

# 2007 Annual Report

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SOUTHERN POWER COMPANY



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

The management of Southern Power Company (the "Company") 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 the 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 the Company's internal control over financial reporting was effective as of December 31, 2007.

This Annual Report does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report.



Ronnie L. Bates  
President and Chief Executive Officer



Michael W. Southern  
Senior Vice President and Chief Financial Officer

February 25, 2008

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

### Southern Power Company

We have audited the accompanying consolidated balance sheets of Southern Power Company and Subsidiary Companies (the "Company") (a wholly owned subsidiary of Southern Company) as of December 31, 2007 and 2006, and the related consolidated statements of income, comprehensive income, common stockholder's 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 20 to 35) present fairly, in all material respects, the financial position of Southern Power 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.

*Deloitte & Touche LLP*

Atlanta, Georgia  
February 25, 2008

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

### **Southern Power Company and Subsidiary Companies 2007 Annual Report**

#### **OVERVIEW**

##### **Business Activities**

Southern Power Company and its wholly-owned subsidiaries (the Company) construct, acquire, own, and manage generation assets and sell electricity at market-based prices in the Super-Southeast wholesale market. The Company 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.

In November 2007, the Company and the Orlando Utilities Commission (OUC) mutually agreed to terminate construction of the gasifier portion of the Integrated Gasification Combined Cycle (IGCC) project in Orlando, Florida. This termination was the result of continuing uncertainty surrounding potential Florida state regulations relating to greenhouse gas emissions. See FUTURE EARNINGS POTENTIAL – “Construction Projects – Integrated Coal Gasification Combined Cycle (IGCC)” herein and Note 4 to the financial statements under “IGCC” for additional information. The Company will continue to construct the combined cycle portion of the project for OUC.

In December 2007, the Company completed construction of Plant Oleander Unit 5, a combustion turbine with a nameplate capacity of 163 megawatts (MW) in Brevard County, Florida. The Company has a PPA covering the entire output of this unit from December 2007 through 2027.

In 2007, the Company continued construction on Plant Franklin Unit 3, a combined cycle unit with an expected capacity of 621 MW near Smiths, Alabama. This unit is expected to be completed in 2008. The Company has a PPA covering the entire output of this unit from 2009 through 2015.

As of December 31, 2007, the Company had units totaling 6,896 MW nameplate capacity in commercial operation. The weighted average duration of the Company's wholesale contracts exceeds 11.3 years, which reduces remarketing risk. The Company continues to face challenges at the federal regulatory level relative to market power and affiliate transactions. See FUTURE EARNINGS POTENTIAL – “FERC Matters” herein for additional information.

##### **Key Performance Indicators**

To evaluate operating results and to ensure the Company's ability to meet its contractual commitments to customers, the Company focuses on several key performance indicators. These indicators include plant availability, peak season equivalent forced outage rate (EFOR), and net income. Plant availability measures the percentage of time during the year that the Company's generating units are available to be called upon to generate (the higher the better), whereas the EFOR more narrowly defines the hours during peak demand times when the Company's generating units are not available due to forced outages (the lower the better). Net income is the primary component of the Company's contribution to Southern Company's earnings per share goal. The Company's actual performance in 2007 met or surpassed targets in these key performance areas. See RESULTS OF OPERATIONS herein for additional information on the Company's financial performance.

##### **Earnings**

The Company's 2007 earnings were \$131.6 million, a \$7.2 million increase over 2006. This increase was primarily the result of increased energy sales due to more favorable weather in 2007. Also contributing to the increase were additional sales from the acquisition of Plant Rowan in September 2006. These increases were partially offset by the \$10.7 million after tax loss as a result of the termination of the construction of the gasifier portion of the IGCC project.

The Company's 2006 earnings were \$124.4 million, a \$9.7 million increase over 2005. This increase was primarily the result of new PPAs started or acquired in the period, including contracts with Piedmont Municipal Power Authority (PMPA) and EnergyUnited Electric Membership Corporation (EnergyUnited) and the PPAs related to the acquisition of Plants DeSoto and Rowan in June 2006 and September 2006, respectively. Short-term energy sales and increased sales from existing resources also contributed to this increase.

The Company's 2005 earnings were \$114.8 million, a \$3.3 million increase over 2004. The 2005 increase was primarily attributed to the acquisition of Plant Oleander in June 2005 and additional revenues associated with energy margins from fully contracted units, which were partially offset by the expiration of PPAs at Plant Dahlberg. In addition, interest expense increased in connection with the

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Plant Oleander acquisition as well as the reduction in capitalized interest due to completion of the Company's initial construction program.

**RESULTS OF OPERATIONS**

A condensed income statement follows:

	Amount		Increase (Decrease) from Prior Year	
	2007	2007	2006	2005
	<i>(in millions)</i>			
Operating revenues	\$ 972.0	\$ 195.0	\$ (4.0)	\$ 79.7
Fuel	238.7	93.4	(63.8)	81.9
Purchased power	199.9	29.3	10.7	(28.4)
Other operations and maintenance	135.0	39.7	14.5	5.6
Loss on IGCC project	17.6	17.6	-	-
Depreciation and amortization	74.0	8.0	11.7	3.1
Taxes other than income taxes	15.7	0.2	2.3	2.0
Total operating expenses	680.9	188.2	(24.6)	64.2
Operating income	291.1	6.8	20.6	15.5
Other income, net	3.3	1.1	(0.2)	0.0
Interest expense	79.2	(1.0)	0.8	13.3
Income taxes	83.6	1.7	9.9	(1.1)
Net Income	\$ 131.6	\$ 7.2	\$ 9.7	\$ 3.3

**Operating Revenues**

Operating revenues in 2007 were \$972 million, a \$195 million (25.1%) increase from 2006. This increase was primarily due to increased short-term energy sales, a full year of operations at Plant Rowan acquired in September 2006, new sales with EnergyUnited, increased demand under existing PPAs with affiliates as a result of favorable weather within the Southern Company service territory, and higher fuel revenues due to an increase in natural gas prices in 2007. The increase in fuel revenues is accompanied by an increase in related fuel costs and does not have a significant impact on net income.

Operating revenues in 2006 were \$777 million, a \$4.0 million (0.5%) decrease from 2005. This decrease was primarily due to reduced energy revenues as a result of lower natural gas prices. This reduction is accompanied by a reduction in related fuel costs and does not have a significant net income impact. Offsetting this energy related reduction were increased sales from a full year of operations at Plant Oleander and new sales under PPAs with PMPA and EnergyUnited and those PPAs acquired in the DeSoto and Rowan acquisitions. See FUTURE EARNINGS POTENTIAL – "Power Sales Agreements" herein and Note 2 to the financial statements under "DeSoto and Rowan Acquisitions" for additional information.

Operating revenues in 2005 were \$781.0 million, a \$79.7 million (11.4%) increase from 2004. This increase was primarily due to PPAs related to the Plant Oleander acquisition, a new PPA with Flint Electric Membership Corporation (Flint EMC), and a full year of revenue from PPAs with Georgia Power at Plant Franklin Unit 2 and Plant Harris Unit 2. The Georgia Power PPA for Plant Franklin Unit 2 had a scheduled sales increase in June 2004, while the PPA for Plant Harris Unit 2 became effective in June 2004. These increases were partially offset by the expiration of PPAs at Plant Dahlberg.

Capacity revenues are an integral component of the Company's PPAs with both affiliate and non-affiliate customers and represent the greatest contribution to net income. Energy under PPAs is generally sold at variable cost or is indexed to published gas indices. Energy revenues also include fees for support services, fuel storage, and unit start charges. Details of these PPA capacity and energy revenues are as follows:

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	2007	2006	2005
	<i>(in millions)</i>		
<b>Capacity revenues –</b>			
Affiliates	\$ 279.7	\$ 279.1	\$ 278.2
Non-Affiliates	136.9	103.3	68.7
<b>Total</b>	<b>416.6</b>	382.4	346.9
<b>Energy revenues –</b>			
Affiliates	227.1	190.1	254.8
Non-Affiliates	189.1	144.9	141.5
<b>Total</b>	<b>416.2</b>	335.0	396.3
<b>Total PPA revenues</b>	<b>\$ 832.8</b>	\$ 717.4	\$ 743.2

Wholesale revenues that were not covered by PPAs totaled \$131 million in 2007, which included \$40 million of revenues from affiliated companies. Wholesale sales were made in accordance with the Intercompany Interchange Contract (IIC), as approved by the Federal Energy Regulatory Commission (FERC). These non-PPA wholesale revenues will vary from year to year depending on demand and the availability and cost of generating resources at each company that participates in the centralized operation and dispatch of the Southern Company fleet of generating plants (Southern Pool).

***Fuel and Purchased Power Expenses***

	2007	2006	2005
	<i>(in millions)</i>		
Fuel	\$ 238.7	\$ 145.2	\$ 209.0
Purchased power-non-affiliates	64.6	53.8	57.2
Purchased power-affiliates	135.3	116.9	102.9
<b>Total fuel and purchased power expenses</b>	<b>\$ 438.6</b>	\$ 315.9	\$ 369.1

Fuel costs constitute the single largest expense for the Company. Additionally, the Company purchases a portion of its electricity needs from the wholesale market.

In 2007, fuel expense increased by \$93.4 million (64.3%) compared to 2006. The increase was driven by a 43.7% increase in generation at Plants Wansley and Dahlberg and a 5.2% increase in the average cost of natural gas.

In 2006, fuel expense decreased by \$63.8 million (30.5%) compared to 2005. The decrease was driven by a 25.4% reduction in the average cost of natural gas. Gas prices in 2006 were lower and had less weather-driven volatility than the previous year. The fuel price decrease was partially offset by volume increases primarily from increased generation at Plants Wansley and Dahlberg.

In 2005, fuel expense increased by \$81.9 million (64.4%). The increase was driven by a 54.2% increase in the average cost of natural gas.

While there has been a significant upward trend in the cost of natural gas since 2003, prices moderated somewhat in 2006 and 2007. 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. The Company's PPAs generally provide that the purchasers are responsible for substantially all of the cost of fuel.

Purchased power expense increased \$29.3 million (17.1%) in 2007 when compared to 2006, primarily due to increased purchases of lower cost energy resources from the Southern Pool and non-affiliates and contracts with Georgia Electric Membership Corporation and Dalton Utilities. Purchased power volume in 2007 increased 21.0% compared to 2006. Purchased power expense increased \$10.7 million (6.6%) in 2006 when compared to 2005, due to purchases from the Southern Pool and contracts with Piedmont Municipal Power Agency (PMPA) and Dalton Utilities. Purchased power expense decreased \$28.4 million (15.1%) in 2005 when compared to 2004, due to limited market energy sales as the Company's generating resources were employed for increased PPA commitments. In 2004, the capacity from the uncontracted units was sold into short-term markets and the related energy sales were often served with lower cost, short-term power purchases from affiliates and non-affiliates.

