2007 Annual Report

GULF POWER COMPANY

GULF POWER
A SOUTHERN COMPANY

CONTENTS

Gulf Power Company 2007 Annual Report

SUMMARY

	2007	2006	Percent Change
Financial Highlights *(in thousands)*:			
Operating revenues	**$1,259,808**	$1,203,914	4.6
Operating expenses	**$1,083,892**	$1,037,242	4.5
Net income after dividends on preferred and preference stock	**$84,118**	$75,989	10.7
Gross property additions	**$239,337**	$147,086	62.7
Total assets	**$2,498,987**	$2,340,489	6.8
Operating Data:			
Kilowatt-hour sales *(in thousands)*:			
Retail	**11,520,888**	11,428,880	0.8
Sales for resale - non-affiliates	**2,227,026**	2,079,165	7.1
Sales for resale - affiliates	**2,884,440**	2,937,735	(1.8)
Total	**16,632,354**	16,445,780	1.1
Customers served at year-end	**427,663**	418,892	2.1
Peak-hour demand, net *(in megawatts)*	**2,626**	2,479	5.9
Capitalization Ratios *(percent)*:			
Common stock equity	**46.6**	45.8	
Preferred and preference stock	**6.2**	3.9	
Long-term debt (excluding amounts due within one year)	**47.2**	50.3	
Return on Average Common Equity *(percent)*	**12.32**	12.29	

Letter to Investors
Gulf Power Company 2007 Annual Report

Securing our energy future.

The biggest challenge that we have is to generate electricity that people can afford, that is there when you need it, and that has as little environmental impact as possible. Others may have the luxury of focusing on only one of these critical outcomes, but we do not—our customers demand all three be accomplished. And we must do it safely, for the sake of our customers and our employees.

Since the early 1990s, Gulf Power Company has provided reliable electricity at some of the lowest rates in the nation and in Florida among major investor-owned utilities, despite tremendous growth in our area. In fact, Gulf Power has reduced emissions 70 percent since 1992 while generating 40 percent more electricity.

Gulf Power will continue to do what's right for our customers, and that means finding solutions for our future electricity generation that make technological, environmental, and economic sense. We will expand our expertise in energy efficiency and conservation; we will continue to search for viable renewable fuel sources; and we are constantly evaluating our current fuel sources for efficiencies and alternatives.

We also will work to ensure that we are leaders in customer satisfaction, and that the communities we serve are strong and growing.

Our financial performance in 2007 was solid. Net income after dividends on preferred and preference stock was $84 million – up 11 percent from 2006, and our return on average common equity was 12.32 percent. Meanwhile, we added 8,771 customers in 2007, bringing us to 427,663 total customers in Northwest Florida. We sold 16.6 billion kilowatt-hours of electricity.

As we move forward, our pledge to you is that we will continue to work hard every day to balance our priorities of keeping electricity reliable, affordable, and environmentally responsible. Our future—and yours—depend on it.

Susan N. Story

Susan N. Story,
President and Chief Executive Officer
April 18, 2008

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Gulf Power Company 2007 Annual Report

The management of Gulf 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.

Susan N. Story
Susan N. Story
President and Chief Executive Officer

Ronnie R. Labrato
Ronnie R. Labrato
Vice President and Chief Financial Officer

February 25, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Gulf Power Company

We have audited the accompanying balance sheets and statements of capitalization of Gulf Power Company (the "Company") (a wholly owned subsidiary of Southern Company) as of December 31, 2007 and 2006, and the related 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 financial statements (pages 26 to 55) present fairly, in all material respects, the financial position of Gulf Power Company at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

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

Deloitte & Touche LLP

Atlanta, Georgia
February 25, 2008

OVERVIEW

Business Activities

Gulf Power Company (the Company) operates as a vertically integrated utility providing electricity to retail customers within its traditional service area located in northwest Florida and to wholesale customers in the Southeast.

