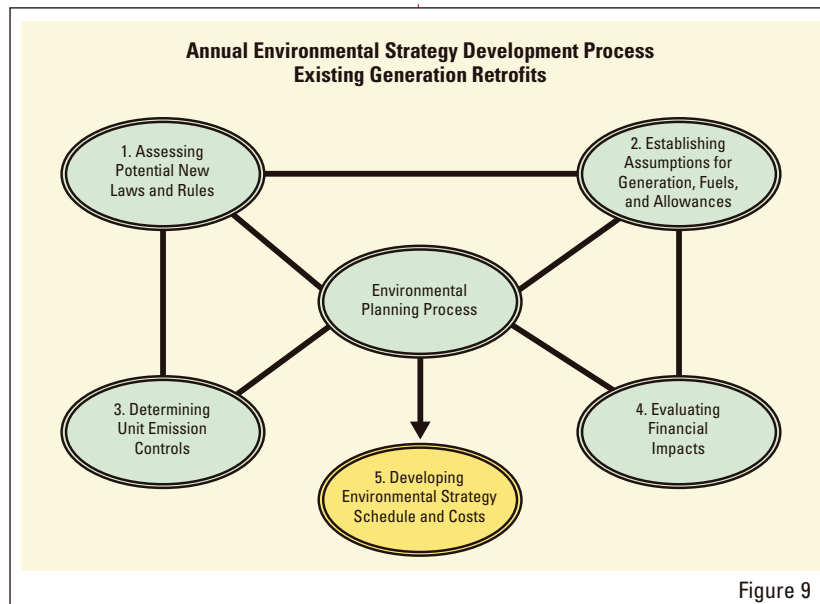


Section 1. Environmental Compliance – Strategy Development

Since the 1990 Clean Air Act Amendments, Southern Company has had in place an annual, formal process to develop plant, operating company and system-wide environmental compliance strategies using sophisticated, state-of-the-art analytical tools. The process itself and the tools it employs are also reviewed annually to ensure that they are up to date. The goal of this process is to produce least-cost compliance strategies that meet or exceed all regulatory requirements and that minimize the effect on and risk for Southern Company customers and shareholders. This process is illustrated (Figure 9) and discussed below:

The process for developing the environmental compliance strategy includes the comprehensive involvement of numerous groups in the company, including environmental, governmental affairs, planning, fuels, engineering, finance, operations, communications, plant operations, and research. The company’s integrated process includes five steps.

1. Assessing Potential New Laws and Rules - One major goal of the environmental strategy process is to maintain flexibility by including as much information as possible about potential new laws and regulations in the process before making final decisions. Therefore, the first step in the strategy development process involves gathering all available knowledge about current and possible future local, state, regional, and national environmental requirements. The future requirements may be in the form of legislation that will require regulatory action, or in the form of draft or proposed new rules that must go through the regulatory process to become final. Some



rules may be part of an allowance-based cap-and-trade¹ program on a regional or national scale and others may be local or state that mandate requirements on specific plants. For many regulatory programs, the possibility exists that litigation will result in changes to the rules. This creates additional uncertainty.

2. Establishing Assumptions for Generation, Fuels, and Allowances

- In order to predict the impacts of the environmental requirements on the generating plants, the company obtains forecasts and makes assumptions about important variables that will affect the strategy chosen. These include:

Future demand for electricity – The company utilizes external and internal expertise to develop forecasts of future electricity demand. The Southeast continues to be one of the fastest-growing regions in the United States, with both economic activity and electricity demand growing faster than the national average. As shown in Figure 10, economic activity in the U.S. is projected to expand by about 49% between now and 2020. The 12-state Southeast region is projected to grow about 62% and the four-state region in which Southern Company is located has projected growth of about 70%.

Demand for electricity is projected to increase with increased economic activity. Over the past 15 years, real

¹ Under a cap-and-trade program, overall emissions of a pollutant are capped at a level lower than existing emissions. Emitters are given “allowances” that represent the authority to emit one unit of the pollutant (for the acid rain SO₂ program, the unit of emissions is one ton). At the end of each year, emitters must surrender allowances equal to their emissions for the year. If a source emits less than its allocation, it can sell those allowances to other sources or can bank them for future use. In this way, emissions reductions are achieved how and where it is most cost effective to do so.

economic activity in the U.S. has increased about 50%; total U.S. electricity demand has increased about 30% over the same period. Over the next 15 years, total U.S. economic activity is projected to increase another 50% and demand for electricity is projected to increase also by another 30%. By 2020, demand for electricity in the company's service territory is expected to increase by about 36% from today's levels (Figure 11).

