

Southern Company

ENVIRONMENTAL ASSESSMENT

Report to Shareholders

May 2005

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Foreword

At Southern Company, our job is to provide reliable energy at an affordable price, in an environmentally responsible way.

A critical aspect of this is the management system and business processes with which we assure we are in compliance with environmental laws and regulations today and in the future. You will learn from this report how that business process works, and you will find further discussion of our environmental management system in Appendix 5.

We are also well aware of our obligation to those who invest in our business – our shareholders. The basis for developing this report came from a request by a group of our shareholders to assess how the company is responding to issues surrounding climate change and emissions reduction. In doing so, we interviewed a number of experts to develop an expanded version of our environmental compliance strategy. The end result is this comprehensive report.

Southern Company believes that the global climate change issue is a serious, long-term, political, energy technology, and environmental issue. The Southern Company policy statement on climate change (Appendix 2) points out that we're committed to protecting and improving the environment. We, along with the entire electric utility industry, determined in the early 1990s that the climate change issue deserved serious research, thoughtful action, and a reasoned policy response. We and others in the industry began voluntary actions to reduce, avoid and sequester greenhouse gases. These actions for Southern Company have resulted to date in the reduction, avoidance and sequestration of some 93 million metric tons of greenhouse gases. Our efforts continue as we work to develop and deploy new, cleaner and more efficient technologies to guarantee a reliable and affordable supply of energy to our customers while addressing challenging issues like climate change.

As we take on these challenges, our overall obligations to our shareholders, as well as to our employees and the communities we serve, are met through our approach to business, anchored by Southern Style, our value statement. It is how we treat each other and how

we conduct our day-to-day business. It is based on three fundamental concepts: unquestionable trust, superior performance and total commitment.

Unquestionable trust, the foundation of our statement, requires honesty, integrity and keeping our promises. We seek to build and maintain, throughout all the relationships of our business, the kind of trust that you never have to question. With trust as our foundation, we are mindful of the expectations of all our stakeholders that we deliver superior performance in all our business objectives and maintain a total commitment to the communities we serve, with sensitivity to the impact of our operations. Our focus on our value statement is unwavering.

Superior performance requires us to operate our system reliably ... so the lights stay on. But it requires much more than that. We must make sure our customers are very satisfied, and we must deliver to our owners, our shareholders, regular predictable and sustainable earnings. We must make certain our employees are treated fairly and rewarded properly.

Total commitment requires that we give back to the communities we serve and that we are responsible environmental stewards. So how do we discharge that stewardship? It is embedded in our approach to business. It is meeting or doing better than what's required by laws and regulations, while working to keep costs down. It is how we operate our plants, and run our transmission system, while continuing to find more efficient operating methods and developing technology through research. It takes the form of a long-term, thorough planning process that looks for solutions to meet growing energy requirements, while reducing our impact on the environment.

There is much work involved in finding the best solutions. World population continues to grow, as does the world's desire for the products and services that run on electricity. In the Southeast alone, the rate of economic growth has been 10% above the U. S. average, and the Energy Information Administration expects our region to continue to experience above average growth over the next 20 years.

So far, we have been able to keep pace with the growth by operating our plants efficiently and effectively and keeping costs low to consumers – at least 15% below the national average. We’ve also maintained a balanced energy mix – coal, natural gas, nuclear and hydroelectric power – which keeps us from relying on a single source and being at the mercy of the future uncertainty of the cost of fuel.

We maintain our facilities and our power lines in a way that keeps energy flowing. We plan extensively, looking to the future, 20 years or longer, scrutinizing every decision, every investment to make sure we maintain reliability, while keeping energy costs low. And we work closely with state and federal agencies to make sure we understand and meet the standards set to protect public health and the environment.

Reasonable electricity prices and reliable service are vital to growth in our region. Many businesses that are important to the economic vitality of our region are highly energy intensive and sensitive to price fluctuations. For all our customers, dollars not spent on energy mean dollars for other needed goods and services which, in turn, help foster regional growth.