Many factors affect the opportunities, challenges, and risks of the Company's business of selling electricity. These factors include the ability to maintain a stable regulatory environment, to achieve energy sales growth, and to effectively manage and secure timely recovery of rising costs. These costs include those related to growing demand, increasingly stringent environmental standards, fuel prices, and storm restoration costs. Appropriately balancing required costs and capital expenditures with customer prices will continue to challenge the Company for the foreseeable future.

In July 2006, the Florida Public Service Commission (PSC) extended the storm-recovery surcharge currently being collected by the Company until June 2009. See Notes 1 and 3 to the financial statements under "Property Damage Reserve" and "Retail Regulatory Matters – Storm Damage Cost Recovery," respectively, for additional information.

Key Performance Indicators

In striving to maximize shareholder value while providing cost-effective energy to over 425,000 customers, the Company continues to focus on several key indicators. These indicators include customer satisfaction, plant availability, system reliability, and net income after dividends on preferred and preference stock. The Company's financial success is directly tied to the satisfaction of its customers. Key elements of ensuring customer satisfaction include outstanding service, high reliability, and competitive prices. Management uses customer satisfaction surveys and reliability indicators to evaluate the Company's results.

Peak season equivalent forced outage rate (Peak Season EFOR) is an indicator of plant availability and efficient generation fleet operations during the months when generation needs are greatest. The rate is calculated by dividing the number of hours of forced outages by total generation hours. The 2007 Peak Season EFOR of 2.82% was better than the target. Transmission and distribution system reliability performance is measured by the frequency and duration of outages. Performance targets for reliability are set internally based on historical performance, expected weather conditions, and expected capital expenditures. The performance for 2007 was better than target for these reliability measures. Net income after dividends on preferred and preference stock is the primary component of the Company's contribution to Southern Company's earnings per share goal.

The Company's 2007 results compared with its targets for some of these key indicators are reflected in the following chart:

Key Performance Indicator	2007 Target Performance	2007 Actual Performance
Customer Satisfaction	Top quartile in customer surveys	Top quartile
Peak Season EFOR	3.00% or less	2.82%
Net Income	$82 million	$84 million

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

Earnings

The Company's 2007 net income after dividends on preferred and preference stock was $84.1 million, an increase of $8.1 million from the previous year. In 2006, earnings were $76.0 million, an increase of $0.8 million from the previous year. In 2005, earnings were $75.2 million, an increase of $7.0 million from the previous year. The increase in earnings in 2007 was due primarily to increases in retail revenues, earnings on additional investments in environmental controls through the environment cost recovery provision, and related allowance for equity funds used during construction partially offset by non-fuel operating expenses. The increase in earnings in 2006 was due primarily to higher operating revenues partially offset by higher operating expenses, higher financing costs, and increases in depreciation expense. The increase in earnings in 2005 was due primarily to higher retail sales and lower non-fuel operating expenses, excluding expenses related to Hurricane Ivan storm damage, which were offset by revenues and did not affect earnings. See FUTURE EARNINGS POTENTIAL – "PSC Matters – Storm Damage Cost Recovery" herein.

RESULTS OF OPERATIONS

A condensed statement of income follows:

	Amount	Increase (Decrease) from Prior Year		
	2007	**2007**	2006	2005
		(in millions)		
Operating revenues	**$ 1,259.8**	**$ 55.9**	$ 120.3	$ 123.5
Fuel	**573.4**	**38.4**	119.1	48.6
Purchased power	**71.5**	**(2.3)**	(24.6)	32.5
Other operations and maintenance	**270.4**	**10.9**	9.8	20.1
Depreciation and amortization	**85.6**	**(3.5)**	4.2	2.2
Taxes other than income taxes	**83.0**	**3.2**	3.4	6.5
Total operating expenses	**1,083.9**	**46.7**	111.9	109.9
Operating income	**175.9**	**9.2**	8.4	13.6
Total other income and (expense)	**(40.8)**	**1.3**	(4.8)	(0.8)
Income taxes	**47.1**	**1.8**	0.3	5.3
Net Income	**88.0**	**8.7**	3.3	7.5
Dividends on Preferred and Preference Stock	**3.9**	**0.6**	2.5	0.5
Net Income after Dividends on Preferred and Preference Stock	**$ 84.1**	**$ 8.1**	$ 0.8	$ 7.0

