissioning trusts, at fair value	**1,132**	1,058
Leveraged leases	**984**	1,139
Other	**238**	296
Total other property and investments	**2,354**	2,493
Deferred Charges and Other Assets:		
Deferred charges related to income taxes	**910**	895
Prepaid pension costs	**2,369**	1,549
Unamortized debt issuance expense	**191**	172
Unamortized loss on reacquired debt	**289**	293
Deferred under recovered regulatory clause revenues	**389**	845
Other regulatory assets	**768**	936

Other	**460**	564
Total deferred charges and other assets	**5,376**	5,254
Total Assets	**$ 45,789**	$ 42,858

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

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CONSOLIDATED BALANCE SHEETS
At December 31, 2007 and 2006
Southern Company and Subsidiary Companies 2007 Annual Report

Liabilities and Stockholders Equity	2007	2006
	(in millions)	
Current Liabilities:		
Securities due within one year	**$ 1,178**	$ 1,418
Notes payable	**1,272**	1,941
Accounts payable	**1,214**	1,081
Customer deposits	**274**	249
Accrued taxes		
Income taxes	**217**	110
Other	**330**	391
Accrued interest	**218**	184
Accrued vacation pay	**171**	151
Accrued compensation	**408**	444
Other	**349**	384
Total current liabilities	**5,631**	6,353
Long-term Debt (See accompanying statements)	**14,143**	12,503
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	**5,839**	5,989
Deferred credits related to income taxes	**272**	291
Accumulated deferred investment tax credits	**479**	503
Employee benefit obligations	**1,492**	1,567
Asset retirement obligations	**1,200**	1,137
Other cost of removal obligations	**1,308**	1,300
Other regulatory liabilities	**1,613**	794
Other	**347**	306
Total deferred credits and other liabilities	**12,550**	11,887
Total Liabilities	**32,324**	30,743
Preferred and Preference Stock of Subsidiaries (See accompanying statements)	**1,080**	744
Common Stockholders Equity (See accompanying statements)	**12,385**	11,371
Total Liabilities and Stockholders Equity	**$ 45,789**	$ 42,858

Commitments and Contingent Matters (See notes)

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

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CONSOLIDATED STATEMENTS OF CAPITALIZATION
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Southern Company and Subsidiary Companies 2007 Annual Report

		2007	2006	2007	2006
		(in millions)		(percent of total)	
Long-Term Debt:					
Long-term debt payable to affiliated trusts					
Maturity	Interest Rates				
2041 through 2044	4.75% to 7.20%	**$ 412**	$ 1,561		
Long-term senior notes and debt					
Maturity	Interest Rates				
2007	3.50% to 7.13%		1,204		
2008	2.54% to 7.00%	**459**	460		
2009	4.10% to 7.00%	**127**	127		
2010	4.70%	**102**	102		
2011	4.00% to 5.10%	**302**	302		
2012	4.85% to 6.25%	**1,478**	778		
2013 through 2047	4.35% to 8.12%	**8,060**	5,952		
Adjustable rates (at 1/1/08):					
2007	5.62%		169		
2008	4.94% to 5.00%	**550**			
2009	5.09% to 5.33%	**440**	440		
2010	6.35%	**202**	221		
Total long-term senior notes and debt		**11,720**	9,755		
Other long-term debt					
Pollution control revenue bonds					
Maturity	Interest Rates				
2012 through 2036	3.76% to 5.45%	**812**	812		
Variable rates (at 1/1/08):					
2011 through 2041	2.67% to 5.25%	**2,170**	1,714		

Total other long-term debt	**2,982**	2,526		
Capitalized lease obligations	**101**	97		
Unamortized debt (discount), net	**(19)**	(18)		
Total long-term debt (annual interest requirement $805 million)	**15,196**	13,921		
Less amount due within one year	**1,053**	1,418		
Long-term debt excluding amount due within one year	**14,143**	12,503	**51.2%**	50.8%

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CONSOLIDATED STATEMENTS OF CAPITALIZATION (continued)
At December 31, 2007 and 2006
Southern Company and Subsidiary Companies 2007 Annual Report

	2007	2006	**2007**	2006
	(in millions)		(percent of total)	
Preferred and Preference Stock of Subsidiaries:				
Cumulative preferred stock				
$100 par or stated value 4.20% to 5.44%				
Authorized 20 million shares				
Outstanding 1 million shares	**81**	81		
$1 par value 4.95% to 5.83%				
Authorized 28 million shares				
Outstanding 12 million shares: $25 stated value	**294**	294		
Outstanding 1,250 shares: $100,000 stated capital	**123**	123		
Non-cumulative preferred stock				
$25 par value 6.00% to 6.13%				
Authorized 60 million shares				
Outstanding 2 million shares	**45**	45		
Preference stock				
Authorized 65 million shares				
Outstanding $1 par value 5.63% to 6.50%	**343**	147		
2007: 14 million shares (non-cumulative)				
2006: 6 million shares (non-cumulative)				
$100 par or stated value 6.00% to 6.50%	**319**	54		
2007: 3 million shares (non-cumulative)				
2006: 1 million shares (non-cumulative)				
Total preferred and preference stock of subsidiaries (annual dividend requirement $71 million)	**1,205**	744		
Less amount due within one year	**125**			
Preferred and preference stock of subsidiaries excluding amount due within one year	**1,080**	744	**3.9**	3.0
Common Stockholders Equity:				
Common stock, par value $5 per share	**3,817**	3,759		
Authorized 1 billion shares				
Issued 2007: 764 million shares				
2006: 752 million shares				
Treasury 2007: 0.4 million shares				
2006: 5.6 million shares				
Paid-in capital	**1,454**	1,096		
Treasury, at cost	**(11)**	(192)		
Retained earnings	**7,155**	6,765		
Accumulated other comprehensive income (loss)	**(30)**	(57)		

Total common stockholders equity	**12,385**	11,371	**44.9**	46.2
Total Capitalization	**$ 27,608**	$ 24,618	**100.0%**	100.0%

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

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CONSOLIDATED STATEMENTS OF COMMON STOCKHOLDERS EQUITY
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Southern Company and Subsidiary Companies 2007 Annual Report

	Common Stock				Accumulated Other	
	Par Value	Paid-In Capital	Treasury	Retained Earnings	Comprehensive Income (Loss)	Total
			(in millions)			
Balance at December 31, 2004	$3,709	$ 869	$ (6)	$ 5,839	$ (133)	$10,278
Net income				1,591		1,591
Other comprehensive income					5	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
Cash dividends				(1,140)		(1,140)
Other			(1)			(1)
Balance at December 31, 2006	**3,759**	**1,096**	**(192)**	**6,765**	**(57)**	**11,371**
Net income				**1,734**		**1,734**
Other comprehensive income					**27**	**27**
Stock issued	**58**	**356**	**183**			**597**
Adjustment to initially apply FIN 48, net of tax				**(15)**		**(15)**
Adjustment to initially apply FSP 13-2, net of tax				**(125)**		**(125)**
Cash dividends				**(1,204)**		**(1,204)**
Other		**2**	**(2)**			
Balance at December 31, 2007	**$3,817**	**$1,454**	**$ (11)**	**$ 7,155**	**$ (30)**	**$12,385**

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2007, 2006, and 2005
Southern Company and Subsidiary Companies 2007 Annual Report

	2007	2006	2005
		(in millions)	
Consolidated Net Income	**$ 1,734**	$ 1,573	$ 1,591
Other comprehensive income:			
Qualifying hedges:			
Changes in fair value, net of tax of $(3), $(5), and $11, respectively	**(5)**	(8)	18
Reclassification adjustment for amounts included in net income, net of tax of $6, $-, and $1, respectively	**9**	1	2
Marketable securities:			
Changes in fair value, net of tax of $3, $4, and $(2), respectively	**4**	8	(4)
Reclassification adjustment for amounts included in net income, net of tax of $-, $-, and $-, respectively	**(1)**		
Pension and other postretirement benefit plans:			
Benefit plan net gain (loss), net of tax of $13, $-, and $-, respectively	**20**		
Additional prior service costs from amendment to non-qualified pension plans, net of tax of $(2), $-, and $-, respectively	**(2)**		
Change in additional minimum pension liability, net of tax of $-, $10, and $(6), respectively		18	(11)
Reclassification adjustment for amounts included in net income, net of tax of $1, $-, and $-, respectively	**2**		
Total other comprehensive income	**27**	19	5
Consolidated Comprehensive Income	**$ 1,761**	$ 1,592	$ 1,596

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

NOTES TO FINANCIAL STATEMENTS

Southern Company and Subsidiary Companies 2007 Annual Report

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The Southern Company (the Company) is the parent company of four traditional operating companies, Southern Power Company (Southern Power), Southern Company Services, Inc. (SCS), Southern Communications Services, Inc. (SouthernLINC Wireless), Southern Company Holdings, Inc. (Southern Holdings), Southern Nuclear Operating Company, Inc. (Southern Nuclear), 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 and 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. The investments in synthetic fuels ended on December 31, 2007. Southern Nuclear operates and provides services to Southern Company s nuclear power plants.