Once again, this report explains our process for meeting the challenges we have regarding existing environmental

air quality rules and scenarios contemplated with regard to greenhouse gas emissions.

These are complex issues that require in-depth scientific analysis. Given these issues, we believe we have presented a thorough summary of our planning process and reasonable outcomes for our future business plans.

The assessment reported here confirms Southern Company’s position on the issue of climate change policy – that technology development is a more prudent use of society’s resources to address the climate change issue than the imposition of mandatory carbon reduction policies, either in the form of cap and trade or emissions taxation.

We plan to continue to work with public and private partners to support the development and deployment of these advanced technologies that are so vital to our energy and environmental future.

David M. Ratcliffe

*Chairman, President and CEO
Southern Company*

Acknowledgements

Management direction for this report was provided by Charles Goodman, senior vice president, research and environmental policy; Chris Hobson, senior vice president, environmental affairs; and Danny Herrin, manager, environmental strategies.

Southern Company management would like to thank the primary authors of this report: Bryan Baldwin, Bob Gehri, Ray Harry, David King, Lee Ann Kozak, Charles Greer Rossmann and Vicky Sullivan.

The company would also like to thank those who provided data, research, and/or editing: Kim Adelberg, Kerry Bowers, David Buckner, Scott Eiserloh, Bill Heerman, Roy Hiller, Ann Jones, Eric Likos, Don Roberts, Deborah Rouse, Randall Rush, Pradeep Vita, and Richard Chastain (retired from Southern Company); as well as David Montgomery, Anne Smith and Ira Shavel of Charles River Associates.

Southern Company met with and sought the views of numerous outside experts in order to develop the assessment reported here. The company would like to thank the following organizations: Electric Power Research Institute, MIT Joint Program on the Science and Policy of Global Change, Resources for the Future, environmental advocacy organizations, and several federal policymakers.

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.

Executive Summary

Background

This assessment was developed in response to a shareholder request, as described in the 2004 Proxy Statement (Appendix 1.) It was produced under the direction of Southern Company's chief executive officer and the Board of Directors. A two-day workshop was held for the senior officers of the company and the Board to review the assessment. In addition, in order to obtain a range of views and input, a number of independent experts outside the company were interviewed (see Acknowledgements and Section 4.)

An ongoing dialogue also was held with an external group that was led by representatives of the shareholder proponents. Under a confidentiality agreement, the company provided them preliminary results and an opportunity to review and comment on the final draft. The group with which the company held discussions represented the following organizations:

- The Sisters of Charity of Saint Elizabeth
- The Sisters of Saint Dominic of Caldwell, New Jersey
- The Board of Pensions, Evangelical Lutheran Church in America
- The United Church Foundation
- The Pension Boards, United Church of Christ
- The State of Connecticut, Office of the Treasurer
- The Benedictine Sisters
- Interfaith Center on Corporate Responsibility
- Ceres
- U.S. PIRG

It should be noted that this is Southern Company's report. It does not have the full endorsement or agreement from the organizations listed above.

This report provides an overview of the process that Southern Company uses to address increasingly strin-

gent requirements related to air emissions from its power plants, including an analysis of potential price signals for carbon dioxide (CO₂) emissions that might result from policies to address climate change.

CO₂ price signals are a representation of the cost, either explicit or implicit, that could be assigned to CO₂ emissions by various policy proposals. They are also referred to as "carbon price signals." These signals can represent cap and trade or emissions taxation, as well as other approaches. They allow an examination of the implications of policies falling in the range of the price signal for investment risks, without becoming mired in the implementation details and uncertainty associated with analyzing particular proposals. Using a price signal methodology implies that the economy is making CO₂ emission reductions at the least possible cost. For example, if the price signal is \$5 per ton of CO₂, it is implied that all reductions anywhere in the economy that cost less than \$5 per ton are made, but that any reductions costing more than \$5 per ton are not.

The potential price signals examined in this assessment are not necessarily views held by the company as to the likelihood of any particular climate change policy that might be adopted in the future, but were merely used to represent a range of views to allow modeling of various scenarios.

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 (Figures 1 and 2).