Operating Revenues

Operating revenues increased in 2007 when compared to 2006 and 2005. The following table summarizes the changes in operating revenues for the past three years:

	Amount		
	2007	2006	2005
		(in millions)	
Retail –prior year	**$ 952.0**	$ 864.9	$ 736.9
Estimated change in –			
Rates and pricing	**2.5**	14.2	12.3
Sales growth	**5.8**	2.5	11.6
Weather	**1.2**	2.4	(4.2)
Fuel and other cost recovery	**44.8**	68.0	108.3
Retail – current year	**1,006.3**	952.0	864.9
Wholesale revenues –			
Non-affiliates	**83.5**	87.2	84.3
Affiliates	**113.2**	118.1	91.3
Total wholesale revenues	**196.7**	205.3	175.6
Other operating revenues	**56.8**	46.6	43.1
Total operating revenues	**$ 1,259.8**	$ 1,203.9	$ 1,083.6
Percent change	**4.6%**	11.1%	12.9%

Retail revenues increased $54.3 million, or 5.7%, in 2007, $87.2 million, or 10.1%, in 2006, and $128.0 million, or 17.4%, in 2005. The significant factors driving these changes are shown in the table above.

Revenues associated with changes in rates and pricing include cost recovery provisions for energy conservation costs and environmental compliance costs. Annually, the Company petitions the Florida PSC for recovery of projected costs, including any true-up amount from prior periods, and approved rates are implemented each January. The recovery provisions include related expenses and a return on average net investment. See Note 3 to the financial statements under "Retail Regulatory Matters – Environmental Cost Recovery" for additional information.

Fuel and other cost recovery provisions include fuel expenses, the energy component of purchased power costs, and purchased power capacity costs. Annually, the Company petitions the Florida PSC for recovery of projected fuel and purchased power costs, including any true-up amount from prior periods, and approved rates are implemented each January. Cost recovery provisions also include revenues related to the recovery of storm damage restoration costs. The recovery provisions generally equal the related expenses and have no material effect on net income. See Note 1 to the financial statements under "Revenues" and "Property Damage Reserve" and Note 3 to the financial statements under "Retail Regulatory Matters – Storm Damage Cost Recovery" for additional information.

Total wholesale revenues were $196.7 million in 2007, a decrease of $8.5 million, or 4.2%, compared to 2006, primarily due to decreased energy sales to affiliates at a lower cost per kilowatt-hour (KWH) supplied by lower-cost generating resources. Total wholesale revenues were $205.2 million in 2006, an increase of $29.5 million, or 16.8%, compared to 2005, primarily due to increased energy sales to affiliates to serve their territorial energy requirements. Total wholesale revenues were $175.7 million in 2005, a decrease of $8.1 million, or 4.4%, compared to 2004, primarily due to lower energy sales to affiliates resulting from decreases in the Company's available generation as a result of outages at Plants Crist and Smith.

Wholesale revenues from sales to non-affiliates include unit power sales under long-term contracts to other Florida utilities. Wholesale revenues from contracts have both capacity and energy components. Capacity revenues reflect the recovery of fixed costs and a return on investment. Energy is generally sold at variable cost. The capacity and energy components under these unit power sales contracts were as follows:

	2007	2006	2005
		(in thousands)	
Unit power sales –			
Capacity	**$ 18,073**	$ 21,477	$ 20,852
Energy	**36,245**	34,597	33,206
Total	**54,318**	56,074	54,058
Other power sales –			
Capacity and other	**2,397**	2,436	3,668
Energy	**26,799**	28,632	26,620
Total	**29,196**	31,068	30,288
Total non-affiliated	**$ 83,514**	$ 87,142	$ 84,346

Wholesale revenues from sales to affiliated companies within the Southern Company system will vary from year to year depending on demand and the availability and cost of generating resources at each company. These affiliated sales and purchases are made in accordance with the Intercompany Interchange Contract (IIC), as approved by the Federal Energy Regulatory Commission (FERC). These transactions do not have a significant impact on earnings, since the energy is generally sold at marginal cost and energy purchases are generally offset by revenues through the Company's fuel cost recovery clause.