The financial statements reflect Southern Company s investments in the subsidiaries on a consolidated basis. The equity method is used for entities 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 transactions have been eliminated in consolidation.

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.

Reclassifications

Certain prior years data presented in the financial statements have been reclassified to conform to the current year presentation. These reclassifications had no effect on total assets, net income, cash flows, or earnings per share.

The balance sheets and the statements of cash flows have been modified to combine Long-term Debt Payable to Affiliate Trusts into Long-term Debt. Correspondingly, the statements of income were modified to report Interest expense to affiliate trusts together with Interest expense, net of amounts capitalized. Due to the immateriality of earnings from discontinued operations during all periods presented, the statements of income and the statements of comprehensive income have been modified to report net income without a separate disclosure of the effect from discontinued operations. Also, due to immateriality, the statements of cash flows were adjusted to reflect Tax benefit of stock options together with the amounts reported in Other, net.

Related Party Transactions

Alabama Power and Georgia Power purchased synthetic fuel from Alabama Fuel Products, LLC (AFP), an entity in which Southern Holdings held a 30% ownership interest until July 2006, when its ownership interest was terminated. Total fuel purchases through June 2006 and for the year 2005 were $354 million and $507 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 and $83 million through June 2006 and for the year 2005, respectively, have been eliminated against fuel expense in the financial

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Southern Company and Subsidiary Companies 2007 Annual Report

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 and $40 million through June 2006 and for the year 2005, respectively. Subsequent to the termination of Southern Company s membership interest in AFP, Alabama Power and Georgia Power continued to purchase an additional $750 million and $384 million in fuel from AFP in 2007 and 2006, respectively. SSI continued to provide fuel transportation services of $131 million in 2007 and $62 million in 2006, which were eliminated against fuel expense in the financial statements. SSI also provided other additional services to AFP and a related party of AFP totaling $47 million and $21 million in 2007 and 2006, respectively. The synthetic fuel investments and related party transactions were terminated on December 31, 2007.

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

	2007	2006	Note
		(in millions)	
Deferred income tax charges	**$ 911**	$ 896	(a)
Asset retirement obligations-asset	**50**	61	(a)
Asset retirement obligations-liability	**(154)**	(155)	(a)
Other cost of removal obligations	**(1,308)**	(1,300)	(a)
Deferred income tax credits	**(275)**	(293)	(a)
Loss on reacquired debt	**289**	293	(b)
Vacation pay	**135**	121	(c)
Under recovered regulatory clause revenues	**371**	411	(d)
Building lease	**49**	51	(d)
Generating plant outage costs	**46**	56	(d)
Under recovered storm damage costs	**43**	89	(d)
Fuel hedging-asset	**25**	115	(d)
Fuel hedging-liability	**(20)**	(13)	(d)
Other assets	**88**	55	(d)
Environmental remediation-asset	**67**	57	(d)
Environmental remediation-liability	**(22)**	(32)	(d)
Deferred purchased power	**(20)**	(38)	(d)
Other liabilities	**(111)**	(50)	(d)
Plant Daniel capacity		(6)	(e)
Overfunded retiree benefit plans	**(1,288)**	(508)	(f)
Underfunded retiree benefit plans	**547**	697	(f)
Total	**$ (577)**	$ 507	

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 65 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 that ended in 2007.

(f) Recovered and amortized over the average remaining service period which may range up to 14 years. See Note 2 under Retirement Benefits.

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Southern Company and Subsidiary Companies 2007 Annual Report

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 values. 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% of the projected fuel revenue applicable 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 Note 3 under Alabama Power Retail Regulatory Matters and Georgia Power Retail Regulatory Matters for additional information.

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

Nuclear Fuel Disposal Costs

Alabama Power and Georgia Power have contracts with the United States, acting through 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.

On July 9, 2007, the U.S. Court of Federal Claims awarded Georgia Power a total of $30 million, based on its ownership interests, and awarded Alabama Power $17.3 million, representing all of the direct costs of the expansion of spent nuclear fuel storage facilities from 1998 through 2004. On July 24, 2007, the government filed a motion for reconsideration, which was denied on November 1, 2007. The government filed an appeal on January 2, 2008. No amounts have been recognized in the financial statements as of December 31, 2007. The final outcome of this matter cannot be determined at this time, but no material impact on net income is expected as any award received is expected to be returned to customers.

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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.

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.

In accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), Southern Company recognizes tax positions that are more likely than not of being sustained upon examination by the appropriate taxing authorities. See Note 5 under Unrecognized Tax Benefits for additional information on the effect of adopting FIN 48.

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:

	2007	2006
	(in millions)	
Generation	**$ 23,879**	$ 23,355
Transmission	**6,761**	6,352
Distribution	**13,134**	12,484
General	**2,619**	2,510
Plant acquisition adjustment	**43**	40
Utility plant in service	**46,436**	44,741
IT equipment and software	**230**	226
Communications equipment	**452**	445
Other	**58**	74
Other plant in service	**740**	745
Total plant in service	**$ 47,176**	$ 45,486

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.

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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% in 2007, 3.0% in 2006, and 2.9% in 2005. Depreciation studies are conducted periodically to update the composite rates. These studies are filed with the respective state PSC for the traditional operating companies. Accumulated depreciation for utility plant in service totaled $17.0 billion and $16.2 billion at December 31, 2007 and 2006, 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 Georgia Power s retail rate plan for the three years ended 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. Georgia Power recorded credits to amortization of $19 million and $14 million in 2007 and 2006, respectively, and an increase to amortization of $33 million in 2005. See Note 3 under Retail Regulatory Matters Rate Plans 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 amortized 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 $429 million and $405 million at December 31, 2007 and 2006, respectively.

Asset Retirement Obligations and Other Costs of Removal

Asset retirement obligations are computed as the present value of the ultimate costs for an asset s future retirement and are 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. 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.

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, 2007 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 FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (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 U.S. 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 FASB Statement No. 143 Accounting for Asset Retirement

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Obligations (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:

	2007	2006
	(in millions)	
Balance beginning of year	**$1,137**	$1,117
Liabilities incurred	**1**	8
Liabilities settled	**(8)**	(5)
Accretion	**74**	73
Cash flow revisions	**(1)**	(56)
Balance end of year	**$1,203**	$1,137

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, 2007 were as follows:

2007	**Unrealized Gains**	**Other-than-Temporary Impairments**	**Fair Value**
		(in millions)	
Equity	**$256.3**	**$ (27.9)**	**$ 787.8**
Debt	**11.8**	**(5.3)**	**312.0**
Other	**0.1**		**32.0**
Total	**$268.2**	**$ (33.2)**	**$1,131.8**

2006	Unrealized Gains	Other-than-Temporary Impairments	Fair Value
		(in millions)	
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

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The contractual maturities of debt securities at December 31, 2007 are as follows: $35.7 million in 2008; $67.3 million in 2009-2012; $58.1 million in 2013-2017; and $151.2 million thereafter.

Sales of the securities held in the trust funds resulted in cash proceeds of $774.8 million, $743.1 million, and $596.3 million in 2007, 2006, and 2005, respectively, all of which were re-invested. Realized gains and other-than-temporary impairment losses were $78.3 million and $76.3 million, respectively, in 2007 and $39.8 million and $30.3 million, respectively, in 2006. Net realized gains were $22.5 million in 2005. 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, 2007, the accumulated provisions for decommissioning were as follows:

	Plant Farley	Plant Hatch	Plant Vogtle
		(in millions)	
External trust funds, at fair value	$543	$ 368	$ 222
Internal reserves	27		
Total	$570	$ 368	$ 222

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)	
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 portion of the facilities as of 2006. The estimates used in current rates are $450 million and $313 million for Plants Hatch and Vogtle, respectively. Amounts expensed were $7 million annually for Plant Vogtle for 2005 through 2007. Significant assumptions used to determine these costs for ratemaking were an inflation rate of 4.5% and 2.9% for

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Alabama Power and Georgia Power, respectively, and a trust earnings rate of 7.0% and 4.9% for Alabama Power and Georgia Power, respectively. As a result of 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. Georgia Power filed an application with the NRC in June 2007 to extend the licenses for Plant Vogtle Units 1 and 2 for an additional 20 years. Georgia Power anticipates the NRC may make a decision regarding the license extension for Plant Vogtle as early as 2009.