Purchased power expenses will vary depending on demand and the availability and cost of generating resources available throughout

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the Southern Company system and other contract resources. Load requirements are submitted to the Southern Pool on an hourly basis and are fulfilled with the lowest cost alternative, whether that is generation owned by the Company, affiliate-owned generation, or external purchases.

***Other Operations and Maintenance Expenses***

In 2007, other operations and maintenance expenses increased \$39.7 million (41.7%) compared to 2006. This increase was due primarily to a full year of operations at Plant DeSoto and Plant Rowan acquired in June 2006 and September 2006, respectively, and additional administrative and general expenses as a result of costs incurred to implement the FERC compliance plan. See FUTURE EARNINGS POTENTIAL – “FERC Matters – Intercompany Interchange Contract” herein, Note 2 to the financial statements under “DeSoto and Rowan Acquisitions,” and Note 3 to the financial statements under “FERC Matters – Intercompany Interchange Contract” for additional information.

In 2006 and 2005, other operations and maintenance expenses increased \$14.5 million (17.9%) and \$5.6 million (7.5%), respectively. These increases were primarily the result of the operation of new generating units from acquisitions of Plant Oleander in June 2005, Plant DeSoto in June 2006, and Plant Rowan in September 2006. See Note 2 to the financial statements under “DeSoto and Rowan Acquisitions” and “Oleander Acquisition” for additional information.

***Loss on IGCC Project***

In November 2007, the Company and OUC mutually agreed to terminate the construction of the gasifier portion of the IGCC project. The Company will continue construction of the gas-fired combined cycle generating facility, owned by OUC. The Company recorded a loss in the fourth quarter 2007 of approximately \$17.6 million related to the cancellation of the gasifier portion of the IGCC project. This loss consists of the write-off of construction costs of \$14.0 million and an accrual for termination payments of \$3.6 million. See FUTURE EARNINGS POTENTIAL – “Construction Projects – Integrated Coal Gasification Combined Cycle (IGCC)” herein and Note 4 to the financial statements under “IGCC” for additional information.

***Depreciation and Amortization***

Depreciation and amortization increased \$8.0 million (12.2%), \$11.7 million (21.6%), and \$3.1 million (6%) in 2007, 2006, and 2005, respectively. These increases were primarily the result of additional depreciation related to Plants DeSoto and Rowan acquired in June 2006 and September 2006, respectively, Plant Oleander acquired in June 2005, and higher depreciation rates from a depreciation study adopted in March 2006. See Note 1 to the financial statements under “Depreciation” and Note 2 to the financial statements under “DeSoto and Rowan Acquisitions” and “Oleander Acquisition” for additional information. See FUTURE EARNINGS POTENTIAL – “Other Matters” herein for additional information regarding a new depreciation study.

***Taxes Other than Income Taxes***

The 2007 increase in taxes other than income taxes was not material.

Taxes other than income taxes increased \$2.3 million (17.4%) and \$2.0 million (18.1%) in 2006 and 2005, respectively. This was primarily due to incremental ad valorem taxes on new assets: Plants DeSoto and Rowan acquired in June 2006 and September 2006, respectively, and Plant Oleander acquired in June 2005. See Note 2 to the financial statements under “DeSoto and Rowan Acquisitions” and “Oleander Acquisition” for additional information.

***Interest Expense, Net of Amounts Capitalized***

Interest expense decreased \$1.0 million (1.2%) in 2007 primarily due to additional capitalized interest of \$10.9 million on active construction projects and reduced interest on commercial paper of \$2.0 million due to lower borrowing levels. This decrease was partially offset by \$11.9 million increase in interest on \$200 million of senior notes that were issued in November 2006.

Interest expense increased \$0.8 million (1.0%) and \$13.3 million (20.0%) in 2006 and 2005, respectively. The 2006 increase was primarily the result of additional debt incurred for acquisitions. This increase was offset by \$5.6 million of interest capitalized on active construction projects. The 2005 increase was due to incremental debt incurred for the Oleander acquisition. Additional factors for the 2005 increase included a reduction of \$17.4 million in interest costs being capitalized as projects reached completion, were sold, or were suspended during those periods. Plant McIntosh Units 10 and 11 were transferred to Georgia Power and construction

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was suspended on Plant Franklin Unit 3 during 2004, effectively ceasing all capitalized interest in 2005. For additional information, see FUTURE EARNINGS POTENTIAL – “Construction Projects,” Note 4 to the financial statements under “IGCC,” and Note 7 to the financial statements under “Construction Programs.”

***Other Income (Expense), Net***

Changes in other income, net in 2007, 2006, and 2005 were primarily the result of unrealized gains and losses on derivative energy contracts. See FINANCIAL CONDITION AND LIQUIDITY – “Market Price Risk” herein and Notes 1 and 6 to the financial statements under “Financial Instruments.”

***Income Taxes***

Income taxes increased \$1.7 million (2.1%) in 2007, increased \$9.9 million (13.9%) in 2006, and decreased \$1.1 million (1.5%) in 2005. Fluctuations in income taxes were primarily the result of changes to pre-tax income.

**Effects of Inflation**

When inflation exceeds projections used in market, term, and cost evaluations performed at contract initiation, the effects of inflation can create an economic loss. In addition, the income tax laws are based on historical costs. Therefore inflation creates an economic loss as the Company is recovering its costs of investments in dollars that could have less purchasing power. While the inflation rate has been relatively low in recent years, it continues to have an adverse effect on the Company due to large investment in utility plant with long economic lives. Conventional accounting for historical costs does not recognize this economic loss or the partially offsetting gain that arises through financing facilities with fixed money obligations such as long-term debt.

**FUTURE EARNINGS POTENTIAL**

**General**

The results of operations for the past three years are not necessarily indicative of future earnings potential. A number of factors affect the opportunities, challenges, and risks of the Company's competitive wholesale energy business. These factors include the ability to achieve sales growth while containing costs. Another major factor is federal regulatory policy, which may impact the Company's level of participation in this market. The level of future earnings depends on numerous factors including regulatory matters (such as those related to affiliate contracts), sales, creditworthiness of customers, total generating capacity available in the Southeast, and the successful remarketing of capacity as current contracts expire.

**Power Sales Agreements**

The Company's sales are primarily through long-term PPAs. The Company is working to maintain and expand its share of the wholesale market in the Super-Southeast power markets. Recent oversupply of generating capacity in the market is being reduced and the Company expects that many areas of the market will need capacity beyond 2011.

The Company's PPAs consist of two types of agreements. The first type, referred to as a unit or block sale, is a customer purchase from a dedicated plant unit where all or a portion of the generation from that unit is reserved for that customer. The second type, referred to as requirements service, provides that the Company serve the customer's capacity and energy requirements from a combination of the customer's own generating units and from Company resources not dedicated to serve unit or block sales. The Company has rights to purchase power from these customers when economically viable.

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The Company has entered into the following PPAs over the past 3 years:

	Date	Megawatts	Plant	Contract Term
<b><u>2007</u></b>				
Progress Energy Carolina Inc.	December 2007	155	Rowan	1/10-12/10
Progress Energy Carolina Inc. <sup>(a)</sup>	December 2007	160	Wansley	1/11-12/11
Georgia Power	April 2007	561	Wansley	6/10-5/17
Georgia Power	April 2007	292	Dahlberg	6/10-5/25
Progress Energy Carolina Inc.	February 2007	150	Rowan	1/10-12/19
<b><u>2006</u></b>				
Gulf Power	October 2006	292	Dahlberg	6/09-5/14
Duke Power <sup>(b)</sup>	September 2006	152	Rowan	9/06-12/10
Duke Power <sup>(b)</sup>	September 2006	304	Rowan	9/06-12/10
North Carolina Municipal Power Agency No. 1 (NCMPA1) <sup>(b)</sup>	September 2006	50	Rowan	9/06-12/10
NCMPA1 <sup>(b)</sup>	September 2006	150	Rowan	1/11-12/30
EnergyUnited (Full Requirements)	May 2006	149 <sup>(c)</sup>	Unassigned	9/06-12/10
EnergyUnited (Full Requirements)	May 2006	388 <sup>(c)</sup>	Unassigned	1/11-12/25
EnergyUnited (Block)	May 2006	205	Rowan	1/11-12/25
Constellation Energy Group, Inc. <sup>(d)</sup>	April 2006	621	Franklin	1/09-12/15
Seminole Electric Cooperative, Inc.	February 2006	465	Oleander	1/10-12/15
Florida Municipal Power Agency	February 2006	162	Oleander	12/07 -12/27
<b><u>2005</u></b>				
Florida Power & Light <sup>(e)</sup>	June 2005	155	Oleander	6/05-5/12
Seminole Electric Cooperative, Inc. <sup>(e)</sup>	June 2005	465	Oleander	6/05-12/09

(a) Subject to obtaining transmission service.

(b) Assumed contract through the Plant Rowan acquisition.

(c) Reflects average annual capacity purchases.

(d) Contract was assumed from Progress Ventures, Inc. in 2007.

(e) Assumed contract through the Plant Oleander acquisition.

The Company has PPAs with some of Southern Company's traditional operating companies and with other investor owned utilities, independent power producers, municipalities, and electric cooperatives. Although some of the Company's PPAs are with the traditional operating companies, the Company's generating facilities are not in the traditional operating companies' regulated rate bases, and the Company is not able to seek recovery from the traditional operating companies' ratepayers for construction, repair, environmental, or maintenance costs. The Company expects that the capacity payments in the PPAs will produce sufficient cash flow to cover costs, pay debt service, and provide an equity return. However, the Company's overall profit will depend on numerous factors, including efficient operation of its generating facilities.

As a general matter, existing PPAs provide that the purchasers are responsible for substantially all of the cost of fuel relating to the energy delivered under such PPAs. To the extent a particular generating facility does not meet the operational requirements contemplated in the PPAs, the Company may be responsible for excess fuel costs. With respect to fuel transportation risk, most of the Company's PPAs provide that the counterparties are responsible for procuring and transporting the fuel to the particular generating facility.

Fixed and variable operation and maintenance costs will be recovered through capacity charges based on dollars-per-kilowatt year or energy charges based on dollars-per-MW hour. In general, the Company has long-term service contracts with General Electric (GE) to reduce its exposure to certain operation and maintenance costs relating to GE equipment. See Note 7 to the financial statements under "Long-Term Service Agreements" for additional information.