Other operating revenues increased $10.2 million in 2007, primarily due to other energy services and an increase in franchise fees, which were proportional to changes in revenue. The increased revenues from other energy services did not have a material impact on earnings since they were generally offset by associated expenses. Other operating revenues increased $3.6 million in both 2006 and 2005, primarily due to an increase in franchise fees, which were proportional to changes in revenue.

Energy Sales

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

	KWHs	**Percent Change**		
	2007	**2007**	2006	2005
	(in millions)			
Residential	**5,477**	**0.9%**	2.0%	2.0%
Commercial	**3,971**	**3.3**	2.9	1.1
Industrial	**2,048**	**(4.1)**	(1.1)	2.3
Other	**25**	**4.2**	5.1	0.7
Total retail	**11,521**	**0.8**	1.7	1.7
Wholesale				
Non-affiliates	**2,227**	**7.1**	(9.4)	1.7
Affiliates	**2,884**	**(1.8)**	48.6	(36.8)
Total wholesale	**5,111**	**1.9**	17.4	(20.6)
Total energy sales	**16,632**	**1.1**	6.0	(5.6)

Residential energy sales increased 0.9% in 2007, compared to 2006, primarily due to more favorable weather conditions and customer growth, partially offset by customer response to higher prices. Residential energy sales increased 2.0% in 2006, compared to 2005, primarily due to more favorable weather conditions and customer growth. Residential energy sales increased 2.0% in 2005, compared to 2004, primarily due to customer growth, partially offset by unfavorable weather conditions.

Commercial energy sales increased 3.3% in 2007, compared to 2006, primarily due to more favorable weather conditions and customer growth. Commercial energy sales increased 2.9% in 2006, compared to 2005, primarily due to more favorable weather conditions and customer growth. Commercial energy sales increased 1.1% in 2005, compared to 2004, primarily due to customer growth, partially offset by unfavorable weather conditions.

Industrial energy sales decreased 4.1% in 2007, compared to 2006, primarily due to a conversion project by a major forest products manufacturer and a production process change by a major petroleum company. Industrial energy sales decreased 1.1% in 2006, compared to 2005, due to reduced demand for and production of building materials and a conversion project by a major paper manufacturer. Industrial energy sales increased 2.3% in 2005, compared to 2004, primarily due to additional sales to customers with gas-fired co-generation resulting from high natural gas prices.

Wholesale energy sales to non-affiliates increased 7.1% in 2007, decreased 9.4% in 2006, and increased 1.7% in 2005, each compared to the prior year primarily as a result of fluctuations in the fuel cost to produce energy sold to non-affiliated utilities under both long-term and short-term contracts. The degree to which oil and natural gas prices, which are the primary fuel sources for these customers, differ from the Company's fuel costs will influence these changes in sales. The fluctuations in sales have a minimal effect on earnings because the energy is generally sold at marginal cost.

Wholesale energy sales to affiliates decreased 1.8% in 2007 compared to 2006, primarily due to the availability of lower cost generation resources at affiliated companies. Wholesale energy sales to affiliates increased 48.6% in 2006 compared to 2005, primarily due to increased territorial energy requirements of affiliates. Wholesale energy sales to affiliates decreased 36.8% in 2005 compared to 2004, due to decreases in the Company's available generation as a result of outages at Plants Crist and Smith.

Fuel and Purchased Power Expenses

Fuel costs constitute the single largest expense for the Company. The mix of fuel sources for generation of electricity is determined primarily by demand, the unit cost of fuel consumed, and the availability of generating units. Additionally, the Company purchases a portion of its electricity needs from the wholesale market.