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. The equity component of AFUDC is not included in calculating taxable income. 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. AFUDC and interest capitalized, net of income taxes were 8.4%, 4.2%, and 4.0% of net income for 2007, 2006, and 2005, respectively.

Cash payments for interest totaled $798 million, $875 million, and $661 million in 2007, 2006, and 2005, respectively, net of amounts capitalized of $64 million, $27 million, and $21 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.

Storm Damage Reserves

Each traditional operating company maintains a reserve to cover the cost of damages from major storms to its transmission and distribution lines and generally the cost of uninsured damages to its generation facilities and other property. In accordance with their respective state PSC orders, the traditional operating companies accrued $25.6 million in 2007 that is recoverable through 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 2007, there were no such accruals. In 2006 and 2005, additional accruals totaled $3 million and $6 million, respectively. See Note 3 under Storm Damage Cost Recovery for additional information regarding 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 recover the deferred costs and accrue reserves for future storms.

Leveraged Leases

Southern Company has several leveraged lease agreements, with terms 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

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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, the credit quality of the lessees, and the timing of expected tax cash flows.
Southern Company s net investment in domestic leveraged leases consists of the following at December 31:

	2007	2006
	(in millions)	
Net rentals receivable	**$ 494**	$ 497
Unearned income	**(244)**	(261)
Investment in leveraged leases	**250**	236
Deferred taxes from leveraged leases	**(163)**	(133)
Net investment in leveraged leases	**$ 87**	$ 103

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

	2007	2006	2005
		(in millions)	
Pretax leveraged lease income	**$16**	$20	$ 23
Income tax expense	**(7)**	(9)	(11)
Net leveraged lease income	**$ 9**	$11	$ 12

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

	2007	2006
	(in millions)	
Net rentals receivable	**$1,298**	$1,299
Unearned income	**(563)**	(396)
Investment in leveraged leases	**735**	903
Deferred taxes from leveraged leases	**(316)**	(492)
Net investment in leveraged leases	**$ 419**	$ 411

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

	2007	2006	2005
		(in millions)	
Pretax leveraged lease income	**$24**	$ 49	$ 51
Income tax expense	**(8)**	(17)	(18)

Net leveraged lease income	**$16**	$ 32	$ 33

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.

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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 years ended December 31, 2007 and 2006 was recognized as the requisite service was rendered and included: (a) compensation cost for the portion of share-based awards granted prior to and that were 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 , 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) resulted in a reduction in earnings before income taxes and net income of $28 million and $17 million, respectively, for the year ended December 31, 2007, and $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 years ended December 31, 2007 and 2006 was $21 million and $10 million, respectively.

The adoption of SFAS No. 123(R) also resulted in a reduction in basic and diluted earnings per share of $0.03 and $0.02, respectively, for the year ended December 31, 2007 and $0.02 and $0.03, respectively, for the year ended December 31, 2006.

For the year ended December 31, 2005, prior to the adoption of SFAS No. 123(R), the pro forma impact of fair-value accounting for options granted on net income and basic and diluted earnings per share was as follows:

2005	As Reported	Options Impact After Tax	Pro Forma
Net income *(in millions)*	$ 1,591	$ (17)	$ 1,574
Earnings per share *(dollars):*			
Basic	$ 2.14		$ 2.12
Diluted	$ 2.13		$ 2.10

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

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The estimated fair values of stock options granted in 2007, 2006, and 2005 were derived using the Black-Scholes stock option pricing model. Expected volatility was based on historical volatility of Southern Company s stock over a period equal to the expected term. Southern Company used 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 was 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:

Year Ended December 31	**2007**	2006	2005
Expected volatility	**14.8%**	16.9%	17.9%
Expected term *(in years)*	**5.0**	5.0	5.0
Interest rate	**4.6%**	4.6%	3.9%
Dividend yield	**4.3%**	4.4%	4.4%
Weighted average grant-date fair value	**$4.12**	$4.15	$3.90

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 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:

	Carrying Amount	**Fair Value**
	(in millions)	
Long-term debt:		
2007	**$15,095**	**$14,931**
2006	$13,824	$13,702

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 certain changes in pension and other post retirement benefit plans, less income taxes and reclassifications for amounts included in net income.

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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 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 included in Long-term Debt in the balance sheets.

In addition, Southern Company holds an 85% 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 $44 million has been funded. Southern Company s investment in the fund at December 31, 2007 totaled $26.4 million.

2. RETIREMENT BENEFITS

Southern Company has a defined benefit, trusteed, 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, 2008. 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, 2008, postretirement trust contributions are expected to total approximately $46 million.

The measurement date for plan assets and obligations is September 30 for each year presented. Pursuant to FASB Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, 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 $5.3 billion in 2007 and $5.1 billion in 2006. Changes during the year in the projected benefit obligations and fair value of plan assets were as follows:

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	2007	2006
	(in millions)	
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 5,491**	$ 5,557
Service cost	**147**	153
Interest cost	**324**	300
Benefits paid	**(241)**	(230)
Plan amendments	**50**	8
Actuarial (gain) loss	**(111)**	(297)
Balance at end of year	**5,660**	5,491
Change in plan assets		
Fair value of plan assets at beginning of year	**6,693**	6,147
Actual return on plan assets	**1,153**	759
Employer contributions	**19**	17
Benefits paid	**(241)**	(230)
Fair value of plan assets at end of year	**7,624**	6,693
Funded status at end of year	**1,964**	1,202
Fourth quarter contributions	**5**	5
Prepaid pension asset, net	**$ 1,969**	$ 1,207

At December 31, 2007, the projected benefit obligations for the qualified and non-qualified pension plans were $5.3 billion and $0.4 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 Company s pension plan assets as of the end of the year, along with the targeted mix of assets, is presented below:

	Target	2007	2006
Domestic equity	36%	**38%**	38%
International equity	24	**24**	23
Fixed income	15	**15**	16
Real estate	15	**16**	16
Private equity	10	**7**	7
Total	100%	**100%**	100%

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

	2007	2006
	(in millions)	
Prepaid pension costs	**$ 2,369**	$1,549
Other regulatory assets	**188**	158
Current liabilities, other	**(21)**	(18)
Other regulatory liabilities	**(1,288)**	(507)
Employee benefit obligations	**(379)**	(324)
Accumulated other comprehensive income	**(26)**	

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Presented below are the amounts included in accumulated other comprehensive income, regulatory assets, and regulatory liabilities at December 31, 2007 and 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:

	Prior Service Cost	Net(Gain)/Loss
	(in millions)	
Balance at December 31, 2007:		
Accumulated other comprehensive income	**$ 14**	**$ (40)**
Regulatory assets	**66**	**122**
Regulatory liabilities	**198**	**(1,486)**
Total	**$ 278**	**$ (1,404)**
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 2008:		
Accumulated other comprehensive income	$ 2	$ 1
Regulatory assets	9	9
Regulatory liabilities	26	
Total	$ 37	$ 10

The components of other comprehensive income, along with the changes in the balances of regulatory assets and regulatory liabilities, related to the defined benefit pension plans for the year ended December 31, 2007 are presented in the following table:

	Accumulated Other Comprehensive Income	Regulatory Assets	Regulatory Liabilities
		(in millions)	
Beginning balance	$	$ 158	$ (507)
Net (gain)	(28)		(753)
Change in prior service costs	4	46	

Reclassification adjustments:			
Amortization of prior service costs	(2)	(7)	(28)
Amortization of net gain		(9)	
Total reclassification adjustments	(2)	(16)	(28)
Total change	(26)	30	(781)
Ending balance	$ (26)	$ 188	$(1,288)

Components of net periodic pension cost were as follows:

	2007	2006	2005
		(in millions)	
Service cost	**$ 147**	$ 153	$ 138
Interest cost	**324**	300	286
Expected return on plan assets	**(481)**	(456)	(456)
Recognized net (gain) loss	**10**	16	10
Net amortization	**35**	26	24
Net periodic pension cost	**$ 35**	$ 39	$ 2

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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, 2007, estimated benefit payments were as follows:

	Benefit Payments
	(in millions)
2008	$ 265
2009	275
2010	289
2011	327
2012	349
2013 to 2017	2,007

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:

	2007	2006
	(in millions)	
Change in benefit obligation		
Benefit obligation at beginning of year	**$1,830**	$ 1,826
Service cost	**27**	30
Interest cost	**107**	98
Benefits paid	**(83)**	(79)
Actuarial (gain) loss	**(90)**	(49)
Retiree drug subsidy	**6**	4
Balance at end of year	**1,797**	1,830
Change in plan assets		
Fair value of plan assets at beginning of year	**731**	684
Actual return on plan assets	**105**	68
Employer contributions	**61**	97
Benefits paid	**(77)**	(118)
Fair value of plan assets at end of year	**820**	731
Funded status at end of year	**(977)**	(1,099)
Fourth quarter contributions	**65**	53

Accrued liability	**$ (912)**	$(1,046)

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:

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	Target	2007	2006
Domestic equity	43%	**45%**	44%
International equity	18	**20**	20
Fixed income	29	**26**	27
Real estate	6	**6**	6
Private equity	4	**3**	3
Total	100%	**100%**	100%

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

	2007	2006
	(in millions)	
Other regulatory assets	**$ 360**	$ 539
Current liabilities, other	**(3)**	(3)
Employee benefit obligations	**(909)**	(1,043)
Accumulated other comprehensive income	**8**	14

Presented below are the amounts included in accumulated other comprehensive income and regulatory assets at December 31, 2007 and 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.

	Prior Service Cost	Net(Gain)/ Loss	Transition Obligation
		(in millions)	
Balance at December 31, 2007:			
Accumulated other comprehensive income	**$ 4**	**$ 4**	**$**
Regulatory assets	**99**	**177**	**84**
Total	**$103**	**$181**	**$ 84**
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 2008:			
Accumulated other comprehensive income	$	$	$
Regulatory assets	9	7	15

Total	$ 9	$ 7	$ 15

The components of other comprehensive income, along with the changes in the balance of regulatory assets, related to the other postretirement benefit plans for the year ended December 31, 2007 are presented in the following table:

	Accumulated Other Comprehensive Income	**Regulatory Assets**
	(in millions)	
Beginning balance	$ 14	$ 539
Net (gain)	(6)	(141)
Change in prior service costs		
Reclassification adjustments:		
Amortization of transition obligation		(15)
Amortization of prior service costs		(9)
Amortization of net gain		(14)
Total reclassification adjustments		(38)
Total change	(6)	(179)
Ending balance	$ 8	$ 360

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

	2007	2006	2005
		(in millions)	
Service cost	**$ 27**	$ 30	$ 28
Interest cost	**107**	98	97
Expected return on plan assets	**(52)**	(49)	(45)
Net amortization	**38**	43	38
Net postretirement cost	**$120**	$122	$118

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Act) provides a 28% prescription drug subsidy for Medicare eligible retirees. The effect of the subsidy reduced Southern Company s expenses for the years ended December 31, 2007, 2006, and 2005 by approximately $35 million, $39 million, and $26 million, respectively.
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:

	Benefit Payments	**Subsidy Receipts**	**Total**
		(in millions)	
2008	$ 94	$ (7)	$ 87
2009	102	(8)	94
2010	113	(10)	103
2011	123	(11)	112
2012	131	(13)	118
2013 to 2017	745	(91)	654

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 were calculated in 2004 for the 2005 plan year using a discount rate of 5.75%.

	2007	2006	2005
Discount	**6.30%**	6.00%	5.50%
Annual salary increase	**3.75**	3.50	3.00
Long-term return on plan assets	**8.50**	8.50	8.50

The Company determined the long-term rate of return based on historical asset class returns and current market conditions, taking into account the diversification benefits of investing in multiple asset classes.
An additional assumption used in measuring the APBO was a weighted average medical care cost trend rate of 9.75% for 2008, decreasing gradually to 5.25% 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% would affect the APBO and the service and interest cost components at December 31, 2007 as follows:

	1 Percent Increase	1 Percent Decrease
	(in millions)	
Benefit obligation	$126	$107
Service and interest costs	9	8

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Employee Savings Plan
Southern Company also sponsors a 401(k) defined contribution plan covering substantially all employees. The Company provides an 85% matching contribution up to 6% of an employee s base salary. Prior to November 2006, the Company matched employee contributions at a rate of 75% up to 6% of the employee s base salary. Total matching contributions made to the plan for 2007, 2006, and 2005 were $73 million, $62 million, and $58 million, respectively.
3. CONTINGENCIES AND REGULATORY MATTERS
General Litigation Matters
Southern Company is subject to certain claims and legal actions arising in the ordinary course of business. In addition, Southern Company s business activities are subject to extensive governmental regulation related to public health and the environment. Litigation over environmental issues and claims of various types, including property damage, personal injury, common law nuisance, and citizen enforcement of environmental requirements such as opacity and air and water 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 in December 2005, and Mirant announced that this plan became effective in January 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. 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 approximately $39 million in additional tax and interest related to Mirant tax items and filed a claim in Mirant s bankruptcy case for that amount. Through December 2007, Southern Company received from the IRS approximately $36 million in refunds related to Mirant. Southern Company believes it has a right to recoup the $39 million tax payment owed by Mirant from such tax refunds. As a result, Southern Company intends to retain the tax refunds and reduce its claim against Mirant for the payment of Mirant taxes by the amount of such refunds. MC Asset Recovery, a special purpose subsidiary of Reorganized Mirant, has objected to and sought to equitably subordinate the Southern Company tax claim in its fraudulent

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transfer litigation against Southern Company. Southern Company has reserved the approximately $3 million amount remaining with respect to its Mirant tax claim.

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 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.

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, May 2006, and March 2007.

In December 2005, the Bankruptcy Court entered an order authorizing the transfer of this proceeding, along with certain other actions, to MC Asset Recovery. 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.

The complaint, as amended in March 2007, 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% 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. In addition, the complaint alleges a claim under the Federal Debt Collection Procedure Act (FDCPA) to void certain transfers from Mirant to Southern Company. MC Asset Recovery claims to have standing to assert violations of the FDCPA and to recover property on behalf of the Mirant debtors estates. 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 April 2007.

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In January 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, in February 2006, granted Southern Company s motion to transfer the case to the U.S. District Court for the Northern District of Georgia. In May 2006, Southern Company filed a motion for summary judgment seeking entry of judgment against the plaintiff as to all counts of the complaint. In December 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 alleged in earlier versions of the complaint 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 other 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. In March 2006, the plaintiffs filed a motion for reconsideration requesting that the court vacate that portion of its July 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. On March 6, 2007, the court granted plaintiffs motion for reconsideration, reinstated the California energy market claims, and granted in part and denied in part defendants motion to compel certain class certification discovery. On March 21, 2007, defendants filed renewed motions to dismiss the California energy claims on grounds originally set forth in their 2003 motions to dismiss, but which were not addressed by the court. On July 27, 2007, certain defendants, including Southern Company, filed motions for reconsideration of the court s denial of a motion seeking dismissal of certain federal securities laws claims based upon, among other things, certain alleged errors included in financial statements issued by Mirant. The ultimate outcome of this matter cannot be determined at this time.

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.

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.

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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. The civil actions request penalties and injunctive relief, including an order requiring the installation of the best available control technology at the affected units. The action against Georgia Power has been administratively closed since the spring of 2001, and the case has not been reopened.

In June 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. In August 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 all of the remaining plants: Plants Barry, Gaston, Gorgas, and Greene County.

The plaintiffs appealed the district court s decision to the U.S. Court of Appeals for the Eleventh Circuit, and the appeal was stayed by the Appeals Court pending the U.S. Supreme Court s decision in a similar case against Duke Energy. The Supreme Court issued its decision in the Duke Energy case in April 2007. On October 5, 2007, the U.S. District Court for the Northern District of Alabama issued an order in the Alabama Power case indicating a willingness to re-evaluate its previous decision in light of the Supreme Court s Duke Energy opinion. On December 21, 2007, the Eleventh Circuit vacated the district court s decision in the Alabama Power case and remanded the case back to the district court for consideration of the legal issues in light of the Supreme Court s decision in the Duke Energy case. The final outcome of these matters cannot be determined at this time.

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 either of these cases could require substantial capital expenditures or affect the timing of currently budgeted 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.

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

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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 and no decision has been issued. The ultimate outcome of these matters cannot be determined at this time.

Environmental Remediation

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. The traditional operating companies have each received authority from their respective state PSCs to recover approved environmental compliance costs through regulatory mechanisms. Within limits approved by the state PSCs, these rates are adjusted annually or as necessary.