Southern Company's obligation and business model is to provide the electricity to meet the needs of this growing region in the most cost-effective manner: this includes utilization of the company's existing generating capacity, the addition of new power plants, power purchased from other entities, and demand-side options. Since the beginning of 2000, for example, Southern Company has added 8,500 MW of new, clean natural-gas fired generation, including 1,200 MW that will come on line in June 2005 at Plant McIntosh in Georgia. The company anticipates the additional need for more than 1,300 MW between now and 2010.

Cost and availability of new generating technology options – The company considers, in a comprehensive fashion, information on the projected cost and avail-

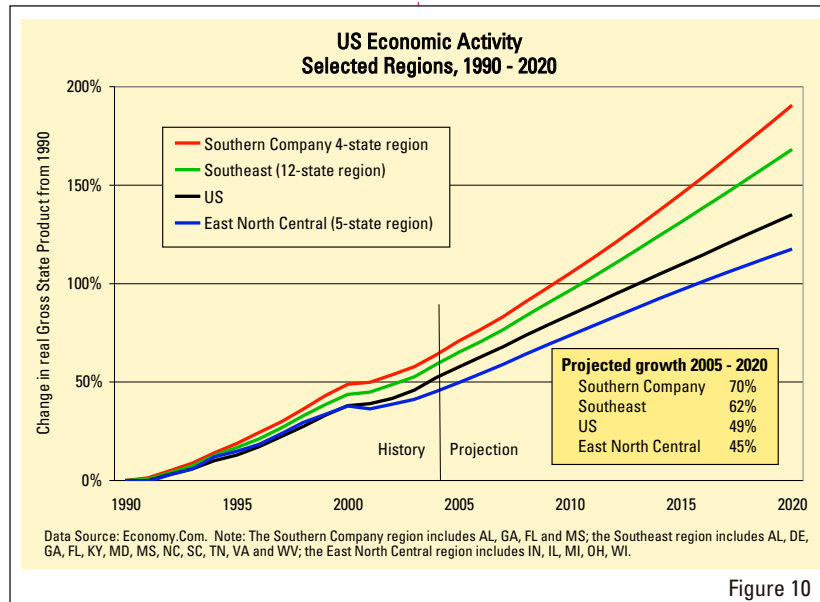


Figure 10

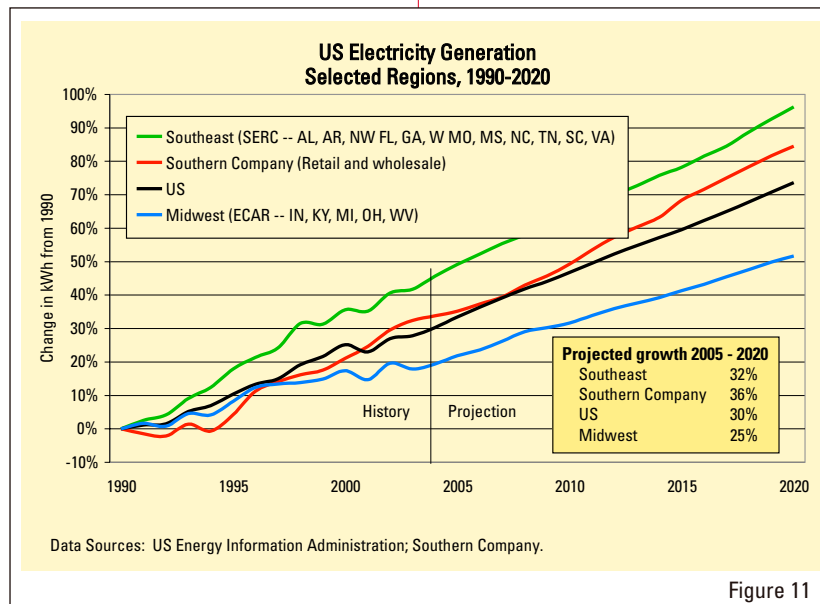


Figure 11

ability of all generating technology options, as well as demand-side options. The generating options include coal- and gas-fired generation, nuclear power, and renewables. The process, in line with its goal of minimizing costs to customers and shareholders, chooses the least cost technology options that are available in the size and timeframe needed, and that have the proper characteristics (e.g., base load vs. peaking capacity) to meet projected demand growth.