Details of the Company's electricity generated and purchased were as follows:

	2007	2006	2005
Total generation *(millions of KWHs)*	**16,657**	16,349	15,024
Total purchased power *(millions of KWHs)*	**798**	876	1,172
Sources of generation *(percent)* –			
Coal	**86%**	87%	86%
Gas	**14**	13	14
Cost of fuel, generated *(cents per net KWH)* –			
Coal	**2.86**	2.68	2.16
Gas	**6.91**	7.24	6.48
Average cost of fuel, generated *(cents per net KWH)*	**3.44**	3.27	2.77
Average cost of purchased power *(cents per net KWH)*	**8.96**	8.43	8.39

Fuel expense was $573.4 million in 2007, an increase of $38.4 million, or 7.2%, above the prior year costs. This increase was the result of a $28.3 million increase in the average cost of fuel and a $10.1 million increase related to total KWHs generated. Fuel expense was $535 million in 2006, an increase of $119.1 million, or 28.7%, above the prior year costs. This increase was the result of an $82.4 million increase in the average cost of fuel and a $36.7 million increase related to total KWHs generated. Fuel expense was $416 million in 2005, an increase of $48.6 million, or 13.2%, above the prior year costs. This increase was the result of a $67.5 million increase in the average cost of fuel, partially offset by $18.9 million decrease related to total KWHs generated.

Purchased power expense was $71.5 million in 2007, a decrease of $2.3 million, or 3.2%, below the prior year costs. This decrease was the result of a $6.5 million decrease in total KWHs purchased, offset by a $4.2 million increase resulting from the higher average cost per net KWH. Purchased power expense was $73.8 million in 2006, a decrease of $24.6 million, or 25.0%, below the prior year costs. This decrease was the result of a $24.9 million decrease in total KWHs purchased and a $0.3 million increase resulting from the higher average cost per net KWH. Purchased power expense was $98.4 million in 2005, an increase of $32.5 million, or 49.3%, above the prior year costs. This increase was the result of a $7.6 million decrease in total KWHs purchased and a $40.1 million increase resulting from the higher average cost per net KWH.

While there has been a significant upward trend in the cost of coal and natural gas since 2003, prices moderated somewhat in 2006 and 2007. Coal prices have been influenced by a worldwide increase in demand from developing countries, as well as increases in mining and fuel transportation costs. While demand for natural gas in the United States continued to increase in 2007, natural gas supplies have also risen due to increased production and higher storage levels.

Fuel expenses generally do not affect net income, since they are offset by fuel revenues under the Company's fuel cost recovery provisions. See FUTURE EARNINGS POTENTIAL – "PSC Matters – Fuel Cost Recovery" herein and Note 3 to the financial statements for additional information.

Other Operations and Maintenance Expenses

In 2007, other operations and maintenance expenses increased $10.9 million, or 4.2%, compared to the prior year primarily due to a $5.0 million increase in other energy services and a $4.3 million increase in severance costs associated with a reorganization. The increased expenses from other energy services did not have a material impact on earnings since they were generally offset by associated revenue. In 2007, the Company offered both voluntary and involuntary severance to a number of employees in connection with a reorganization of certain functions. In 2006, other operations and maintenance expenses increased $9.7 million, or 3.9%, compared to the prior year primarily due to a $4.2 million increase in the recovery of incurred costs for storm damage activity as approved by the Florida PSC, a $1.9 million increase in employee benefit expenses, and a $1.1 million increase in property insurance costs. In 2005, other operations and maintenance expenses increased $20.1 million, or 8.7%, compared to the prior year primarily due to the recovery of $20.4 million in Hurricane Ivan restoration costs as approved by the Florida PSC. Since these storm damage expenses were recognized as revenues were recorded, there was no impact on net income. See FUTURE EARNINGS POTENTIAL – "PSC Matters – Storm Damage Cost Recovery" herein and Notes 1 and 3 to the financial statements under "Property Damage Reserve" and "Retail Regulatory Matters – Storm Damage Cost Recovery," respectively, for additional information.