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Many of the Company's PPAs have provisions that require the posting of collateral or an acceptable substitute guarantee in the event that Standard & Poor's or Moody's downgrades the credit ratings of the counterparty to an unacceptable credit rating or the counterparty is not rated or fails to maintain a minimum coverage ratio. The PPAs are expected to provide the Company with a stable source of revenue during their respective terms.

The Company has entered into long-term power sales agreements for an average of 91% of its available capacity for the next 10 years as follows:

	2008- 2009	2010- 2011	2012- 2013	2014- 2015	2016- 2017
Total available capacity <sup>1</sup>	7,618	7,506	7,393	7,393	7,393
Average contracted capacity	6,706	7,210	6,893	7,079	5,936
<b>% contracted</b>	<b>88%</b>	<b>96%</b>	<b>93%</b>	<b>96%</b>	<b>80%</b>

1. Includes confirmed third party power purchases for 2008 through 2010.

## **FERC Matters**

### ***Market-Based Rate Authority***

The Company 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 the 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 Company 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 \$0.7 million, plus interest. The Company believes that there is no meritorious basis for this proceeding and is vigorously defending itself 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 majority of the Company's generation fleet is operated under the IIC, as approved by the FERC. In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among the traditional operating companies, the Company, and Southern Company Services, Inc., as agent, under the terms of which the Southern Pool 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 the Company as a "system company" rather than a "marketing affiliate" is just and reasonable. In connection with the formation of the Company, the FERC authorized the Company'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

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behalf of the Company. 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. 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. The Company's cost of implementing the plan, including the modifications, is expected to be approximately \$8 million annually.

**Income Tax Matters**

***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 of 1986, as amended, 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.

***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. The Company is currently assessing the financial implications of the Stimulus Act; however, the ultimate impact cannot be determined at this time.

**Environmental Matters**

The 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; the Endangered Species Act; and related federal and state regulations. 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 the Company.

New environmental legislation or regulations, such as requirements related to greenhouse gases, or changes to existing statutes or regulations, could affect many areas of the Company's operations. While the Company's PPAs generally contain provisions that permit charging the counterparty with some of the new costs incurred as a result of changes in environmental laws and regulations, the full impact of any such regulatory or legislative changes cannot be determined at this time.

Because the Company's units are newer gas-fired generating facilities, costs associated with environmental compliance for these facilities have been less significant than for similarly situated coal-fired generating facilities or older gas-fired generating facilities. Environmental, natural resource, and land use concerns, including the applicability of air quality limitations, the availability of water withdrawal rights, uncertainties regarding aesthetic impacts such as increased light or noise, and concerns about potential adverse health impacts, can, however, increase the cost of siting and operating any type of future electric generating facility. The impact of such statutes and regulations on the Company cannot be determined at this time.

Litigation over environmental issues and claims of various types, including property damage, common law nuisance, and citizen enforcement of environmental requirements such as 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 potential litigation against the Company cannot be determined at this time.

**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 compliance costs that could affect results of operations, cash flows, and financial condition if such costs are not recovered under applicable power purchase agreements.

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In April 2007, the U.S. Supreme Court ruled that the Environmental Protection Agency (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 results of operations, cash flows, and financial condition if such costs are not recovered under applicable PPAs.

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 Public Service Commission to initiate rulemaking requiring utilities to produce at least 20% of their electricity from renewable sources. The impact of these orders on the 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 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.

**Construction Projects**

***Plant Franklin Unit 3***

The Company restarted construction activities on Plant Franklin Unit 3 in 2006, with an expected completion date in June 2008. The total cost is expected to be approximately \$318.6 million, of which \$280.4 million had been spent as of December 31, 2007. The expected capacity of this unit is 621 MW and will be used to provide annual capacity for a PPA with Constellation Energy Group, Inc. from 2009 through 2015.

***Plant Oleander Unit 5***

The Company completed construction of Plant Oleander Unit 5 in December 2007. Costs incurred through December 31, 2007 were \$56.9 million. This unit is a combustion turbine with a nameplate capacity of 163 MW in Brevard County, Florida. This unit is contracted to provide annual capacity for a PPA with the Florida Municipal Power Agency from 2007 through 2027.

***Integrated Coal Gasification Combined Cycle (IGCC)***

In December 2005, the Company and the OUC executed definitive agreements for development of a 285-MW IGCC project in Orlando, Florida. The definitive agreements provided that the Company 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. The Company signed cooperative agreements with the U.S. Department of Energy (DOE) that provided up to \$293.75 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, the Company and OUC mutually agreed to terminate the construction of the gasifier portion of the IGCC project in November 2007. The Company will continue construction of the gas-fired combined cycle generating facility for OUC under a fixed-price, long-term contract for engineering, procurement and construction services. The Company recorded a loss in the fourth quarter 2007 of approximately \$17.6 million related to cancellation of the gasifier portion of the IGCC project. This amount is net of reimbursements from OUC and the DOE. This loss consists of the write-off of construction costs of \$14.0 million and an accrual for termination costs of \$3.6 million. All termination costs are expected to be paid in 2008. As part of the termination agreement with OUC, the Company agreed to sell a tract of land in Orange County, Florida to OUC. The Company will record a gain of approximately \$6 million on this sale in the first quarter of 2008.

## **Other Matters**

The Company completed a depreciation study in 2006 and updated the composite depreciation rates for its property, plant, and equipment. This change in estimate arises from changes in useful life assumptions for certain components of plant in service. This change increased depreciation expense and reduced net income. The 2006 net income impact of this change was \$3.8 million. See Note 1 to the financial statements under "Depreciation" for additional information. The Company is currently undergoing a new depreciation study that will be implemented in 2008. It is expected that the results of this new study will increase depreciation expense and reduce net income. The net income impact of this change is estimated to be \$2.7 million annually.

From time to time, the Company is involved in various other matters being litigated and regulatory matters that could affect future earnings. In addition, the Company is subject to certain claims and legal actions arising in the ordinary course of business. The 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 air and water quality standards, has increased generally throughout the United States. The ultimate outcome of such pending or potential litigation against the Company 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 the 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**

The 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 the 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 reviewed and discussed the critical accounting policies and estimates described below with the Audit Committee of Southern Company's Board of Directors.

### ***Revenue Recognition***

The Company's revenue recognition depends on appropriate classification and documentation of transactions in accordance with Financial Accounting Standards Board (FASB) Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted (SFAS No. 133). In general, the Company's power sale transactions can be classified in one of four categories: non-derivatives, normal sales, cash flow hedges, and mark to market. For more information on derivative transactions, see FINANCIAL CONDITION AND LIQUIDITY – "Market Price Risk" and Notes 1 and 6 to the financial statements under "Financial Instruments." The Company's revenues are dependent upon significant judgments used to determine the appropriate transaction classification, which must be documented upon the inception of each contract. Factors that must be considered in making these determinations include:

- Assessing whether a sales contract meets the definition of a lease;
- Assessing whether a sales contract meets the definition of a derivative;
- Assessing whether a sales contract meets the definition of a capacity contract;
- Assessing the probability at inception and throughout the term of the individual contract that the contract will result in physical delivery;
- Ensuring that the contract quantities do not exceed available generating capacity (including purchased capacity);
- Identifying the hedging instrument, the hedged transaction, and the nature of the risk being hedged; and
- Assessing hedge effectiveness at inception and throughout the contract term.

***Normal Sale and Non-Derivative Transactions***

The Company has capacity contracts that provide for the sale of electricity and that involve physical delivery in quantities within the Company's available generating capacity. These contracts either do not meet the definition of a derivative or are designated as normal sales thus exempting them from fair value accounting under SFAS No. 133. As a result, such transactions are accounted for as executory contracts; additionally the related revenue is recognized in accordance with Emerging Issues Task Force (EITF) No. 91-6, "Revenue Recognition of Long-Term Power Sales Contracts" on an accrual basis in amounts equal to the lesser of the levelized amount or the amount billable under the contract, over the respective contract periods. Revenues are recorded on a gross basis in accordance with EITF No. 99-19 "Reporting Revenue Gross as a Principal versus Net as an Agent." Revenues from transactions that do not meet the definition of a derivative are also recorded in this manner. Contracts recorded on the accrual basis represented the majority of the Company's operating revenues for the year ended December 31, 2007.

***Cash Flow Hedge Transactions***

The Company designates other derivative contracts for the sale of electricity as cash flow hedges of anticipated sale transactions. These contracts are marked to market through other comprehensive income over the life of the contract. Realized gains and losses are then recognized in revenues as incurred.

***Mark-to-Market Transactions***

Contracts for sales of electricity that are not normal sales and are not designated as cash flow hedges are marked to market and recorded directly through net income. Net unrealized gains on such contracts were not material for the year ended December 31, 2007.

***Percentage of Completion***

The Company is currently engaged in a long-term contract for engineering, procurement, and construction services to build a combined cycle unit for OUC. Construction activities commenced in 2006 and are expected to be complete by the end of 2010. Revenues and costs are recognized using the percentage-of-completion method. The Company utilizes the cost-to-cost approach as this method is less subjective than relying on assessments of physical progress. The percentage of completion represents the percentage of the total costs incurred to the estimated total cost of the contract. Revenues and costs are recognized by applying this percentage to the total revenues and estimated costs of the contract.

***Asset Impairments***

The Company's investments in long-lived assets are primarily generation assets, whether in service or under construction. The Company evaluates the carrying value of these assets under FASB Statement No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," whenever indicators of potential impairment exist. Examples of impairment indicators could include significant changes in construction schedules, current period losses combined with a history of losses, or a projection of continuing losses or a significant decrease in market prices. If an indicator exists, the asset is tested for recoverability by comparing the asset carrying value to the sum of the undiscounted expected future cash flows directly attributable to the asset. A high degree of judgment is required in developing estimates related to these evaluations, which are based on projections of various factors, including the following:

- Future demand for electricity based on projections of economic growth and estimates of available generating capacity;
- Future power and natural gas prices, which have been quite volatile in recent years; and
- Future operating costs.

***Acquisition Accounting***

The Company has been engaged in a strategy of acquiring assets. The Company has accounted for these acquisitions under the purchase method in accordance with FASB Statement No. 141, "Business Combinations." Accordingly, the Company has included these operations in the consolidated financial statements from the respective date of acquisition. The purchase price of each acquisition was allocated to the identifiable assets and liabilities based on a valuation prepared by a third party.