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,

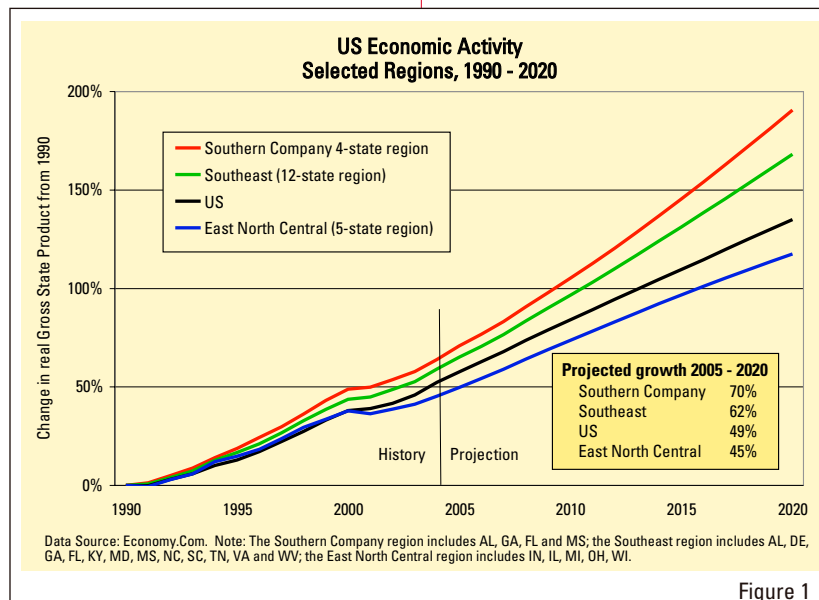


Figure 1

and demand-side options. Since the beginning of 2000, for example, Southern Company has added 8,500 megawatts (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.

This growing need for electricity is one of the key foundations of the Southern Company environmental compliance planning process. This process was reviewed during the 2004 assessment, and then additional carbon price signal scenarios were analyzed. The following paragraphs describe that review, an overview of the findings from the analysis, as well as a description of actions the company is taking.

Environmental Compliance - Strategy Development –

The company has an annual planning and analysis process to revise and update its long-term environmental compliance strategy. This process has been ongoing in a formal fashion for 15 years. It determines the most cost-effective compliance strategy in light of current and anticipated environmental requirements. Since the beginning of this decade, the process has included a CO₂ price signal scenario. The overall objective of the