Depreciation and Amortization

Depreciation and amortization expense decreased $3.6 million, or 4.0%, in 2007 compared to the prior year primarily due to new depreciation rates implemented in January 2007. Depreciation and amortization expense increased $4.2 million, or 4.9%, in 2006 compared to the prior year primarily due to the construction of environmental control projects at Plants Crist and Daniel that were placed in service in 2005. Depreciation and amortization expense increased $2.2 million, or 2.7%, in 2005 compared to the prior year primarily due to the completion of environmental control projects at Plant Crist Unit 7.

Taxes Other than Income Taxes

Taxes other than income taxes increased $3.2 million, or 4.0%, in 2007, $3.4 million, or 4.5%, in 2006, and $6.5 million, or 9.3%, in 2005 primarily due to increases in franchise and gross receipts taxes, which were directly related to the increase in retail revenues.

Interest Income

Interest income increased $0.1 million, or 2.3%, in 2007 and increased $1.4 million, or 37.4%, in 2006 compared to the prior years primarily due to interest received related to the recovery of financing costs associated with the fuel clause and incurred costs for storm damage activity as approved by the Florida PSC. Interest income increased $2.6 million, or 210.8%, in 2005 compared to the prior year primarily due to interest received from a tax refund resulting from Hurricane Ivan and interest received related to the recovery of financing costs associated with Hurricane Ivan. See FUTURE EARNINGS POTENTIAL – "Storm Damage Cost Recovery" herein and Note 3 to the financial statements under "Retail Regulatory Matters – Storm Damage Cost Recovery" for additional information.

Interest Expense, Net of Amounts Capitalized

Interest expense, net of amounts capitalized increased $0.5 million, or 1.2%, in 2007 compared to the prior year as the result of the issuance of $110 million and $85 million in senior notes in December 2006 and June 2007, respectively. These increases were offset by the extinguishment of $25 million aggregate principal amount of first mortgage bonds in 2006, the redemption of $41.2 million of junior subordinated notes and the related trust preferred and common securities of Gulf Power Capital Trust IV, and a decrease in outstanding short-term indebtedness. Interest expense, net of amounts capitalized increased $3.8 million, or 9.5%, in 2006 compared to the prior year as the result of higher interest rates on variable rate pollution control bonds, increased levels of short-term borrowings at higher interest rates, and the issuance of $60 million in senior notes in August 2005. These increases were partially offset by the maturity of a $100 million bank note in October 2005 and the extinguishment of $30 million aggregate principal amount of first mortgage bonds in 2005. Interest expense increased $5.4 million, or 15.4%, in 2005 compared to the prior year as the result of higher interest rates on variable rate pollution control bonds, an increase in outstanding short-term indebtedness as a result of hurricane-related costs, and the issuance of $72.2 million of junior subordinated notes and the related trust preferred and common securities of Gulf Power Capital Trusts III and IV in 2004.

Allowance for Equity Funds Used During Construction

Allowance for equity funds used during construction (AFUDC) increased $2.0 million, or 553.6%, in 2007 compared to the prior year primarily due to construction of an environmental control project at Plant Crist. AFUDC decreased $0.8 million, or 68.9%, in 2006 compared to the prior year primarily due to the completion of an environmental control project at Plant Crist Unit 7 during 2005. AFUDC decreased $0.7 million, or 37.1%, in 2005 compared to the prior year primarily due to the construction and completion of an environmental control project at Plant Crist Unit 7. See FUTURE EARNINGS POTENTIAL – "Environmental Matters – Environmental Statutes and Regulations" herein and Note 1 to the financial statements under "Allowance for Funds Used During Construction (AFUDC)" for additional information.

Other Deductions

Other deductions increased $0.3 million, or 6.7%, in 2007, increased $1.5 million, or 52.9%, in 2006, and decreased $1.4 million, or 32.2%, in 2005 compared to the prior years primarily as a result of changes in charitable contributions.