### ***Contingent Obligations***

The Company is subject to a number of federal and state laws and regulations, as well as other factors and conditions that potentially subject it 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. The 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 the Company's financial statements. These events or conditions include the following:

- Changes in existing state or federal regulation by governmental authorities having jurisdiction over air quality, water quality, control of toxic substances, hazardous and solid wastes, and other environmental matters.
- Changes in existing income tax regulations or changes in Internal Revenue Service (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 the Company may be asserted to be a potentially responsible party.
- Identification and evaluation of other potential lawsuits or complaints in which the Company 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.

### **New Accounting Standards**

#### ***Income Taxes***

On January 1, 2007, the 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 adoption of FIN 48 did not have a material impact on the Company's financial statements.

#### ***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. The 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. The 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. The 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 the Company after January 1, 2009.

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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 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. The Company plans to adopt SFAS No. 160 on January 1, 2009 and is currently assessing its impact, if any.

## **FINANCIAL CONDITION AND LIQUIDITY**

### **Overview**

Net cash provided from operating activities totaled \$315.4 million in 2007 increasing 30% from 2006. This increase is primarily due to the increase in sales due to favorable weather and cash received under billings for the engineering, procurement, and construction services to build a combined cycle unit for OUC. The OUC contract is not expected to have any positive or negative cash impacts to the Company over the term of the contract as the Company is not anticipating a profit or loss from this transaction at this time. Net cash used for investing activities totaled \$183.9 million in 2007 decreasing 61% from 2006. This decrease was primarily due to the acquisition of Plants DeSoto and Rowan in June 2006 and September 2006, respectively. Gross property additions to utility plant of \$183.7 million in 2007 were primarily related to the on-going construction activity at Plant Franklin Unit 3 and the completion of construction at Plant Oleander Unit 5. Net cash used for financing activities was \$161.5 million in 2007 compared to \$233.4 million provided to the Company in 2006. This change was primarily due to the cash proceeds of \$200 million from the issuance of 30-year senior notes in 2006 and borrowings and equity contributions to finance the acquisitions of Plants DeSoto and Rowan.

Other significant balance sheet changes consist of an increase in assets and liabilities for risk management activities of \$14.1 million and \$12.5 million, respectively. These increases, which do not affect cash, are primarily due to mark-to-market changes on forward energy sales of uncovered plant assets and related gas hedges on the forward sales.

In 2007, the Company also paid \$89.8 million in dividends to Southern Company and reduced short-term indebtedness outstanding by \$74 million.

### **Sources of Capital**

The Company may use operating cash flows, external funds, or equity capital from Southern Company to finance any new projects, acquisitions, and ongoing capital requirements. The Company expects to generate external funds from the issuance of unsecured senior debt and commercial paper or utilization of credit arrangements from banks. However, the amount, type, and timing of any financings, if needed, will depend upon regulatory approval, prevailing market conditions, and other factors.

The Company's current liabilities frequently exceed current assets due to the use of short-term indebtedness as a funding source, as well as cash needs which can fluctuate significantly due to the seasonality of the business. To meet liquidity and capital resource requirements, the Company had at December 31, 2007, \$400 million of committed credit arrangements with banks that expire in 2012. Borrowings of \$13 million under this facility were outstanding as of December 31, 2007. Proceeds from these credit arrangements may be used for working capital and general corporate purposes as well as liquidity support for the Company's commercial paper program. See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information.

The Company's commercial paper program is used to finance acquisition and construction costs related to electric generating facilities and for general corporate purposes. At December 31, 2007, there was \$36.7 million of commercial paper outstanding. See Note 6 to the financial statements under "Commercial Paper" for additional information.

Management believes that the need for working capital can be adequately met by utilizing commercial paper programs and lines of credit without maintaining large cash balances.

### **Financing Activities**

During 2007, the Company did not issue any new long-term securities.

During 2006, the Company issued \$200 million of 30-year unsecured long-term senior notes. The proceeds of the issuance were used

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to repay a portion of the Company's outstanding short-term indebtedness and for other general corporate purposes, including the Company's continuous construction program. In conjunction with issuing the securities, the Company terminated \$200 million in interest swaps at a cost of \$8.1 million. This cost was recorded in other comprehensive income and is being amortized to interest expense over a 10-year period.

The issuance of all securities by the Company is generally subject to regulatory approval by the FERC. Additionally, with respect to the public offering of securities, the Company files 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 FERC, as well as the amounts registered under the 1933 Act, are continuously monitored and appropriate filings are made to ensure flexibility in the capital markets.

**Credit Rating Risk**

The 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 to 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 \$270 million. At December 31, 2007 the maximum potential collateral requirements at a rating below BBB- or Baa3 were approximately \$457 million. Generally, collateral may be provided by a Southern Company guaranty, letter of credit, or cash.

In addition, through the acquisition of Plant Rowan, the Company assumed a PPA with Duke Energy that could require collateral, but not accelerated payment, in the event of a downgrade to the Company's credit rating to below BBB- or Baa3. The amount of collateral required would depend upon actual losses, if any, resulting from a credit downgrade, limited to the Company's remaining obligations under the contract.

The Company, along with the other members of the Southern Pool, is 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, the Company's total exposure to these types of agreements was approximately \$15 million.

**Market Price Risk**

The Company is exposed to market risks, including changes in interest rates, certain energy-related commodity prices, and, occasionally, currency exchange rates. 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 hedging practices. Company policy is that derivatives are to be used primarily for hedging purposes. Derivative positions are monitored using techniques that include market valuation and sensitivity analysis.

Because energy from the Company's facilities is primarily sold under long-term PPAs with tolling agreements and provisions shifting substantially all of the responsibility for fuel cost to the counterparties, the Company's exposure to market volatility in commodity fuel prices and prices of electricity is limited.

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

	<b>Changes in Fair Value</b>	
	<b>2007</b>	<b>2006</b>
	<i>(in thousands)</i>	
Contracts beginning of year	<b>\$ 1,850</b>	\$ 223
Contracts realized or settled	<b>(1,887)</b>	(5,233)
New contracts at inception	-	-
Changes in valuation techniques	-	-
<b>Current period changes (a)</b>	<b>3,408</b>	6,860
<b>Contracts end of year</b>	<b>\$ 3,371</b>	\$ 1,850

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

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At December 31, 2007, the sources of the valuation prices were as follows:

	<b>Source of 2007 Year-End Valuation Prices</b>		
	Total Fair Value	Maturity	
		Year 1	1-3 Years
	<i>(in thousands)</i>		
Actively quoted	\$ (406)	\$ (337)	\$ (69)
External sources	3,777	3,777	-
Models and other methods	-	-	-
<b>Contracts end of year</b>	<b>\$3,371</b>	<b>\$3,440</b>	<b>\$ (69)</b>

Unrealized pre-tax gains and losses on electric contracts used to hedge anticipated sales, and gas contracts used to hedge anticipated purchases and sales, are deferred in other comprehensive income. Gains and losses on contracts that do not represent 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:

	<b>Amounts</b>
	<i>(in thousands)</i>
Net Income	<b>\$ 3,293</b>
Accumulated other comprehensive income	<b>78</b>
<b>Total fair value</b>	<b>\$ 3,371</b>

Unrealized pre-tax gains and losses from energy-related derivative contracts recognized in income were not material for any year presented. The Company is exposed to market-price risk in the event of nonperformance by counterparties to the derivative energy contracts. The Company's policy is to enter into agreements with counterparties that have investment grade credit ratings by Standard & Poor's and Moody's or with counterparties who have posted collateral to cover potential credit exposure. Therefore, the 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."

At December 31, 2007, the Company had no variable long-term debt outstanding. Therefore, there would be no effect on annualized interest expense related to long-term debt if the Company sustained a 100 basis point change in interest rates. The Company is not aware of any facts or circumstances that would significantly affect such exposures in the near term.

### **Capital Requirements and Contractual Obligations**

The capital program of the Company is currently estimated to be \$109.1 million for 2008, \$281.9 million for 2009, and \$765.4 million for 2010. These amounts include estimates for potential plant acquisitions and/or new construction as well as ongoing capital improvements. Actual construction costs may vary from these estimates because of changes in factors such as: business conditions; environmental statutes and regulations; FERC rules and regulations; load projections; the cost and efficiency of construction labor, equipment, and materials; and the cost of capital. Currently, there is one unit at Plant Franklin under construction.

Other funding requirements related to obligations associated with scheduled maturities of long-term debt, as well as the related interest, leases, derivative obligations, 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	Total
	<i>(in millions)</i>				
Long-term debt <sup>(a)</sup> –					
Principal	\$ -	\$ -	\$575.0	\$725.0	\$1,300.0
Interest	74.2	148.6	148.6	382.8	754.2
Other derivative obligations <sup>(b)</sup>	12.6	0.1	-	-	12.7
Operating leases	0.5	0.8	0.7	22.3	24.3
Purchase commitments <sup>(c)</sup> –					
Capital <sup>(d)</sup>	109.1	1,047.3	-	-	1,156.4
Natural gas <sup>(e)</sup>	194.9	155.9	72.0	211.0	633.8
Purchased power	5.4	21.7	-	-	27.1
Long-term service agreements <sup>(f)</sup>	33.3	101.4	70.6	963.5	1,168.8
<b>Total</b>	<b>\$430.0</b>	<b>\$1,475.8</b>	<b>\$866.9</b>	<b>\$2,304.6</b>	<b>\$5,077.3</b>

- (a) All amounts are reflected based on final maturity dates. The Company plans to retire higher-cost securities and replace these obligations with lower-cost capital if market conditions permit.
- (b) For additional information, see Notes 1 and 6 to the financial statements.
- (c) The Company generally does not enter into non-cancelable commitments for other operations and maintenance expenditures. Total other operations and maintenance expenses for the last three years were \$135.0 million, \$95.3 million, and \$80.8 million, respectively.
- (d) The Company forecasts capital expenditures over a three-year period. Amounts represent current estimates of total expenditures.
- (e) Natural gas purchase commitments are based on various indices at the time of delivery. Amounts reflected have been estimated based on New York Mercantile Exchange future prices at December 31, 2007.
- (f) Long-term service agreements include price escalation based on inflation indices.