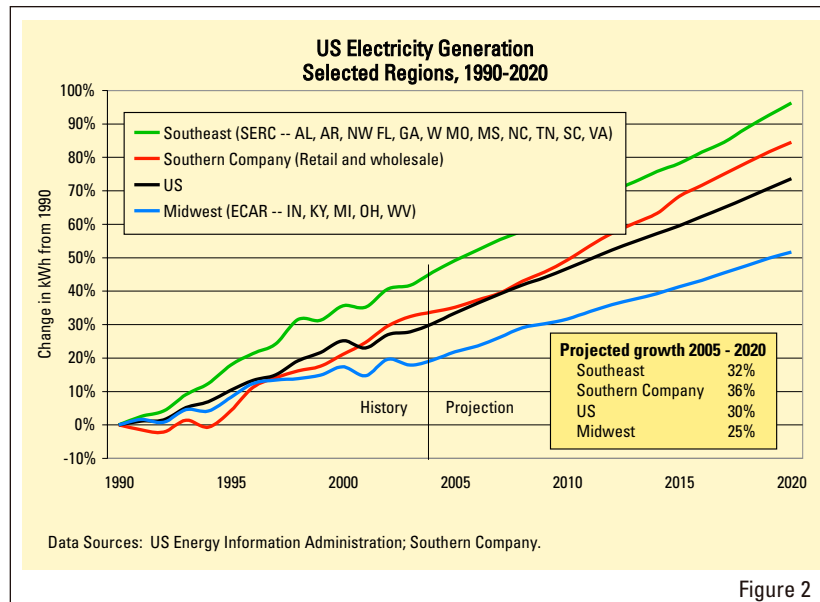


Figure 2

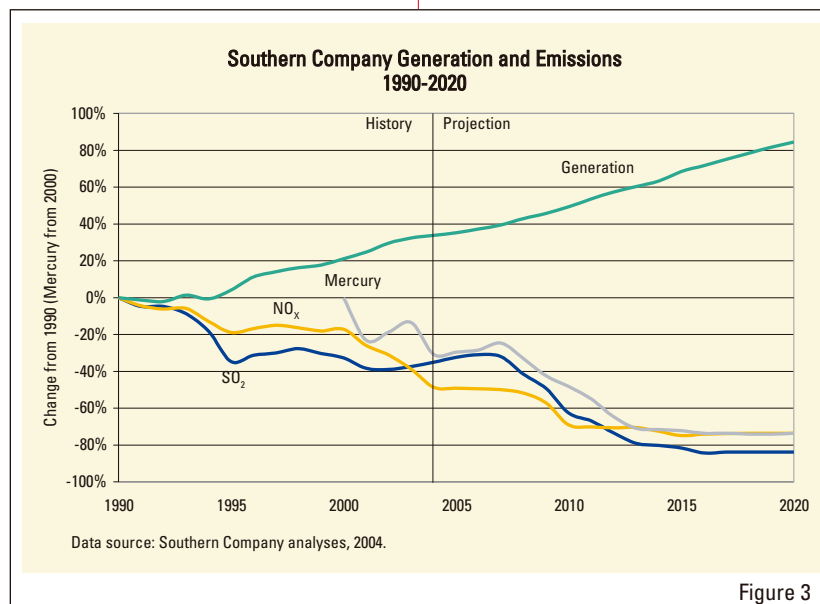


Figure 3

process is to assure that impacts on customers are kept to a minimum and that both shareholder value and the company's competitive position are maintained. The assessment found that the process is quantitative, systematic, thorough, and uses state-of-the-art modeling techniques.

Actions: The company will continue to annually update its environmental compliance strategy development process, including an annual review of the models and input assumptions. It will continue to include one or more scenarios with price signals for CO₂ emissions.

Environmental Requirements – Sulfur Dioxide (SO₂), Nitrogen Oxides (NO_x), and Mercury –

EPA has recently finalized additional requirements to further reduce SO₂ and NO_x emissions from power plants (the Clean Air Interstate Rule), as well as a new program to reduce mercury emissions from coal-fired power plants (the Clean Air Mercury Rule). Southern Company's environmental compliance strategy includes plans to make the required reductions, resulting in additional costs of more than \$6 billion for the installation of new environmental controls over the next decade. This investment will result in reduction of these emissions by about 70% from today's levels, over a period when the

demand for electricity is anticipated to grow by about 35% (Figure 3).

Strategic Issues - Climate Change –

The climate change issue is an integral part of the company's planning process and strategic initiatives. Southern Company's program for managing the strategic issues related to climate change includes research; voluntary actions to reduce, avoid, or sequester greenhouse gas emissions; participation in the public policy process; and development and deployment of technology.

Actions: Southern Company will continue to explore, evaluate, and undertake additional voluntary actions to reduce, avoid, or sequester greenhouse gas emissions. The

company will continue to participate in scientific research and the public policy process on the climate change issue. As outlined on the following pages, the company also will continue to research, develop, and deploy advanced technologies for electricity generation.

Analysis - Carbon Price Scenarios – During 2004, the company expanded its strategy development process to include additional potential price signals for CO₂ emissions, in response to a shareholder request. This assessment solicited input from a wide variety of external experts. A range of potential CO₂ price signals –