Through 2007, Georgia Power recovered environmental costs through its base rates. Beginning in 2008, in connection with the retail rate plan for the years 2008 through 2010 (2007 Retail Rate Plan), an environmental compliance cost recovery tariff, including an annual accrual of $1.2 million for environmental remediation, was implemented. Environmental remediation expenditures will be charged against the reserve as they are incurred. The annual accrual amount will be reviewed and adjusted as necessary in future regulatory proceedings. The balance of Georgia Power s environmental remediation liability at December 31, 2007 was $13.5 million.

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 (CERCLA), including a large site in Brunswick, Georgia on the CERCLA National Priorities List (NPL). The parties have completed the removal of wastes from the Brunswick site as ordered by the EPA. Additional claims for recovery of natural resource damages at this site or for the assessment and potential cleanup of other sites on the Georgia Hazardous Sites Inventory and CERCLA NPL are anticipated.

Gulf Power s environmental remediation liability includes estimated costs of environmental remediation projects of approximately $66.9 million as of December 31, 2007. 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 through Gulf Power s environmental cost recovery clause; therefore, there was no impact on net income as a result of these estimates.

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 the proceeding.

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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 that ended in May 2006 could be subject to refund to a cost-based rate level.

In late June and July 2007, hearings were held in this proceeding and the presiding administrative law judge issued an initial decision on November 9, 2007 regarding the methodology to be used in the generation dominance tests. The proceedings are ongoing. The ultimate outcome of this generation dominance proceeding cannot now be determined, but an adverse decision by the FERC in a final order could require the traditional operating companies and Southern Power 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 and could also result in refunds of up to $19.7 million, plus interest. Southern Company and its subsidiaries believe that there is no meritorious basis for this proceeding and are vigorously defending themselves in this matter.

On June 21, 2007, the FERC issued its final rule regarding market-based rate authority. The FERC generally retained its current market-based rate standards. The impact of this order and its effect on the generation dominance proceeding cannot now be determined.

Intercompany Interchange Contract

The Company s generation fleet in its retail service territory is operated under the Intercompany Interchange Contract (IIC), as approved by the FERC. In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among the traditional operating companies, Southern Power, and SCS, as agent, under the terms of which the power pool of Southern Company is operated, (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.

In October 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 and 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 in November 2006 a compliance plan in connection with the order. On April 19, 2007, the FERC approved, with certain modifications, the plan submitted by Southern Company. Implementation of the plan is not expected to have a material impact on the Company s financial statements. On November 19, 2007, Southern Company notified the FERC that the plan had been implemented and the FERC division of audits subsequently began an audit pertaining to compliance implementation and related matters, which is ongoing.

Generation Interconnection Agreements

In November 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. No other similar 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 required the modification of Tenaska s interconnection agreements, under the provisions of the order, Southern Company determined that no refund was payable to Tenaska. Southern Company requested rehearing asserting that the FERC retroactively applied a new principle to existing interconnection agreements. Tenaska requested rehearing of FERC s methodology for determining the amount of refunds. The requested rehearings were denied, and

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Southern Company and Tenaska have appealed the orders to the U.S. Circuit Court for the District of Columbia. The final outcome of this matter cannot now be determined.

Right of Way Litigation

Southern Company and certain of its subsidiaries, including Gulf Power, Mississippi Power, and Southern Telecom, Inc. (a subsidiary of SouthernLINC Wireless), 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. Gulf Power filed an appeal to the Florida First District Court of Appeals in December 2005. In October 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 was returned to the trial court for further proceedings. The parties reached agreement on a proposed settlement plan that was subject to approval by the trial court. On November 7, 2007, the trial court granted preliminary approval and set forth the requirements for the trial court to make its final determination on the proposed settlement. Although the final outcome of this matter cannot now be determined, if approved the settlement is not expected to have a material effect on Southern Company s financial statements.

To date, Mississippi Power has entered into agreements with plaintiffs in approximately 90% 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 Southern Company s financial statements.

In addition, in late 2001, certain subsidiaries of Southern Company, including Alabama Power, Georgia Power, Gulf Power, Mississippi Power, and Southern Telecom, Inc. (a subsidiary of SouthernLINC Wireless), 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.

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Income Tax Matters
Leveraged Leases

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 prior to 2004. The IRS challenged Southern Company s deductions related to three international lease transactions (SILO or sale-in-lease-out transactions), in connection with its audits of Southern Company s 2000 through 2003 tax returns. 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 and 2001 and filed a claim for refund which was denied by the IRS. The disputed tax amount was $79 million and the related interest 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 has initiated litigation in the U.S. District Court for the Northern District of Georgia for a complete refund of tax and interest paid for the 2000 and 2001 tax years. The IRS also challenged the SILO deductions for the tax years 2002 and 2003. The estimated amount of disputed tax and interest for tax years 2002 and 2003 was 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. For tax years 2000 through 2007, Southern Company has claimed approximately $330 million in tax benefits related to these SILO transactions challenged by the IRS. These tax benefits relate to timing differences and do not impact total net income. Southern Company believes these transactions are valid leases for U.S. tax purposes and the related deductions are allowable. Southern Company is continuing to pursue resolution of these matters; however, the ultimate outcome cannot now be determined. In addition, the U.S. Senate is currently considering legislation that would disallow tax benefits for SILO losses and other international leveraged lease transactions (such as lease-in-lease-out transactions) occurring after December 31, 2007. The ultimate impact on Southern Company s net income and cash flow will be dependent on the outcome of pending litigation and proposed legislation, but could be significant, and potentially material.

Effective January 1, 2007, Southern Company adopted both FIN 48 and 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). FIN 48 requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest and penalties. FSP 13-2 amends FASB Statement No. 13, Accounting for Leases requiring 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 with recognition of the resulting gain or loss in the year of the revision. FSP 13-2 also requires that all recognized tax positions in a leveraged lease must be measured in accordance with the criteria in FIN 48 and any changes resulting from FIN 48 must be reflected as a change in an important lease assumption as of the date of adoption. In adopting these standards, Southern Company concluded that a portion of the SILO tax benefits were uncertain tax positions, as defined in FIN 48. Accordingly, Southern Company also concluded that there was a change in the timing of project income tax cash flows and, as required by FSP 13-2, recalculated the rate of return and allocation of income under the lease-in-lease-out (LILO) and SILO transactions.

The cumulative effect of the initial adoption of FIN 48 and FSP 13-2 was recorded as an adjustment to beginning retained earnings. For the LILO transaction settled with the IRS in February 2005, the cumulative effect of adopting FSP 13-2 was a $17 million reduction in beginning retained earnings. With respect to Southern Company s SILO transactions, the adoption of FSP 13-2 reduced beginning retained earnings by $108 million and the adoption of FIN 48 reduced beginning retained earnings by an additional $15 million. The adjustments to retained earnings are non-cash charges and those related to FSP 13-2 will be recognized as income over the remaining terms of the affected leases. The adoption of FSP 13-2 also resulted in a reduction of net income of approximately $15 million during 2007. Any future changes in the projected or actual income tax cash flows will result in an additional recalculation of the net investment in the leases and will be recorded currently in income.

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Georgia State Income Tax Credits
Georgia Power s 2005 through 2007 income tax filings for the State of Georgia include state income tax credits for increased activity through Georgia ports. Georgia Power has also filed similar claims for the years 2002 through 2004. The Georgia Department of Revenue has not responded to these claims. On July 24, 2007, Georgia Power filed a complaint in the Superior Court of Fulton County to recover the credits claimed for the years 2002 through 2004. If Georgia Power prevails, these claims could have a significant, and possibly material, positive effect on Southern Company s net income. If Georgia Power is not successful, payment of the related state tax could have a significant, and possibly material, negative effect on Southern Company s cash flow. The ultimate outcome of this matter cannot now be determined.

Alabama Power Retail Regulatory Matters

Alabama Power operates under a Rate Stabilization and Equalization Plan (Rate RSE) approved by the Alabama PSC. Prior to 2007, Rate RSE provided for periodic annual adjustments based upon Alabama Power s earned return on end-of-period retail common equity. Beginning in 2007, Rate RSE adjustments are effective in January based on forward-looking information for the applicable upcoming calendar year. Rate adjustments for any two-year period, when averaged together, cannot exceed 4% per year and any annual adjustment is limited to 5%. Rates remain unchanged when the retail return on common equity (ROE) is projected to be between 13% and 14.5%. 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. The Rate RSE increase for 2007 was 4.76%, or $193 million annually. The ratemaking procedures will remain in effect until the Alabama PSC votes to modify or discontinue them.