### **Cautionary Statement Regarding Forward-Looking Statements**

The Company's 2007 Annual Report contains forward-looking statements. Forward-looking statements include, among other things, statements concerning environmental regulations and expenditures, financing activities, access to sources of capital, impacts of the adoption of new accounting rules, impacts of the new depreciation study, completion of construction projects, and estimated construction and other expenditures. In some cases, forward-looking statements can be identified by terminology such as "may," "will," "could," "should," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential," or "continue" or the negative of these terms or other similar terminology. There are various factors that could cause actual results to differ materially from those suggested by the forward-looking statements; accordingly, there can be no assurance that such indicated results will be realized. These factors include:

- the impact of recent and future federal and state regulatory change, including legislative and regulatory initiatives regarding deregulation and restructuring of the electric utility industry, implementation of the Energy Policy Act of 2005, 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 the Company is subject, as well as changes in application of existing laws and regulations;
- current and future litigation, regulatory investigations, proceedings, or inquiries, including FERC matters;
- the effects, extent, and timing of the entry of additional competition in the markets in which the Company operates;
- 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;
- advances in technology;
- state and federal rate regulations;
- the ability to control costs and avoid cost overruns during the development and construction of facilities;
- 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 the Company;
- the ability of counterparties of the Company 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 the 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 the Company's credit ratings;
- the ability of the Company 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 the 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.

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

**CONSOLIDATED STATEMENTS OF INCOME**

For the Years Ended December 31, 2007, 2006, and 2005

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	2007	2006	2005
		<i>(in thousands)</i>	
<b>Operating Revenues:</b>			
Wholesale revenues --			
Non-affiliates	\$416,648	\$279,384	\$223,058
Affiliates	547,229	491,762	556,664
Other revenues	8,137	5,902	1,282
<b>Total operating revenues</b>	<b>972,014</b>	<b>777,048</b>	<b>781,004</b>
<b>Operating Expenses:</b>			
Fuel	238,680	145,236	209,008
Purchased power --			
Non-affiliates	64,604	53,795	57,182
Affiliates	135,336	116,902	102,874
Other operations	98,156	73,804	61,235
Maintenance	36,815	21,472	19,570
Loss on IGCC project	17,619	-	-
Depreciation and amortization	73,985	65,959	54,254
Taxes other than income taxes	15,744	15,637	13,314
<b>Total operating expenses</b>	<b>680,939</b>	<b>492,805</b>	<b>517,437</b>
<b>Operating Income</b>	<b>291,075</b>	<b>284,243</b>	<b>263,567</b>
<b>Other Income and (Expense):</b>			
Interest expense, net of amounts capitalized	(79,175)	(80,154)	(79,322)
Other income (expense), net	3,285	2,191	2,379
<b>Total other income and (expense)</b>	<b>(75,890)</b>	<b>(77,963)</b>	<b>(76,943)</b>
<b>Earnings Before Income Taxes</b>	<b>215,185</b>	<b>206,280</b>	<b>186,624</b>
Income taxes	83,548	81,811	71,833
<b>Net Income</b>	<b>\$131,637</b>	<b>\$124,469</b>	<b>\$114,791</b>

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

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

	2007	2006	2005
	<i>(in thousands)</i>		
<b>Operating Activities:</b>			
Net income	\$131,637	\$124,469	\$114,791
Adjustments to reconcile net income to net cash provided from operating activities --			
Depreciation and amortization	89,221	82,365	68,210
Deferred income taxes	31,665	33,150	24,055
Deferred revenues	(4,852)	2,248	(370)
Mark-to-market adjustments	(3,033)	(328)	(154)
Accumulated billings on construction contract	60,417	12,810	-
Accumulated costs on construction contract	(29,645)	(7,198)	-
Loss on IGCC project	17,619	-	-
Other, net	7,874	2,484	3,617
Changes in certain current assets and liabilities --			
Receivables	(3,155)	38,479	(42,355)
Fossil fuel stock	(4,105)	(374)	(4,316)
Materials and supplies	(1,169)	(119)	(4,096)
Other current assets	(1,863)	(3,003)	(5,900)
Accounts payable	23,028	(34,163)	41,662
Accrued taxes	1,474	(8,522)	5,782
Accrued interest	319	687	535
<b>Net cash provided from operating activities</b>	<b>315,432</b>	<b>242,985</b>	<b>201,461</b>
<b>Investing Activities:</b>			
Property additions	(183,669)	(91,491)	(30,780)
Acquisition of plant facilities	-	(409,213)	(210,323)
Sale of property to affiliates	4,291	15,674	-
Change in construction payables, net	(1,960)	10,965	(124)
Other	(2,514)	-	-
<b>Net cash used for investing activities</b>	<b>(183,852)</b>	<b>(474,065)</b>	<b>(241,227)</b>
<b>Financing Activities:</b>			
Increase (decrease) in notes payable, net	(74,004)	13,060	110,692
Proceeds --			
Senior notes	-	200,000	-
Capital contributions	3,533	108,689	5,022
Redemptions --			
Other long-term debt	(1,209)	(200)	(200)
Payment of common stock dividends	(89,800)	(77,700)	(72,400)
Other	(24)	(10,471)	(958)
<b>Net cash provided from (used for) financing activities</b>	<b>(161,504)</b>	<b>233,378</b>	<b>42,156</b>
<b>Net Change in Cash and Cash Equivalents</b>	<b>(29,924)</b>	<b>2,298</b>	<b>2,390</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>29,929</b>	<b>27,631</b>	<b>25,241</b>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 5</b>	<b>\$ 29,929</b>	<b>\$ 27,631</b>
<b>Supplemental Cash Flow Information:</b>			
Cash paid during the period for --			
Interest (net of \$16,541, \$5,648 and \$- capitalized, respectively)	\$63,766	\$ 65,206	\$ 64,487
Income taxes (net of refunds)	50,724	53,608	33,751

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

## CONSOLIDATED BALANCE SHEETS

At December 31, 2007 and 2006

Southern Power Company and Subsidiary Companies 2007 Annual Report

<b>Assets</b>	<b>2007</b>	<b>2006</b>
	<i>(in thousands)</i>	
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 5	\$ 29,929
Receivables --		
Customer accounts receivable	19,100	16,789
Other accounts receivable	1,025	125
Affiliated companies	27,004	26,215
Fossil fuel stock, at average cost	15,160	11,056
Materials and supplies, at average cost	19,284	19,877
Prepaid service agreements - current	14,233	30,280
Other prepaid expenses	2,840	5,878
Assets from risk management activities	16,079	2,006
Other	4,226	-
<b>Total current assets</b>	<b>118,956</b>	<b>142,155</b>
<b>Property, Plant, and Equipment:</b>		
In service	2,534,507	2,434,146
Less accumulated provision for depreciation	280,962	219,654
	<b>2,253,545</b>	<b>2,214,492</b>
Construction work in progress	283,084	260,279
<b>Total property, plant, and equipment</b>	<b>2,536,629</b>	<b>2,474,771</b>
<b>Deferred Charges and Other Assets:</b>		
Prepaid long-term service agreements	87,058	51,615
Other--		
Affiliated	4,138	4,473
Other	21,993	17,929
<b>Total deferred charges and other assets</b>	<b>113,189</b>	<b>74,017</b>
<b>Total Assets</b>	<b>\$2,768,774</b>	<b>\$2,690,943</b>

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

## CONSOLIDATED BALANCE SHEETS

At December 31, 2007 and 2006

Southern Power Company and Subsidiary Companies 2007 Annual Report

<b>Liabilities and Stockholder's Equity</b>	<b>2007</b>	<b>2006</b>
	<i>(in thousands)</i>	
<b>Current Liabilities:</b>		
Securities due within one year	\$ -	\$ 1,209
Notes payable	49,748	123,752
Accounts payable --		
Affiliated	48,475	33,205
Other	20,322	16,453
Accrued taxes --		
Income taxes	392	393
Other	2,658	2,183
Accrued interest	30,168	29,849
Liabilities from risk management activities	12,639	156
Billings in excess of cost on construction contract	36,384	-
Other	9,523	4,684
<b>Total current liabilities</b>	<b>210,309</b>	<b>211,884</b>
<b>Long-Term Debt:</b>		
Senior notes --		
6.25% due 2012	575,000	575,000
4.875% due 2015	525,000	525,000
6.375% due 2036	200,000	200,000
Unamortized debt discount	(2,901)	(3,155)
<b>Long-term debt</b>	<b>1,297,099</b>	<b>1,296,845</b>
<b>Deferred Credits and Other Liabilities:</b>		
Accumulated deferred income taxes	138,123	106,016
Deferred capacity revenues -- Affiliated	34,801	36,313
Other --		
Affiliated	7,754	8,958
Other	2,801	5,423
<b>Total deferred credits and other liabilities</b>	<b>183,479</b>	<b>156,710</b>
<b>Total Liabilities</b>	<b>1,690,887</b>	<b>1,665,439</b>
<b>Common Stockholder's Equity:</b>		
Common stock, par value \$0.01 per share --		
Authorized - 1,000,000 shares		
Outstanding - 1,000 shares	-	-
Paid-in capital	858,466	854,933
Retained earnings	253,131	211,295
Accumulated other comprehensive income (loss)	(33,710)	(40,724)
<b>Total common stockholder's equity</b>	<b>1,077,887</b>	<b>1,025,504</b>
<b>Total Liabilities and Stockholder's Equity</b>	<b>\$2,768,774</b>	<b>\$2,690,943</b>
<b>Commitments and Contingent Matters (See notes)</b>		

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



## NOTES TO FINANCIAL STATEMENTS

Southern Power Company and Subsidiary Companies 2007 Annual Report

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### General

Southern Power Company (the Company) is a wholly-owned subsidiary of Southern Company, which is also the parent company of four traditional operating companies, 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 Company (APC), Georgia Power Company (GPC), Gulf Power Company, and Mississippi Power Company, are vertically integrated utilities providing electric service in four Southeastern states. The Company 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 its 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 Company is subject to regulation by the Federal Energy Regulatory Commission (FERC). The Company follows accounting principles generally accepted in the United States. 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.

The financial statements include the accounts of the Company and its wholly-owned subsidiaries, Southern Company – Florida LLC (SCF), Oleander Power Project, LP (Oleander), DeSoto County Generating Company, LLC (DeSoto), and Southern Power Company – Orlando Gasification LLC (SPC-OG), which own, operate, and maintain the Company's ownership interests in Plant Stanton Unit A, Plant Oleander, Plant DeSoto, and construct the combined cycle for the Orlando Utilities Commission (OUC), respectively. See Note 2 under "DeSoto and Rowan Acquisitions" and "Oleander Acquisition" and Note 4 under "IGCC" for further information. All intercompany accounts and transactions have been eliminated in consolidation.

#### 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, or cash flows.

The statements of cash flows has been modified to remove the line presented in prior years as "Tax benefit of stock options" and include these amounts in the line item "Other,net."