Unit operating characteristics – The strategy process uses forecasts of pertinent characteristics of each generating unit, including capacity, availability, heat rates, and emis-

sion rates.

Fuel characteristics and costs – Annually, the company consults with outside and internal experts and develops detailed forecasts, including transportation to individual plant locations, for natural gas, coal, and oil. The strategy process considers the cost, emissions, and performance characteristics of each of these options, as appropriate, for individual units.

Allowance prices – The company obtains allowance price forecasts from outside experts, and, together with its own internal expertise, develops forecasts for the

prices of allowances that are needed to participate in cap-and-trade programs. These programs include the sulfur dioxide (SO₂) trading program under the Clean Air Act Amendments of 1990, the nitrogen oxides (NO_x) budget trading program (also known as the NO_x State Implementation Plan (SIP) Call), as well as the new Clean Air Interstate Rule (CAIR) and Clean Air Mercury Rule (CAMR). These programs are discussed more in Section 2.

Control technologies options and costs - The company develops detailed estimates of the cost of installing various control technologies – e.g., flue gas desulphurization devices (FGD or scrubbers) for controlling SO₂ and selective catalytic reduction (SCR) for controlling NO_x – at each individual unit.

3. Determining Unit Emissions Controls – The application of control technology is dictated initially by what environmental requirements are anticipated for each specific generating plant or unit. In some cases, the plant or unit’s emission control requirement is mandated, like a plant-specific limit to meet local air quality requirements. In cases like the cap-and-trade program for SO₂ to address acid rain, utilities can choose the most cost-effective option – fuel switching, applying control technology, or purchasing emission allowances. The decision process reviews the cost effectiveness of each of these options for each unit, and, if allowed by the regulations, controls are applied to the most cost-effective units first.

The availability of control technology options varies by pollutant. For example, for compliance with SO₂ reduction requirements, the choices are basically fuel switching to lower sulfur coal, installing flue gas desul-

phurization devices (scrubbers), or buying allowances. In contrast, for NO_x control, there are more control technology options available, such as low NO_x burners, SCR, and selective non-catalytic reduction. The cost, control effectiveness, and appropriateness of each technology for each unit are considered.

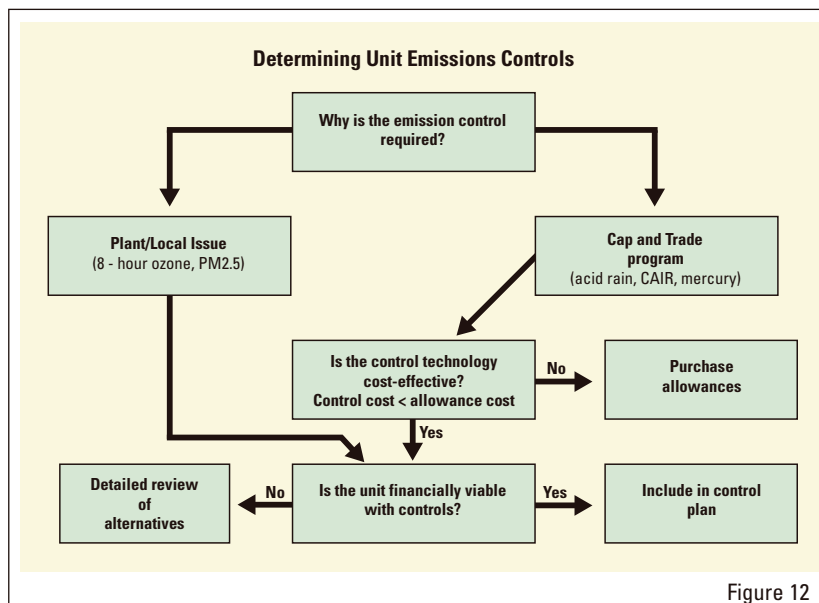


Figure 12

All of these considerations are taken into account in developing a unit-specific decision on the application of emissions control technology. Figure 12 reviews this process.