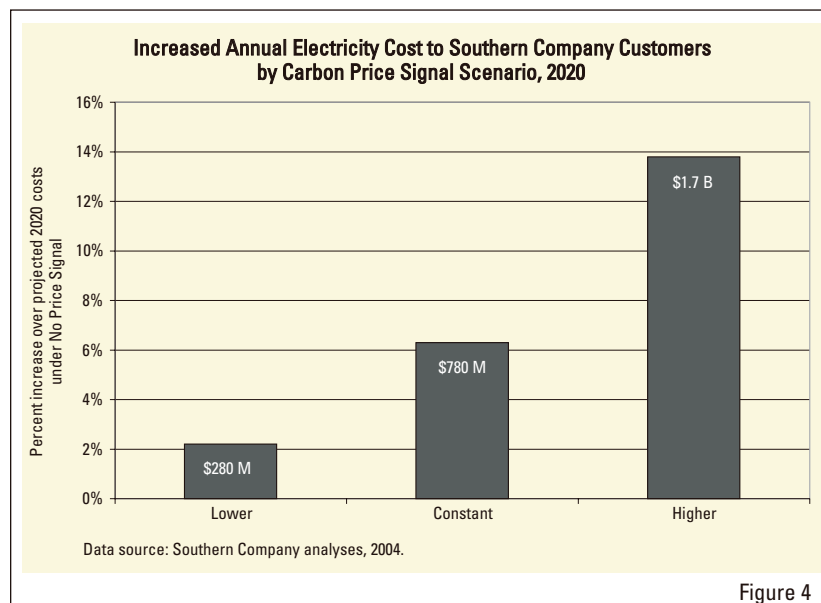


Figure 4

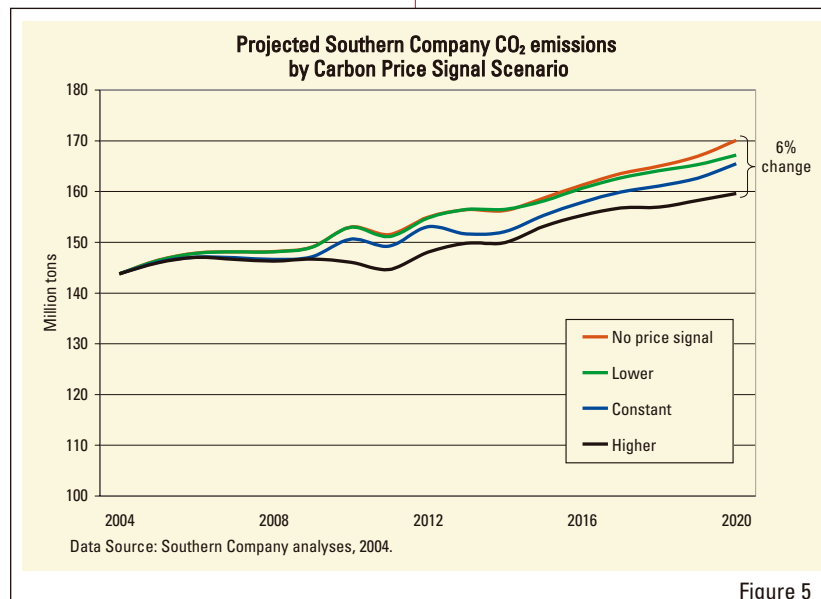


Figure 5

ranging from no price signal (which reflects the views of several experts that no policies mandating CO₂ emissions reductions will be adopted), to \$5 per metric ton of carbon starting in 2015, up to \$80 per ton of carbon in 2020 – were developed. These signals were analyzed using Charles River Associates' national models and the company's existing environmental strategy process.

The findings of this assessment were:

- When the potential CO₂ price signals were applied to Southern Company's projected emissions, the annual cost increases to customers in 2020 range from \$280 million to

\$1.7 billion. While there is no guarantee of retail recovery, environmental expenditures that are deemed prudent by retail ratemaking authorities are allowed to be recovered from customers. Under this assumption, the potential CO₂ price signals would raise the cost of electricity, thus impacting the company's customers (Figure 4).

- The investments in environmental controls being made today and in the near-term at Southern Company's coal-fired plants make sense under all the

price signal scenarios modeled. Even under the most costly scenario, plans for pollution control expenditures for SO₂, NO_x, and mercury would have to be evaluated further on capacity representing only about 5% of the company's coal-fired generation.