#### Affiliate Transactions

The Company has an agreement with SCS under which the following services are rendered to the Company at amounts in compliance with FERC regulation: general and design engineering, purchasing, accounting and statistical analysis, finance and treasury, tax, information resources, marketing, auditing, insurance and pension administration, human resources, systems and procedures and other services with respect to business and operations and power pool transactions. SCS also enters into fuel purchase and transportation arrangements and contracts, financial instruments for purposes of hedging, and wholesale energy purchase and sale transactions for the benefit of the Company. Because the Company has no employees, all employee-related charges are rendered at amounts in compliance with FERC regulation under agreements with SCS or the traditional operating companies. Costs for these services from SCS amounted to approximately \$125.4 million in 2007, \$77.8 million in 2006, and \$51.9 million in 2005. Approximately \$74.1 million in 2007, \$59.7 million in 2006, and \$47.8 million in 2005 were general, administrative, operations, and maintenance expenses; the remainder was capitalized to construction work in progress and other assets. Cost allocation methodologies used by SCS were approved by the Securities and Exchange Commission prior to the repeal of the Public Utility Holding Company Act of 1935, as amended, and management believes they are reasonable. The FERC permits services to be rendered at cost by system service companies.

In 2003, the Company entered into agreements with APC and GPC under which APC and GPC operated and maintained Plants Dahlberg, Wansley, Franklin, and Harris. GPC also supplied various services for other plants. On August 1, 2007, those agreements were terminated and replaced with service agreements under which APC and GPC provided labor and other specifically requested services to the Company. These services are billed at amounts in compliance with FERC regulation on a monthly basis and are

**NOTES** (continued)**Southern Power Company and Subsidiary Companies 2007 Annual Report**

recorded as operations and maintenance expenses in the statements of income. For the periods ended December 31, 2007, 2006, and 2005, billings under these agreements totaled approximately \$9.2 million, \$7.6 million, and \$7.1 million, respectively.

Total billings for all purchased power agreements (PPAs) in effect with affiliates totaled \$505.2 million, \$467.9 million, and \$531.5 million in 2007, 2006, and 2005, respectively. Included in these billings were \$34.8 million, \$36.3 million, and \$37.5 million of "Deferred capacity revenues – affiliated" recorded on the balance sheets at December 31, 2007, December 31, 2006, and December 31, 2005, respectively. The Company and the traditional operating companies may jointly enter into various types of wholesale energy, natural gas, and certain other contracts, either directly or through SCS as agent. Each participating company may be jointly and severally liable for the obligations incurred under these agreements.

The Company and the traditional operating companies generally settle amounts related to the above transactions on a monthly basis in the month following the performance of such services or the purchase or sale of electricity.

In 2007, the Company sold plots of land in Prattville, Alabama and Chilton County, Alabama to APC. The total sales price was \$4.3 million and is recorded in "Sale of property to affiliates" on the statements of cash flows. In addition, the Company sold a turbine rotor to Gulf Power for \$7.9 million.

In 2006, the Company sold its membership interests in Cherokee Falls Development of South Carolina LLC to Southern Company's nuclear development affiliate. The sales price was \$15.7 million and is recorded in "Sale of property to affiliates" on the statements of cash flows.

**Revenues**

Capacity is sold at rates specified under contractual terms and is recognized at the lesser of the levelized amount or the amount billable under the contract over the respective contract periods. Energy is generally sold at market-based rates and the associated revenue is recognized as the energy is delivered. Transmission revenues and other fees are recognized as incurred as other operating revenue. Revenues are recorded on a gross basis for all full requirements PPAs. See "Financial Instruments" for additional information.

Significant portions of the Company's revenues have been derived from certain customers. For the year ended December 31, 2007, GPC accounted for 45.6% of revenues, APC accounted for 6.9% of revenues, and Sawnee Electric Membership Corporation accounted for 5.5% of revenues. For the year ended December 31, 2006, GPC accounted for 52.7% of revenues, APC accounted for 8.2% of revenues, and Flint Electric Membership Corporation accounted for 4.6% of revenues. For the year ended December 31, 2005, GPC accounted for 60.1% of revenues and APC accounted for 8.2% of revenues.

The Company has a long-term contract for engineering, procurement, and construction services to build a combined cycle unit for the OUC. Construction activities commenced in 2006 and are expected to be complete by the end of 2010. Revenue and costs are recognized using the percentage-of-completion method. The Company utilizes the cost-to-cost approach as this method is less subjective than relying on assessments of physical progress. The percentage of completion represents the percentage of the total costs incurred to the estimated total cost of the contract. Revenues and costs are recognized by applying this percentage to the total revenues and estimated costs of the contract.

**Fuel Costs**

Fuel costs are expensed as the fuel is consumed.

**Income and Other Taxes**

The Company uses the liability method of accounting for deferred income taxes and provides deferred income taxes for all significant income tax temporary differences.

In accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), the 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

The Company's depreciable property, plant, and equipment consist entirely of generation assets.

Property, plant, and equipment is stated at original cost. Original cost includes materials, direct labor incurred by contractors and affiliated companies, minor items of property, and interest capitalized. Interest is capitalized on qualifying projects during the development and construction period. The cost to replace significant items of property defined as retirement units is capitalized. The cost of maintenance, repairs, and replacement of minor items of property is charged to maintenance expense as incurred.

## Depreciation

Depreciation of the original cost of assets is computed under the straight-line method and applies a composite depreciation rate based on the assets' estimated useful lives determined by the Company. The primary assets in property, plant, and equipment are power plants, all of which have an estimated useful life of 35 years, except combustion turbines at Plant Dahlberg, Plant Oleander, Plant Rowan, and Plant DeSoto, all of which have an estimated useful life of 40 years. These lives reflect a composite of the significant components (retirement units) that make up the plants. Depreciation studies are conducted periodically to update the composite rates.

A depreciation study was completed and the applicable remaining plant lives and associated depreciation rates were revised in March 2006. This change in estimate was due to revised useful life assumptions for certain components of plant in service. Depreciation rates by generating facility increased from a range of 2.5% to 2.9% to an adjusted range of 2.8% to 3.8%. These changes increased depreciation and reduced net income. The result of these changes decreased 2006 net income by \$3.8 million.

When property subject to composite depreciation is retired or otherwise disposed of in the normal course of business, its cost is charged to accumulated depreciation. For other property dispositions, the applicable cost and accumulated depreciation is removed from the accounts and a gain or loss is recognized.

## Asset Retirement Obligations and Other Costs of Removal

The present value of the ultimate costs for an asset's future retirement is recorded in the period in which the liability is incurred. The costs are capitalized as part of the related long-lived asset and depreciated over the asset's useful life.

At December 31, 2007, the Company had no material liability for asset retirement obligations.

## Interest Capitalized

Interest related to the construction of new facilities is capitalized in accordance with standard interest capitalization requirements per FASB Statement No. 34, "Capitalization of Interest Cost."

## Impairment of Long-Lived Assets and Intangibles

The 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 impairment has occurred is based on 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 estimating the fair value of the assets and recording a loss for the amount 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.

## Deferred Project Development Costs

The Company capitalizes project development costs once it is determined that it is probable that a specific site will be acquired and a power plant constructed. These costs include professional services, permits, and other costs directly related to the construction of a new project. These costs are generally transferred to construction work in progress upon commencement of construction. The total deferred project development costs were \$8.4 million at December 31, 2007, \$1.3 million at December 31, 2006, and \$3.8 million at

December 31, 2005.

### Cash and Cash Equivalents

For purposes of the financial statements, temporary cash investments are considered cash equivalents. Temporary cash investments are securities with original maturities of 90 days or less.

### Materials and Supplies

Generally, materials and supplies include the average costs of 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 cost of oil and emission allowances. The Company maintains minimal oil levels for use at Plant Dahlberg, Plant Oleander, Plant DeSoto, and Plant Rowan. Inventory is maintained using the weighted average cost method. Fuel inventory and emissions allowances are recorded at actual cost when purchased and then expensed at weighted average cost as used.

### Financial Instruments

The Company uses derivative financial instruments to limit exposure to fluctuations in interest rates, the prices of certain fuel purchases, and electricity purchases and sales. All derivative financial instruments are recognized as either assets or liabilities and are measured at fair value. Substantially all of the 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. This results in the deferral of related gains and losses in other comprehensive income until the hedged transactions occur. Any ineffectiveness is recognized currently in net income. Other derivative contracts are marked to market through current period income and are recorded on a net basis in the statements of income.

The 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 Company's financial instruments for which the carrying amounts did not equal fair value at December 31 were as follows:

	Carrying Amount	Fair Value
Long-term debt:	<i>(in millions)</i>	
2007	\$1,297	\$ 1,298
2006	1,298	1,288

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 and changes in the fair value of qualifying cash flow hedges, less income taxes and reclassifications of amounts included in net income.

## 2. ACQUISITIONS

### Oleander Acquisition

In June 2005, the Company acquired all of the outstanding general and limited partnership interests of Oleander from subsidiaries of Constellation Energy Group, Inc. The results of Oleander's operations have been included in the Company's consolidated financial statements since that date. The Company's acquisition of the general and limited partnership interests in Oleander was pursuant to a Purchase and Sale Agreement dated April 8, 2005, for an aggregate total cost of approximately \$218.1 million, including

**NOTES** (continued)**Southern Power Company and Subsidiary Companies 2007 Annual Report**

approximately \$11.9 million of working capital and other adjustments. At the time of acquisition, Plant Oleander, a dual-fueled generating plant in Brevard County, Florida, had a nameplate capacity of 628 megawatts (MW). The Oleander acquisition was in accordance with the Company's overall regional growth strategy.

Subsequent to the acquisition, the Company completed construction of Plant Oleander Unit 5 in December 2007. This unit is a combustion turbine with a nameplate capacity of 163 MW and is contracted to provide annual capacity for a PPA with the Florida Municipal Power Agency from 2007 through 2027.

**Desoto and Rowan Acquisitions**

Effective June 1, 2006, the Company acquired all of the outstanding membership interests of DeSoto County Generating Company, LLC (DeSoto) from a subsidiary of Progress Energy, Inc. The results of DeSoto's operations have been included in the Company's consolidated financial statements since that date. The Company's acquisition of the membership interest in DeSoto was pursuant to an agreement dated May 8, 2006, for an aggregate total cost of \$79.7 million. DeSoto owns a dual-fired generating plant near Arcadia, Florida with a nameplate capacity of 344 MW. The DeSoto acquisition was in accordance with the Company's overall regional growth strategy.