The Alabama PSC has also approved a rate mechanism that provides for adjustments to recognize the cost of placing new generating facilities in retail service and for the recovery of retail costs associated with certificated purchased power agreements (Rate CNP). In April 2005, an adjustment to Rate CNP decreased retail rates by approximately 0.5%, or $19 million annually. The annual true-up adjustment effective in April 2006 increased retail rates by 0.5%, or $19 million annually. In April 2007, there was no adjustment to Rate CNP.

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 operations and maintenance expenses, depreciation, and a return on invested capital. Retail rates increased approximately 1.2% in January 2006 and 0.6% 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 June 2007, the Alabama PSC approved Alabama Power s request to increase the retail energy cost recovery rate to 3.100 cents per kilowatt hour, effective with billings beginning July 2007 for the 30-month period ending December 2009. As of December 31, 2007, Alabama Power had an under recovered fuel balance of approximately $280 million, of which approximately $82 million is included in deferred charges and other assets in the balance sheets.

Georgia Power Retail Regulatory Matters

In December 2007, the Georgia PSC approved the 2007 Retail Rate Plan. Under the 2007 Retail Rate Plan, Georgia Power s earnings will continue to be evaluated against a retail ROE range of 10.25% to 12.25%. Two-thirds of any earnings above 12.25% will be applied to rate refunds with the remaining one-third applied to an environmental compliance cost recovery (ECCR) tariff. Georgia Power has agreed that it will not file for a general base rate increase during this period unless its projected retail ROE falls below 10.25%. Retail base rates increased by

NOTES (continued)
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approximately $99.7 million effective January 1, 2008 to provide for cost recovery of transmission, distribution, generation, and other investments, as well as increased operating costs. In addition, the ECCR tariff was implemented to allow for the recovery of costs for required environmental projects mandated by state and federal regulations. The ECCR tariff increased rates by approximately $222 million effective January 1, 2008. Georgia Power is required to file a general rate case by July 1, 2010, in response to which the Georgia PSC would be expected to determine whether the 2007 Retail Rate Plan should be continued, modified, or discontinued.

In December 2004, the Georgia PSC approved the retail rate plan for the years 2005 through 2007 (2004 Retail Rate Plan) for Georgia Power. Under the terms of the 2004 Retail Rate Plan, Georgia Power s earnings were evaluated against a retail ROE range of 10.25% to 12.25%. Two-thirds of any earnings above 12.25% were applied to rate refunds, with the remaining one-third retained by Georgia Power. Retail rates and customer fees increased by approximately $203 million effective January 1, 2005 to cover the higher costs of purchased power, operating and maintenance expenses, environmental compliance, and continued investment in new generation, transmission, and distribution facilities to support growth and ensure reliability. In 2007, Georgia Power refunded 2005 earnings above 12.25% retail ROE. There were no refunds related to earnings for 2006 or 2007.

Georgia Power has established fuel cost recovery rates approved by the Georgia PSC. On February 6, 2007, the Georgia PSC approved an increase in Georgia Power s total annual billings of approximately $383 million effective March 1, 2007. 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. As of December 31, 2007, Georgia Power had an under recovered fuel balance of approximately $692 million, of which approximately $307 million is included in deferred charges and other assets in the balance sheets. The Georgia PSC order also requires Georgia Power to file for a new fuel cost recovery rate no later than March 1, 2008.

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 lines and generally the cost of uninsured damages to its generation facilities and other property. In addition, each traditional operating company affected by recent hurricanes has been authorized 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, 2007, the under recovered balance in Southern Company s storm damage reserve accounts totaled approximately $43 million, of which approximately $40 million and $3 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 that 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). In October 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.

In October 2006, the Mississippi PSC issued a financing order that authorized 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 were issued by the Mississippi Development Bank on behalf of the State of Mississippi on June 1, 2007.

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On June 1, 2007, Mississippi Power received a grant payment of $85.2 million from the State of Mississippi representing recovery of $25.2 million in retail storm restoration costs incurred or to be incurred and $60.0 million to increase Mississippi Power s property damage reserve. In the fourth quarter 2007, Mississippi Power received additional grant payments of $24.1 million for expenditures incurred for construction of a new storm operations center. The funds received related to previously incurred storm restoration expenditures have been accounted for as a government grant and have been recorded as a reduction to the regulatory asset that was recorded as the storm restoration expenditures were incurred. The funds received for storm restoration expenditures to be incurred were recorded as a regulatory liability. Mississippi Power will receive further grant payments of up to $11.9 million as expenditures are incurred to construct the new storm operations center. As of December 31, 2007, Mississippi Power had no under recovered balance in the property damage reserve account.

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 provided for an extension of the storm-recovery surcharge then 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 surcharge were first credited to the unrecovered balance of storm-recovery costs associated with Hurricane Ivan until these costs were fully recovered. The funds are now being 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 and $6 million in 2006 and 2005, respectively. Gulf Power made no discretionary accrual to the reserve in 2007. 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% 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, 2007, Gulf Power s unrecovered balance in the property damage reserve totaled approximately $18.6 million which is included in the balance sheets under Current Assets.

At Alabama Power, 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 (NDR). 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 storm restoration costs over a two-year period and to replenish its reserve to a target balance of $75 million over a five-year period.

In June 2007, Alabama Power fully recovered its prior storm cost of $51 million resulting from Hurricanes Dennis and Katrina. As a result, customer rates decreased by this portion of the NDR charge effective in July 2007. At December 31, 2007, Alabama Power had accumulated a balance of $26.1 million in the target reserve for future storms, which is included in the balance sheets under Other Regulatory Liabilities.

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Kemper County Integrated Coal Gasification Combined Cycle

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 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 integrated gasification combined cycle 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 undertaking 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 Mississippi PSC has authorized Mississippi Power to create a regulatory asset for the approved retail portion of the costs associated with the generation resource planning, evaluation, and screening activities up to approximately $23.8 million ($16 million for the retail portion). The retail portion of these costs will be charged to and remain as a regulatory asset until the Mississippi PSC determines the prudence and ultimate recovery, which decision is expected in January 2009. The final outcome of this matter cannot now be determined.

4. JOINT OWNERSHIP AGREEMENTS

Alabama Power owns an undivided interest in units 1 and 2 of Plant Miller and related facilities jointly with Alabama Electric Cooperative, Inc. Georgia Power owns undivided interests in Plants Vogtle, Hatch, Scherer, and Wansley in varying amounts jointly with Oglethorpe Power Corporation (OPC), the Municipal Electric Authority of Georgia, the city of Dalton, Georgia, Florida Power & Light Company, and Jacksonville Electric Authority. In addition, Georgia Power has joint ownership agreements with OPC for the Rocky Mountain facilities and with Florida Power Corporation for a combustion turbine unit at Intercession City, Florida. 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, 2007, 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	**Amount of Investment**	**Accumulated Depreciation**
		(in millions)	
Plant Vogtle (nuclear)	**45.7%**	$3,288	$ 1,900
Plant Hatch (nuclear)	**50.1**	938	509
Plant Miller (coal) Units 1 and 2	**91.8**	965	418
Plant Scherer (coal) Units 1 and 2	**8.4**	116	64
Plant Wansley (coal)	**53.5**	406	185
Rocky Mountain (pumped storage)	**25.4**	170	99
Intercession City (combustion turbine)	**33.3**	12	3
Plant Stanton (combined cycle) Unit A	**65.0**	151	19

At December 31, 2007, the portion of total construction work in progress related to Plants Miller, Scherer, Wansley, and Rocky Mountain was $49.1 million, $66.5 million, $170.3 million, and $4.0 million, respectively, primarily for environmental projects.

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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.