- Southern Company's overall CO₂ emissions projection would change little under the price signals analyzed (Figure 5). Even under the highest price signal scenario, Southern Company CO₂ emissions will decline only about 6% from projected 2020 levels. The company, as discussed above, serves the needs of one of the fastest-growing regions of the country and with increased electricity demand will come increased CO₂ emissions unless generating technologies that emit significantly less CO₂ are available and cost effective.

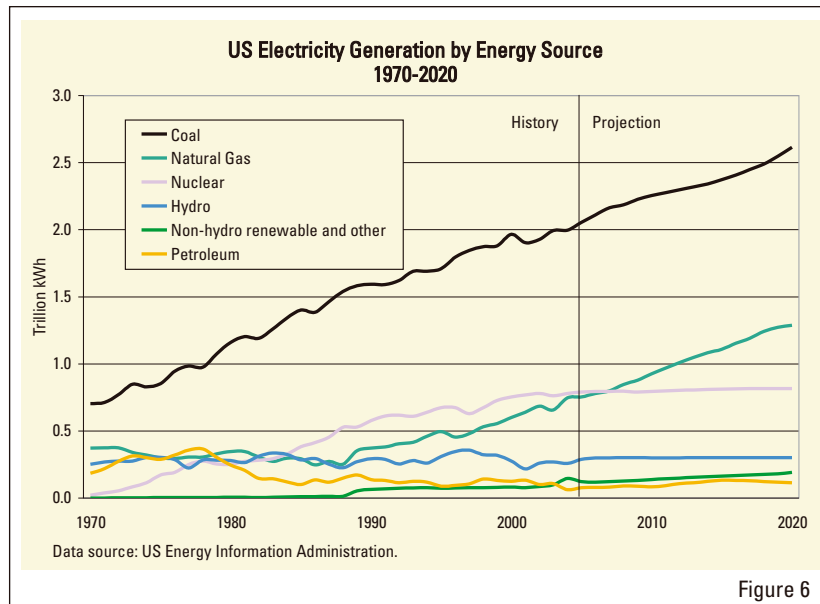


Figure 6

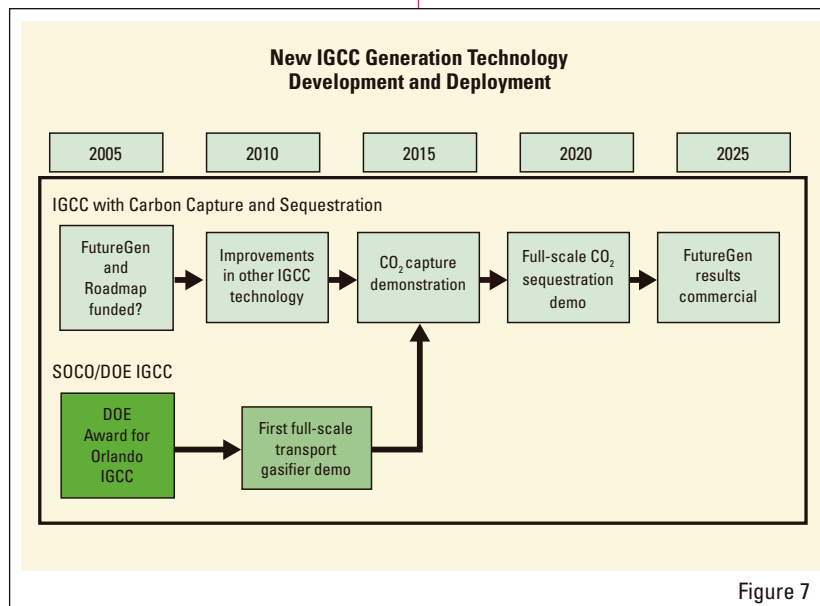


Figure 7

- The analysis confirmed Southern Company's long-held belief that the development and deployment of cost-effective, large-scale, environmentally-friendly electricity generating technologies is crucial.

Strategic Options and Actions - Technology

Society needs environmentally-friendly, economically-viable, large-scale U.S. electricity generation technologies to supply the projected 30% increase in electricity generation over the next 20 years (Figure 6).