Effective September 1, 2006, the Company acquired all of the outstanding membership interests of Rowan County Power, LLC (Rowan) from a subsidiary of Progress Energy, Inc. Rowan was merged into the Company, and the results of Rowan's operations have been included in the Company's consolidated financial statements since that date. The Company's acquisition of the membership interests in Rowan was pursuant to an agreement dated May 8, 2006 for an aggregate total cost of \$329.5 million. Through the Rowan acquisition, the Company owns a dual-fired generating plant near Salisbury, North Carolina with a nameplate capacity of 986 MW. The Rowan acquisition was in accordance with the Company's overall regional growth strategy.

The pro forma data of the Company below is unaudited and gives effect to the DeSoto and Rowan plant acquisitions as if they had occurred at January 1, 2005. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of the Company that would have been reported had the acquisitions been completed as of the dates presented nor should be taken as representative of any future consolidated results of operations or financial condition of the Company.

	<b>For the Twelve Months Ended December 31</b>	
	2006	2005
	<i>(in thousands)</i>	
Pro forma revenues	\$795,701	\$825,655
Pro forma net income	118,703	116,108

**3. CONTINGENCIES AND REGULATORY MATTERS****General Litigation Matters**

The Company is subject to certain claims and legal actions arising in the ordinary course of business. In addition, the 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 the 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 the Company's financial statements.

**FERC Matters*****Market-Based Rate Authority***

The Company 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

**NOTES** (continued)**Southern Power Company and Subsidiary Companies 2007 Annual Report**

by the 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 Company 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 \$0.7 million, plus interest. The Company believes that there is no meritorious basis for this proceeding and is vigorously defending itself 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 majority of the Company's generation fleet is operated under the Intercompany Interchange Contract (IIC), as approved by the FERC. The IIC also governs the operation of the Southern Company generation fleet (Southern Pool). In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among the traditional operating companies, the Company, and SCS, as agent, under the terms of which the Southern Pool 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 the Company as a "system company" rather than a "marketing affiliate" is just and reasonable. In connection with the formation of the Company, the FERC authorized the Company'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 the Company. 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. 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. The Company's cost of implementing the compliance plan, including the modifications, is expected to be approximately \$8 million annually.

**4. JOINT OWNERSHIP AGREEMENTS****Plant Stanton A**

The Company is a 65% owner of Plant Stanton A, a combined-cycle project with a nameplate capacity of 630 MW. The unit is co-owned by OUC (28%), Florida Municipal Power Agency (3.5%), and Kissimmee Utility Authority (3.5%). The Company has a service agreement with SCS whereby SCS is responsible for the operation and maintenance of Plant Stanton A. As of December 31, 2007, \$150.7 million was recorded in plant in service with associated accumulated depreciation of \$18.7 million. These amounts represent the Company's share of the total plant assets and each owner must provide its own financing. The Company's proportionate share of Plant Stanton A's operating expense is included in the corresponding operating expenses in the statements of income.

**IGCC**

In December 2005, the Company and the OUC executed definitive agreements for development of a 285-MW integrated coal gasification combined cycle project in Orlando, Florida. The definitive agreements provided that the Company 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. The Company signed cooperative agreements with the U.S. Department of Energy (DOE) that provided up to \$293.75 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, the Company and OUC mutually agreed to terminate the construction of the gasifier portion of the IGCC project in November 2007. The Company will continue construction of the gas-fired combined cycle generating facility for OUC. The Company recorded a loss in the fourth quarter 2007 of approximately \$17.6 million related to cancellation of the gasifier portion of the IGCC project. This amount is net of reimbursements from OUC and the DOE. This loss consists of the write-off of construction costs

**NOTES** (continued)**Southern Power Company and Subsidiary Companies 2007 Annual Report**

of \$14.0 million and an accrual for termination costs of \$3.6 million. All termination costs are expected to be paid in 2008. As part of the termination agreement with OUC, the Company agreed to sell a tract of land in Orange County, Florida to OUC. The Company will record a gain of \$6 million on this sale in 2008.

**5. INCOME TAXES**

Southern Company files a consolidated federal income tax return and combined tax returns for the State of Georgia, the State of Alabama, and the State of Mississippi. Under a joint consolidated income tax allocation agreement, each subsidiary's current and deferred tax expense is computed on a stand-alone basis, and no subsidiary is allocated more expense than would be paid if it filed a separate income tax return. In accordance with Internal Revenue Service (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
	<i>(in thousands)</i>		
Federal –			
Current	<b>\$42,841</b>	\$39,653	\$40,468
Deferred	<b>26,808</b>	26,915	20,437
	<b>69,649</b>	66,568	60,905
State –			
Current	<b>9,042</b>	9,008	7,310
Deferred	<b>4,857</b>	6,235	3,618
	<b>13,899</b>	15,243	10,928
<b>Total</b>	<b>\$83,548</b>	\$81,811	\$71,833

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:

	2007	2006
	<i>(in thousands)</i>	
Deferred tax liabilities–		
Accelerated depreciation	<b>\$(197,271)</b>	\$(164,172)
Book/tax basis difference on asset transfers	<b>(4,125)</b>	(4,469)
<b>Total</b>	<b>(201,396)</b>	(168,641)
Deferred tax assets–		
Book/tax basis differences on asset transfers	<b>7,754</b>	8,958
Other comprehensive loss on interest rate swaps	<b>32,052</b>	29,798
Levelized capacity revenues	<b>13,377</b>	15,404
Other	<b>10,090</b>	8,465
<b>Total</b>	<b>63,273</b>	62,625
<b>Accumulated deferred income taxes in the balance sheets</b>	<b>\$ (138,123)</b>	\$ (106,016)

Deferred tax liabilities are the result of property related timing differences. The transfer of the Plant McIntosh construction project to GPC in 2004 resulted in a deferred gain for federal income tax purposes. GPC is reimbursing the Company for the related tax liability balance of \$4.6 million. Of this total, \$0.4 million is included in the balance sheets in "Receivables – Affiliated companies" and the remainder is included in "Deferred Charges and Other Assets: Other – Affiliated."

Deferred tax assets consist primarily of timing differences related to the recognition of capacity revenues, and the deferred loss on interest rate swaps reflected in other comprehensive income. The transfer of Plants Dahlberg, Wansley, and Franklin to the Company from GPC in 2001 also resulted in a deferred gain for federal income tax purposes. The Company will reimburse GPC for the related tax asset of \$9.1 million. Of this total, \$1.3 million is included in the balance sheets in "Accounts payable – Affiliated" and the remainder is included in "Deferred Credits and Other Liabilities: Other – Affiliated."

**Effective Tax Rate**

A reconciliation of the federal statutory tax rate to the effective income tax rate is as follows:

	<b>2007</b>	2006	2005
Federal statutory rate	<b>35.0%</b>	35.0%	35.0%
State income tax, net of federal deduction	<b>4.2</b>	4.8	3.8
Other	<b>(0.4)</b>	(0.1)	(0.3)
Effective income tax rate	<b>38.8%</b>	39.7%	38.5%

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 of 1986, as amended, 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 the Company's 2007 deduction by \$1.2 million over the 2006 deduction. The resulting additional tax benefit was \$0.4 million.

**Unrecognized Tax Benefits**

On January 1, 2007, the 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, the Company had unrecognized tax benefits which were previously accrued under Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" of approximately \$0.2 million. The total \$0.2 million in unrecognized tax benefits would impact the Company's effective tax rate if recognized. For 2007, the total amount of unrecognized tax benefits increased by \$1.2 million, resulting in a balance of \$1.4 million as of December 31, 2007.

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

	<b>2007</b>
	<i>(in millions)</i>
Unrecognized tax benefits as of adoption	\$ 0.2
Tax positions from current periods	0.4
Tax positions from prior periods	0.8
Reductions due to settlements	-
Reductions due to expired statute of limitations	-
Balance at end of year	<b>\$ 1.4</b>

Impact on the Company's effective tax rate, if recognized, was as follows:

	<b>2007</b>
	<i>(in millions)</i>
Tax positions impacting the effective tax rate	\$ 1.4
Tax positions not impacting the effective tax rate	-
Balance at end of year	<b>\$ 1.4</b>

**NOTES** (continued)**Southern Power Company and Subsidiary Companies 2007 Annual Report**

Accrued interest for unrecognized tax benefits:

	<b>2007</b>
	<i>(in millions)</i>
Interest accrued as of adoption	\$ -
Interest accrued during the year	0.1
Balance at end of year	\$ 0.1

The Company classifies interest on tax uncertainties as interest expense. Net interest accrued for the year ended December 31, 2007 was \$0.1 million. The 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 statutes or limitations have expired for years prior to 2002.

It is reasonably possible that the amount of the unrecognized benefit with respect to certain of the Company's unrecognized tax positions will significantly increase or decrease within the next 12 months. The possible settlement of the production activities deduction methodology and/or the conclusion or settlement of federal or state audits could impact the balances significantly. At this time, an estimate of the range of reasonably possible outcomes cannot be determined.

## 6. FINANCING

### Senior Notes

In 2007, the Company did not issue any long-term debt securities. The Company issued a total of \$200 million unsecured 30-year senior notes in 2006. The proceeds of the issuance were used to repay a portion of the Company's short-term indebtedness and for other general corporate purposes, including the Company's construction program. Long term debt outstanding was \$1.3 billion at December 31, 2007 and 2006.

### Bank Credit Arrangements

The Company has a \$400 million unsecured syndicated revolving credit facility (Facility) expiring in July 2012. The purpose of the Facility is to provide liquidity support to the Company's commercial paper program and for other general corporate purposes. Borrowings of \$13 million were outstanding under the Facility at December 31, 2007.

The Company is required to pay a commitment fee on the unused balance of the Facility. This fee is less than  $\frac{1}{8}$  of 1%. In 2007 and 2006, the Company incurred approximately \$0.4 million and \$0.5 million, respectively, in expenses from commitment fees under the Facility. In 2005, the Company incurred expenses of \$0.8 million from commitment fees under a previous facility.

The Facility contains a covenant that limits the debt to capitalization ratio to a maximum of 65%, as defined in the Facility. The Facility also contains a cross default provision that would be triggered if the Company defaulted on other indebtedness above a specified threshold. As of December 31, 2007, the Company was in compliance with all such covenants.

### Dividend Restrictions

The Company can only pay dividends to Southern Company out of retained earnings or paid-in-capital.

The Facility and the senior note indenture related to certain series of the Company's senior notes also contain certain limitations on the payment of common stock dividends. No dividends may be paid unless, as of the end of any calendar quarter, the Company's projected cash flows from fixed priced capacity PPAs (as defined in the agreements) are at least 80% of total projected cash flows for the next 12 months or the Company's debt to capitalization ratio is no greater than 60%. At December 31, 2007, the Company was in compliance with these ratios and had no restrictions on its ability to pay dividends.