5. INCOME TAXES

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

Current and Deferred Income Taxes

Details of income tax provisions are as follows:

	2007	2006	2005
		(in millions)	
Federal			
Current	**$ 715**	$465	$ 61
Deferred	**11**	207	419
	726	672	480
State			
Current	**114**	110	35
Deferred	**(5)**	(2)	80
	109	108	115
Total	**$ 835**	$780	$ 595

Net cash payments for income taxes in 2007, 2006, and 2005 were $732 million, $649 million, and $100 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:

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	2007	2006
	(in millions)	
Deferred tax liabilities		
Accelerated depreciation	**$4,878**	$4,675
Property basis differences	**950**	962
Leveraged lease basis differences	**479**	625
Employee benefit obligations	**856**	530
Under recovered fuel clause	**443**	543
Premium on reacquired debt	**114**	120
Regulatory assets associated with employee benefit obligations	**303**	362
Regulatory assets associated with asset retirement obligations	**483**	453
Storm reserve	**3**	33
Other	**137**	126
Total	**8,646**	8,429
Deferred tax assets		
Federal effect of state deferred taxes	**305**	267
State effect of federal deferred taxes	**97**	63
Employee benefit obligations	**656**	615
Other property basis differences	**147**	156
Deferred costs	**131**	131
Unbilled revenue	**90**	76
Other comprehensive losses	**48**	60
Regulatory liabilities associated with employee benefit obligations	**514**	196
Asset retirement obligations	**483**	453
Other	**259**	272
Total	**2,730**	2,289
Total deferred tax liabilities, net	**5,916**	6,140
Portion included in prepaid expenses (accrued income taxes), net	**(106)**	(175)
Deferred state tax assets	**88**	83
Valuation allowance	**(59)**	(59)
Accumulated deferred income taxes in the balance sheets	**$5,839**	$5,989

At December 31, 2007, Southern Company had a State of Georgia net operating loss (NOL) carryforward totaling $1.0 billion, which could result in net state income tax benefits of $59 million, if utilized. However, Southern Company has established a valuation allowance for the potential $59 million tax benefit due to the remote likelihood that the tax benefit will be realized. These NOLs will expire between 2008 and 2021. During 2007, Southern Company utilized $0.8 million in available NOLs, which resulted in a $0.05 million state income tax benefit. The State of Georgia allows the filing of a combined return, which should substantially reduce any additional NOL carryforwards.

At December 31, 2007, the tax-related regulatory assets and liabilities were $911 million and $275 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.

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 2007, $23 million in 2006, and $25 million in 2005. At December 31, 2007, all investment tax credits available to reduce federal income taxes payable had been utilized.

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Effective Tax Rate

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 and preference dividends of subsidiaries, as a result of the following:

	2007	2006	2005
Federal statutory rate	**35.0%**	35.0%	35.0%
State income tax, net of federal deduction	**2.7**	2.9	3.4
Synthetic fuel tax credits	**(1.4)**	(2.7)	(8.0)
Employee stock plans dividend deduction	**(1.3)**	(1.4)	(1.5)
Non-deductible book depreciation	**0.9**	1.0	1.1
Difference in prior years deferred and current tax rate	**(0.2)**	(0.3)	(1.8)
AFUDC-Equity	**(1.4)**	(0.7)	(0.8)
Production activities deduction	**(0.8)**	(0.2)	(0.1)
Donations	**(0.8)**		
Other	**(0.8)**	(0.9)	(0.5)
Effective income tax rate	**31.9%**	32.7%	26.8%

The American Jobs Creation Act of 2004 created a tax deduction for a portion of income attributable to United States production activities as defined in Internal Revenue Code Section 199 (production activities deduction). The deduction is equal to a stated percentage of qualified production activities income. The percentage is phased in over the years 2005 through 2010 with a 3% rate applicable to the years 2005 and 2006, a 6% rate applicable for years 2007 through 2009, and a 9% rate applicable for all years after 2009. This increase from 3% in 2006 to 6% in 2007 was one of several factors that increased Southern Company s 2007 deduction by $32 million over the 2006 deduction. The resulting additional tax benefit was $11 million.

In 2007, Georgia Power donated 2,200 acres of land in the Tallulah Gorge State Park to the State of Georgia. The estimated value of the donation caused a lower effective income tax rate for the year ended December 31, 2007, when compared to December 31, 2006.

Unrecognized Tax Benefits

On January 1, 2007, Southern Company adopted FIN 48, which requires companies to determine whether it is more likely than not that a tax position will be sustained upon examination by the appropriate taxing authorities before any part of the benefit can be recorded in the financial statements. It also provides guidance on the recognition, measurement, and classification of income tax uncertainties, along with any related interest and penalties.

Prior to the adoption of FIN 48, Southern Company had unrecognized tax benefits which were previously accrued under Statement of Financial Accounting Standards No. 5, Accounting for Contingencies of approximately $65 million. Upon adoption of FIN 48, an additional $146 million of unrecognized tax benefits were recorded, which resulted in a total balance of $211 million. The $146 million relates to tax positions for which ultimate deductibility is highly certain, but for which there is uncertainty as to the timing of such deductibility. For 2007, the total amount of unrecognized tax benefits increased by $53 million, resulting in a balance of $264 million as of December 31, 2007.

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Changes during the year in unrecognized tax benefits were as follows:

	2007
	(in millions)
Unrecognized tax benefits as of adoption	**$ 211**
Tax positions from current periods	**46**
Tax positions from prior periods	**7**
Reductions due to settlements	
Reductions due to expired statute of limitations	
Balance at end of year	**$ 264**

Impact on Southern Company s effective tax rate, if recognized, is as follows:

	2007
	(in millions)
Tax positions impacting the effective tax rate	**$ 96**
Tax positions not impacting the effective tax rate	**168**
Balance at end of year	**$ 264**

Accrued interest for unrecognized tax benefits:

	2007
	(in millions)
Interest accrued as of adoption	**$ 27**
Interest accrued during the year	**4**
Balance at end of year	**$ 31**

Southern Company classifies interest on tax uncertainties as interest expense. The net amount of interest accrued as of adoption of FIN 48 was $27 million, which resulted in a reduction to beginning 2007 retained earnings of approximately $15 million, net of tax. Net interest accrued for the year ended December 31, 2007 was $4 million. Southern Company did not accrue any penalties on uncertain tax positions.
The IRS has audited and closed all tax returns prior to 2004. The audits for the state returns have either been concluded, or the statute of limitations has expired, for years prior to 2002.
It is reasonably possible that the amount of the unrecognized benefit with respect to certain of Southern Company s unrecognized tax positions will significantly increase or decrease within the next 12 months. The possible settlement of the SILO litigation, the Georgia state tax credits litigation, the production activities deduction methodology, and/or the conclusion or settlement of federal or state audits could impact the balances significantly. At this time, other than the SILO litigation, an estimate of the range of reasonably possible outcomes cannot be determined. The unrecognized

benefit related to the SILO litigation could decrease by $165 million within the next 12 months. See Note 3 under Income Tax Matters for additional information.

6. FINANCING

Long-Term Debt Payable to Affiliated Trusts

Southern Company and certain of the traditional operating companies have 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 $412 million, which constitute substantially all of the

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assets of these trusts and are reflected in the balance sheets as Long-term Debt. Southern Company and such 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, 2007, preferred securities of $400 million were outstanding. 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 was as follows:

	2007	2006
	(in millions)	
Capitalized leases	**$ 15**	$ 13
Senior notes	**1,005**	1,369
Other long-term debt	**33**	36
Preferred stock	**125**	
Total	**$1,178**	$1,418

Debt and preferred stock redemptions, and/or serial maturities through 2012 applicable to total long-term debt are as follows: $1.2 billion in 2008; $609 million in 2009; $291 million in 2010; $332 million in 2011; and $1.6 billion in 2012.

Assets Subject to Lien

Each of Southern Company s subsidiaries is organized as a legal entity, separate and apart from Southern Company and its other subsidiaries. Alabama Power 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.

Bank Credit Arrangements

At the beginning of 2008, unused credit arrangements with banks totaled $4.1 billion, of which $811 million expires during 2008 and $3.3 billion expires in 2012. The following table outlines the credit arrangements by company:

			Expires	
Company	**Total**	**Unused**	**2008**	**2012**
		(in millions)		
Alabama Power	$1,235	$1,235	$435	$ 800
Georgia Power	1,160	1,152	40	1,120
Gulf Power	125	125	125	
Mississippi Power	181	181	181	
Southern Company	1,000	1,000		1,000
Southern Power	400	387		400
Other	30	30	30	
Total	$4,131	$4,110	$811	$3,320

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Approximately $79 million of the credit facilities expiring in 2008 allow the execution of term loans for an additional two-year period and $500 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% 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% of total capitalization, as defined in the agreements. For purposes of these definitions, debt excludes the long-term debt payable to affiliated trusts and, in certain arrangements, other hybrid securities. At December 31, 2007, 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.

A portion of the $4.1 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, 2007 was $927 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 amounts of commercial paper outstanding and included in notes payable in the balance sheets at December 31, 2007 and December 31, 2006 were $1.2 billion and $1.8 billion, respectively. The amounts of short-term bank loans included in notes payable in the balance sheets at December 31, 2007 and December 31, 2006 were $113 million and $140 million, respectively. There were no extendible commercial notes outstanding at December 31, 2007 and $30 million outstanding at December 31, 2006.