The assessment reviewed several technologies, including demand-side options, renewables, coal- and gas-fired generation, and nuclear power. Southern Company is involved in

research on and the further development of all of these technologies. Two of them offer the unique potential for large-scale electricity generation with little to no CO₂ emissions – nuclear power and coal-based Integrated Gasification Combined Cycle (IGCC) with carbon capture and sequestration.

However, the assessment found that further technological development is needed before IGCC includes cost-effective carbon capture and sequestration (Figure 7). A sensitivity analysis found that the potential addition of new nuclear units in 2015 and 2016 would reduce

the growth in Southern Company's CO₂ emissions by about 7% (Figure 8) – an amount greater than that achieved by the “higher” carbon price signal scenario as shown earlier in Figure 5.

Actions: Southern Company will promote national energy policies that include the development of new, cost-effective, lower-emitting technologies, including nuclear power and IGCC.

The company will be involved in research and development on renewable energy options and will work to improve their cost-effectiveness and viability in the Southeast.

Southern Company will continue to be at the forefront of the development of the next generation of coal-based technology. The company has operated the Power Systems Development Facility near Wilsonville, Alabama, with the Department of Energy (DOE) for more than 10 years. Technology developed there will be deployed at a full-scale, 285 MW IGCC power plant that Southern Company and Orlando Utilities Commission are constructing with partial funding from the DOE. The project is expected to begin commercial operation in 2011, with a projected cost of \$557 million. DOE is expected to contribute approximately

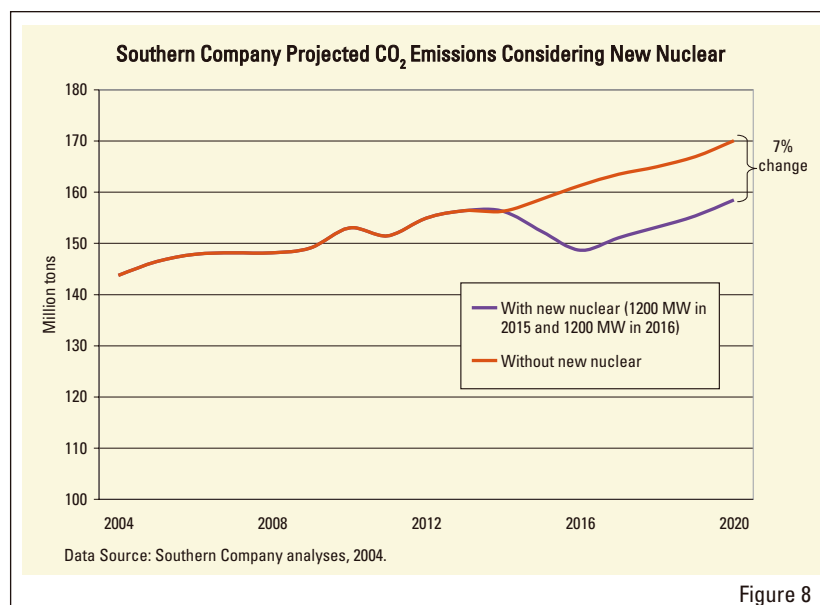


Figure 8

\$235 million of the cost. The company is also a member of the FutureGen consortium that is partnering with DOE to develop a near-zero emissions advanced coal plant with carbon capture and sequestration.

In addition, Southern Company is part of the NuStart Energy consortium that seeks to keep the nuclear option open

for future generation development. The company has filed a proposal with DOE for an evaluation of the feasibility of siting and licensing new nuclear generation in Southern Company's service territory and has filed a letter with the Nuclear Regulatory Commission stating its intent to pursue an Early Site Permit. Southern Company is moving as quickly as possible to make nuclear power an option for its future needs, with high expectations that additional nuclear capacity will be sought in the 2015-2016 timeframe.

Conclusions

This assessment confirmed Southern Company's position on climate change policy – that technology development is a more prudent use of society's resources than imposing mandatory carbon reduction policies, whether in the form of a cap-and-trade program or emission taxes.