### Commercial Paper

The Company has the ability to borrow under a commercial paper program. For the period ended December 31, 2007, the peak commercial paper balance outstanding was \$167 million. The average amount outstanding was \$95.8 million in 2007. The average

**NOTES** (continued)**Southern Power Company and Subsidiary Companies 2007 Annual Report**

annual interest rate was 5.5% in 2007. As of December 31, 2007, the commercial paper program had an outstanding balance of \$36.7 million. The outstanding balance on December 31, 2006 was \$123.8 million.

**Financial Instruments**

The Company enters into energy related derivatives to hedge exposures to electricity, gas, and other fuel price changes. The Company's exposure to market volatility in commodity fuel prices and prices of electricity is limited because its long-term sales contracts shift substantially all fuel cost responsibility to the purchaser. At December 31, 2007, the fair value gains/(losses) of derivative energy contracts was reflected in the financial statements as follows:

	<b>Amounts</b>
	<i>(in thousands)</i>
Net Income	\$3,293
Accumulated other comprehensive income	78
<b>Total fair value</b>	<b>\$3,371</b>

Derivatives not qualifying for hedge accounting are reflected in other income on the Company's consolidated statement of income. Fair value gains or losses for cash flow hedges are recorded in other comprehensive income and reclassified to fuel expense. There were no material amounts reclassified during any year presented. For the year 2008, the reclassifications from other comprehensive income to fuel expense are also expected to be immaterial. There was no significant ineffectiveness recorded in earnings for any period presented. The Company has energy-related hedges in place through 2008. At December 31, 2007, there were approximately \$9.4 million of deferred pre-tax realized net hedging gains relating to capitalized costs and revenues during the construction of specific plants. This will be reclassified from other comprehensive income to depreciation and amortization over the remaining life of the respective plants, which is approximately 27 years. For any year presented, the pre-tax gains reclassified from other comprehensive income to depreciation and amortization have been immaterial.

At December 31, 2007, the Company had no interest derivatives outstanding. The Company has deferred losses totaling \$65.1 million in other comprehensive income that will be amortized to interest expense through 2016. For the years 2007, 2006, and 2005, approximately \$13.3 million, \$12.0 million, and \$11.2 million, respectively, of pre-tax losses were reclassified from other comprehensive income to interest expense. During 2008, approximately \$12.0 million of pre-tax losses are expected to be reclassified from other comprehensive income to interest expense.

**7. COMMITMENTS****Construction Program**

The Company currently estimates property additions to be \$109.1 million, \$281.9 million, and \$765.4 million in 2008, 2009, and 2010, respectively. There is currently one unit at Plant Franklin actively under construction.

**Long-Term Service Agreements**

The Company has entered into Long-Term Service Agreements (LTSAs) with General Electric (GE) for the purpose of securing maintenance support for its combined cycle and combustion turbine generating facilities. In summary, the LTSAs provide that GE will perform all planned inspections and certain unplanned maintenance on the covered equipment, which includes the cost of all labor and materials.

Scheduled payments to GE, 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 to GE under these agreements are currently estimated at \$1.2 billion over the remaining term of the agreements, which may range up to 40 years. However, the LTSAs contain various cancellation provisions at the Company's option.

Payments made to GE prior to the performance of any planned inspections or unplanned maintenance are recorded as a prepayment in current assets or deferred charges and other assets on the balance sheets and are recorded as property additions in the statement of cash flows. Inspection and maintenance costs are capitalized or charged to expense based on the nature of the work performed. These transactions are non-cash and are not reflected in the statements of cash flows.

### Fuel and Purchased Power Commitments

SCS, as agent for the traditional operating companies and the Company, has entered into various fuel transportation and procurement agreements to supply a portion of the fuel (primarily natural gas) requirements for the operating facilities. In most cases, these contracts contain provisions for firm transportation costs, storage costs, minimum purchase levels, and other financial commitments.

Natural gas purchase commitments contain given volumes with prices based on various indices at the actual time of delivery. Amounts included in the chart below represent estimates based on the New York Mercantile Exchange future prices at December 31, 2007. Also, the Company has entered into various long-term commitments for the purchase of electricity.

Total estimated minimum long-term obligations at December 31, 2007 were as follows:

	<b>Natural Gas Commitments</b>	<b>Purchased Power Commitments</b>
	<i>(in millions)</i>	
2008	\$ 194.9	\$ 5.4
2009	53.3	10.9
2010	102.6	10.8
2011	34.2	-
2012	37.8	-
2013 and beyond	211.0	-
<b>Total</b>	<b>\$633.8</b>	<b>\$ 27.1</b>

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

Acting as an agent for all of Southern Company's traditional operating companies and the Company, SCS may enter into various types of wholesale energy and natural gas contracts. Under these agreements, each of the traditional operating companies and the Company may be jointly and severally liable. The creditworthiness of the Company is currently inferior to the creditworthiness of the traditional operating companies; therefore, Southern Company has entered into keep-well agreements with each of the traditional operating companies to ensure they will not subsidize nor be responsible for any costs, losses, liabilities, or damages resulting from the inclusion of the Company as a contracting party under these agreements.

### Operating Leases

The Company has operating lease agreements with various terms and expiration dates. Total operating lease expenses were \$0.5 million, \$0.6 million, and \$0.7 million for 2007, 2006, and 2005, respectively. At December 31, 2007, estimated minimum rental commitments for noncancelable operating leases were as follows:

	<b>Operating Lease Commitments</b>
	<i>(in millions)</i>
2008	\$ 0.5
2009	0.4
2010	0.4
2011	0.3
2012	0.4
2013 and beyond	22.3
<b>Total</b>	<b>\$ 24.3</b>

**NOTES** (continued)

## Southern Power Company and Subsidiary Companies 2007 Annual Report

**8. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Summarized quarterly financial information for 2007 and 2006 is as follows:

<b>Quarter Ended</b>	<b>Operating Revenues</b>	<b>Operating Income</b>	<b>Net Income</b>
		<i>(in thousands)</i>	
<b>March 2007</b>	<b>\$192,492</b>	<b>\$74,517</b>	<b>\$32,036</b>
<b>June 2007</b>	<b>244,018</b>	<b>84,840</b>	<b>39,854</b>
<b>September 2007</b>	<b>347,751</b>	<b>107,208</b>	<b>51,438</b>
<b>December 2007</b>	<b>187,753</b>	<b>24,510</b>	<b>8,309</b>
March 2006	\$139,829	\$50,432	\$19,900
June 2006	193,639	72,373	31,821
September 2006	270,031	99,303	45,871
December 2006	173,549	62,135	26,877

The Company's business is influenced by seasonal weather conditions. Fourth quarter 2007 operating income and net income were impacted by the loss on the IGCC project of \$17.6 million pretax and \$10.7 million after tax.

**SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA 2003-2007**
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	2007	2006	2005	2004	2003
<b>Operating Revenues (in thousands):</b>					
Wholesale - non-affiliates	\$416,648	\$279,384	\$223,058	\$266,463	\$278,559
Wholesale - affiliates	547,229	491,762	556,664	425,065	312,586
Total revenues from sales of electricity	963,877	771,146	779,722	691,528	591,145
Other revenues	8,137	5,902	1,282	9,783	90,635
Total	\$972,014	\$777,048	\$781,004	\$701,311	\$681,780
<b>Net Income (in thousands)</b>	<b>\$131,637</b>	\$124,469	\$114,791	\$111,508	\$155,149
<b>Cash Dividends</b>					
<b>on Common Stock (in thousands)</b>	<b>\$89,800</b>	\$ 77,700	\$ 72,400	\$ 207,000	\$ -
<b>Return on Average Common Equity (percent)</b>	<b>12.52</b>	13.16	13.68	12.23	17.65
<b>Total Assets (in thousands)</b>	<b>\$2,768,774</b>	\$2,690,943	\$2,302,976	\$2,067,013	\$2,409,285
<b>Gross Property Additions/Plant Acquisitions (in thousands)</b>	<b>\$183,669</b>	\$500,704	\$241,103	\$115,606	\$344,362
<b>Capitalization (in thousands):</b>					
Common stock equity	\$1,077,887	\$1,025,504	\$866,343	\$811,611	\$1,011,476
Long-term debt	1,297,099	1,296,845	1,099,520	1,099,435	1,149,112
Total (excluding amounts due within one year)	\$2,374,986	\$2,322,349	\$1,965,863	\$1,911,046	\$2,160,588
<b>Capitalization Ratios (percent):</b>					
Common stock equity	45.4	44.2	44.1	42.5	46.8
Long-term debt	54.6	55.8	55.9	57.5	53.2
Total (excluding amounts due within one year)	100.0	100.0	100.0	100.0	100.0
<b>Security Ratings:</b>					
Unsecured Long-Term Debt -					
Moody's	Baa1	Baa1	Baa1	Baa1	Baa1
Standard and Poor's	BBB+	BBB+	BBB+	BBB+	BBB+
Fitch	BBB+	BBB+	BBB+	BBB+	BBB+
<b>Kilowatt-Hour Sales (in thousands):</b>					
Sales for resale - non-affiliates	6,985,592	5,093,527	3,932,638	5,369,261	6,057,053
Sales for resale - affiliates	10,766,003	8,493,441	6,355,249	6,583,017	5,430,973
Total	17,751,595	13,586,968	10,287,887	11,952,278	11,488,026
<b>Average Revenue Per Kilowatt-Hour (cents)</b>	<b>5.43</b>	5.68	7.58	5.79	5.15
<b>Plant Nameplate Capacity Ratings (year-end) (megawatts)</b>	<b>6,896</b>	6,733	5,403	4,775	4,775
<b>Maximum Peak-Hour Demand (megawatts):</b>					
Winter	2,815	2,780	2,037	2,098	2,077
Summer	3,717	2,869	2,420	2,740	2,439
<b>Annual Load Factor (percent)</b>	<b>48.2</b>	53.6	48.9	54.4	54.9
<b>Plant Availability (percent)</b>	<b>96.7</b>	98.3	97.6	97.9	96.8
<b>Source of Energy Supply (percent):</b>					
Gas	70.4	68.3	72.6	61.9	53.4
Purchased power -					
From non-affiliates	8.8	9.6	9.6	24.7	30.5
From affiliates	20.8	22.1	17.8	13.4	16.1
Total	100.0	100.0	100.0	100.0	100.0