4. Evaluating Financial Impacts – The final step is to make sure on a plant, operating company, and Southern Company basis that the right financial decision is being made for the company and its customers. Some units and plants may not be able to achieve the required emission reductions in a cost-effective manner and, under cap-and-trade programs, would need to acquire additional allowances to comply. In considering emission control options for a specific unit, the financial value of the generating asset, which includes future operating costs and the potential for retirement, is part of the consideration before application of the technology.

5. Developing Environmental Strategy Schedule and Costs – After the process is completed, a strategy is compiled specifying actions and costs for each unit, as well as projected overall costs. This strategy is reviewed annually based on the most current information.

A key advantage of this process is that it enables the company to make decisions on an incremental basis. Although the strategy includes emission control plans for the next 15 years, final decisions on specific pollution control projects are not made until commitments are required so that construction can begin. That is,

Section 1. Environmental Compliance – Strategy Development

while Southern Company may “plan” to install scrubbers on a particular unit in 2013, no firm commitment to that plan will be made until about 2010, when requests for bids will be sent to vendors (this schedule assumes construction permits have been obtained). This flexibility allows the company to adapt to changing requirements.

Assessment of Compliance Strategy Process

During 2004, Southern Company asked Charles River Associates (CRA) to review its environmental compliance strategy development process and provide an assessment of the ways in which it might be improved.

CRA is a business consulting firm focused on strategic issues that require expert economic or financial analysis. (See Appendix 6 for information on CRA.) CRA’s review found that the company’s strategy development process is robust², systematic, quantitative, and thorough. They stated: “In brief, CRA deems the process to be well-founded in good analytical principles.” CRA also stated that the ongoing annual updates of the strategy should include reviews of the process to ensure that the company continues to use state-of-the-art modeling techniques and takes advantage of advances in analytical techniques.

² “Robust” is defined by economists and policy analysts as a system that is able to deal effectively with widely varying inputs and changing conditions.

Forward looking statement cautionary note

Much of the information contained in this report is forward-looking information based on current expectations and plans that involve risks and uncertainties. Some of the forward-looking information relates to scenarios that seek to predict future environmental rules and regulations, Southern Company's ability to address those rules and regulations in a cost-effective manner, solutions for addressing such rules and regulations, costs involved in addressing those rules and regulations, and continued economic growth in Southern Company's service territory. Southern Company cautions that there are certain factors that can cause actual results to differ materially from the forward-looking information that has been provided. The reader is cautioned not to put undue reliance on this forward-looking information, which is not a guarantee of future performance and is subject to a number of uncertainties and other factors, many of which are outside the control of Southern Company; accordingly, there can be no assurance that such suggested results will be realized.

The following factors, in addition to those discussed in Southern Company's Annual Report on Form 10-K for the year ended December 31, 2004, and subsequent securities filings, could cause results to differ materially from management expectations as suggested by such forward-looking information: the impact of recent and future federal and state regulatory change, including legislative and regulatory initiatives regarding deregulation and restructuring of the electric utility industry, and also changes in environmental, tax and other laws and regulations to which Southern Company and its subsidiaries are subject, as well as

changes in application of existing laws and regulations; current and future litigation, regulatory investigations, proceedings or inquiries, including the pending Environmental Protection Agency (EPA) civil actions against certain Southern Company subsidiaries; the effects, extent and timing of the entry of additional competition in the markets in which Southern Company's subsidiaries operate; variations in demand for electricity and gas, including those relating to weather, the general economy and population and business growth (and declines); available sources and costs of fuels; ability to control costs; advances in technology; state and federal rate regulations and the impact of pending and future rate cases and negotiations; 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 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 credit ratings; the ability of Southern Company and its subsidiaries to obtain additional generating capacity at competitive prices; and catastrophic events such as fires, earthquakes, floods, hurricanes or other similar occurrences. Southern Company and its subsidiaries expressly disclaim any obligation to update any forward-looking information.