During 2007, the peak amount outstanding for short-term debt was $2.3 billion, and the average amount outstanding was $1.4 billion. The average annual interest rate on short-term debt was 5.3% for 2007 and 5.2% for 2006.

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.

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At December 31, 2007, the fair value gains/(losses) of energy-related derivative contracts was reflected in the financial statements as follows:

	Amounts (in millions)
Regulatory assets, net	$
Accumulated other comprehensive income	**1**
Net income	**3**
Total fair value	**$ 4**

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 2007, 2006, and 2005, the pre-tax gains/(losses) reclassified from other comprehensive income to fuel expense or revenues were not material. For the year 2008, approximately $1 million of gains are expected to be reclassified from other comprehensive income to revenues. There was no significant ineffectiveness recorded in earnings for any period presented. Southern Company has energy-related hedges in place up to and including 2010.

During 2006 and 2007, Southern Company entered into derivative transactions to reduce its exposure to a potential phase-out of certain income tax credits related to synthetic fuel production in 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, 2007, the fair value of all derivative transactions related to synthetic fuel production was a $43 million net asset. For 2007, 2006, and 2005, the fair value gain/(loss) recognized in other income (expense) to mark the transactions to market was $27 million, $(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 for any period presented.

At December 31, 2007, Southern Company had $865 million notional amount of interest rate swaps and options outstanding with net fair value losses of $21 million as follows:

Cash Flow Hedges

	Notional Amount *(in millions)*	**Variable Rate Received**	**Weighted Average Fixed Rate Paid**	**Hedge Maturity Date**	**Fair Value Gain(Loss) December 31, 2007** *(in millions)*
Alabama Power*	$ 246	SIFMA Index	2.96%	February 2010	$ (1.4)
Georgia Power**	100	1-month LIBOR	3.85%	January 2008	

Georgia Power	225	3-month LIBOR	5.26%	March 2018	(10.4)
Georgia Power	100	3-month LIBOR	5.12%	June 2018	(3.3)
Georgia Power	100	3-month LIBOR	5.28%	February 2019	(3.6)
Georgia Power*	14	SIFMA Index	2.50%	January 2008	
Gulf Power	80	3-month LIBOR	5.10%	July 2018	(2.4)

* Hedged using the Securities Industry and Financial Markets Association Municipal Swap Index (SIFMA), (Formerly the Bond Market Association/PSA Municipal Swap Index)

** Interest rate collar with variable rate based on a percentage of 1-month LIBOR (showing rate cap)

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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 2007, 2006, and 2005, the Company incurred net gains/(losses) of $9 million, $1 million, and $(19) million, respectively, upon termination of certain interest derivatives at the same time it issued debt. The effective portion of these gains/(losses) have been deferred in other comprehensive income and will be amortized to interest expense over the life of the original interest derivative. For 2007, 2006, and 2005, approximately $15 million, $1 million, and $10 million, respectively, of pre-tax losses were reclassified from other comprehensive income to interest expense. For 2008, pre-tax losses of approximately $16 million are expected to be reclassified from other comprehensive income to interest expense. The Company has interest-related hedges in place through 2019 and has deferred gains/(losses) that are being amortized through 2037.

7. COMMITMENTS

Construction Program

Southern Company is engaged in continuous construction programs, currently estimated to total $4.5 billion in 2008, $4.8 billion in 2009, and $4.3 billion in 2010. These amounts include $176 million, $188 million, and $170 million in 2008, 2009, and 2010, 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 statutes and 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, 2007, 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), ABB Power Generation, Inc., and Mitsubishi Power Systems Americas, Inc. for the purpose of securing maintenance support for the combined cycle and combustion turbine generating facilities owned or under construction by the subsidiaries. The LTSAs cover all planned inspections on the covered equipment, which generally includes the cost of all labor and materials. The LTSAs are also obligated to cover the costs of unplanned maintenance on the covered equipment subject to limits and scope specified in each contract.

In general, these LTSAs are in effect through two major inspection cycles per unit. Scheduled payments under the LTSAs, which are subject to price escalation, are made at various intervals based on actual operating hours or number of gas turbine starts of the respective units. Total remaining payments under these agreements for facilities owned are currently estimated at $2.3 billion over the remaining life of the agreements, which are currently estimated to range up to 40 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 $9 million. The contract contains cancellation provisions at the option of Georgia Power.

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

Limestone Commitments

As part of Southern Company s program to reduce sulfur dioxide emissions from certain of its coal plants, the traditional operating companies are constructing certain equipment and have entered into various long-term commitments for the procurement of limestone to be used in such equipment. Contracts are structured with tonnage minimums and maximums in order to account for changes in coal burn and sulfur content. Southern Company has a minimum contractual obligation of 7.7 million tons, equating to approximately $305 million, through 2019. Estimated expenditures over the next five years are $7 million in 2008, $13 million in 2009, $36 million in 2010, $34 million in 2011, and $35 million in 2012.

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, 2007. Also, Southern Company has entered into various long-term commitments for the purchase of capacity and electricity. Total estimated minimum long-term obligations at December 31, 2007 were as follows:

	Commitments			
	Natural Gas	Coal	Nuclear Fuel	Purchased Power
	(in millions)			
2008	$1,735	$ 3,413	$ 176	$ 177
2009	1,178	2,456	188	205
2010	595	1,310	170	231
2011	466	715	157	213
2012	482	644	156	168
2013 and thereafter	3,530	1,683	167	1,656
Total	$7,986	$10,221	$1,014	$ 2,650

Additional commitments for fuel will be required to supply Southern Company s future needs. Total charges for nuclear fuel included in fuel expense amounted to $144 million in 2007, $137 million in 2006, and $134 million in 2005.

Operating Leases

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), 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% 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% 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

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calls for Mississippi Power to amortize an additional 17% 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% 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 $7 million and $9 million for the fair market value of this residual value guarantee is included in the balance sheets as of December 31, 2007 and 2006, respectively.

Southern Company also has other operating lease agreements with various terms and expiration dates. Total operating lease expenses were $163 million, $161 million, and $150 million for 2007, 2006, and 2005, 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, 2007, estimated minimum lease payments for noncancelable operating leases were as follows:

	Minimum Lease Payments			
	Plant Daniel	Barges & Rail Cars	Other	Total
		(in millions)		
2008	$ 29	$ 49	$ 47	$ 125
2009	28	39	41	108
2010	28	30	33	91
2011	28	23	25	76
2012		16	17	33
2013 and thereafter		46	118	164
Total	$113	$ 203	$ 281	$ 597

For the traditional operating companies, a majority of 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 $41 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. Southern Company has paid approximately $1.4 million in connection with the guarantees. The total notional amount of guarantees outstanding at December 31, 2007 is less than $10 million.

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

8. COMMON STOCK

Stock Issued

In 2007, Southern Company raised $379 million (11.6 million shares) from the issuance of new common shares and $159 million (5.3 million shares) from the issuance of treasury stock under the Company s various stock programs.

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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.

Shares Reserved

At December 31, 2007, a total of 68 million shares were 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, 2007, 6,728 current and former employees participated in the stock option plan. The maximum number of shares of common stock that may be issued under this plan may not exceed 40 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.

Southern Company s activity in the stock option plan for 2007 is summarized below:

	Shares Subject To Option	**Weighted Average Exercise Price**
Outstanding at December 31, 2006	34,609,243	$ 28.69
Granted	6,958,668	36.42
Exercised	(7,393,430)	26.32
Cancelled	(99,859)	33.94
Outstanding at December 31, 2007	**34,074,622**	**$ 30.77**
Exercisable at December 31, 2007	**21,300,097**	**$ 28.23**

The number of stock options vested, and expected to vest in the future, as of December 31, 2007 was not significantly different from the number of stock options outstanding at December 31, 2007 as stated above. As of December 31, 2007, the weighted average remaining contractual term for the options outstanding and options exercisable was 6.5 years and 5.3 years, respectively, and the aggregate intrinsic value for the options outstanding and options exercisable was $272 million and $224 million, respectively.

As of December 31, 2007, 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 10 months.

The total intrinsic value of options exercised during the years ended December 31, 2007, 2006, and 2005 was $81 million, $36 million, and $130 million, respectively. The actual tax benefit realized by the Company for the tax deductions from stock option exercises totaled $31 million, $14 million, and $50 million, respectively, for the years ended December 31, 2007, 2006, and 2005.

Southern Company has a policy of issuing shares to satisfy share option exercises. Cash received from issuances related to option exercises under the share-based payment arrangements for the years ended December 31, 2007, 2006, and 2005 was $195 million, $77 million, and $213 million, respectively.

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