Effects of Inflation

The Company is subject to rate regulation based on the recovery of historical costs. When historical costs are included, or when inflation exceeds projected costs used in rate regulation or market-based prices, the effects of inflation can create an economic loss since the recovery of costs could be in dollars that have less purchasing power. In addition, the income tax laws are based on historical costs. While the inflation rate has been relatively low in recent years, it continues to have an adverse effect on the Company because of the large investment in utility plant with long economic lives. Conventional accounting for historical cost does not recognize this economic loss nor the partially offsetting gain that arises through financing facilities with fixed-money obligations such as long-term debt, preference stock, and preferred securities. Any recognition of inflation by regulatory authorities is reflected in the rate of return allowed in the Company's approved electric rates.

FUTURE EARNINGS POTENTIAL

General

The Company operates as a vertically integrated utility providing electricity to retail customers within its traditional service area located in northwest Florida and to wholesale customers in the Southeast. Prices for electricity provided by the Company to retail customers are set by the Florida PSC under cost-based regulatory principles. Prices for electricity relating to power purchase agreements (PPAs), interconnecting transmission lines, and the exchange of electric power are regulated by the FERC. Retail rates and earnings are reviewed and may be adjusted periodically within certain limitations. See ACCOUNTING POLICIES – "Application of Critical Accounting Policies and Estimates – Electric Utility Regulation" herein and Note 3 to the financial statements for additional information about regulatory matters.

The results of operations for the past three years are not necessarily indicative of future earnings potential. The level of the Company's future earnings depends on numerous factors that affect the opportunities, challenges, and risks of the Company's business of selling electricity. These factors include the ability of the Company to maintain a stable regulatory environment that continues to allow for the recovery of all prudently incurred costs during a time of increasing costs. Future earnings in the near term will depend, in part, upon growth in energy sales, which is subject to a number of factors. These factors include weather, competition, new energy contracts with neighboring utilities, energy conservation practiced by customers, the price of electricity, the price elasticity of demand, and the rate of economic growth in the Company's service area.

Environmental Matters

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

New Source Review Actions

In November 1999, the Environmental Protection Agency (EPA) brought a civil action in the U.S. District Court for the Northern District of Georgia against certain Southern Company subsidiaries, including Alabama Power and Georgia Power, alleging that these subsidiaries had violated the New Source Review (NSR) provisions of the Clean Air Act and related state laws at certain coal-fired generating facilities. Through subsequent amendments and other legal procedures, the EPA filed a separate action in January 2001 against Alabama Power in the U.S. District Court for the Northern District of Alabama after Alabama Power was dismissed from the original action. In these lawsuits, the EPA alleged that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power and Georgia Power. The civil actions request penalties and injunctive relief, including an order requiring the installation of the best available control technology at the affected units. The EPA concurrently issued notices of violation relating to the Company's Plant Crist and a unit partially owned by the Company at Plant Scherer. See Note 4 to the financial statements for information on the Company's ownership interest in Plant Scherer Unit 3. In early 2000, the EPA filed a motion to amend its complaint to add the allegations in the notices of violation and to add the Company as a defendant. However, in March 2001, the court denied the motion based on lack of jurisdiction, and the EPA has not refiled. The action against Georgia Power has been administratively closed since the spring of 2001, and the case has not been reopened.

In June 2006, the U.S. District Court for the Northern District of Alabama entered a consent decree between Alabama Power and the EPA, resolving the alleged NSR violations at Plant Miller. The consent decree required Alabama Power to pay $100,000 to resolve the government's claim for a civil penalty and to donate $4.9 million of sulfur dioxide emission allowances to a nonprofit charitable organization and formalized specific emissions reductions to be accomplished by Alabama Power, consistent with other Clean Air Act programs that require emissions reductions. In August 2006, the district court in Alabama granted Alabama Power's motion for summary judgment and entered final judgment in favor of Alabama Power on the EPA's claims related to the remaining plants.

The plaintiffs appealed the district court's decision to the U.S. Court of Appeals for the Eleventh Circuit, and the appeal was stayed by the Appeals Court pending the U.S. Supreme Court's decision in a similar case against Duke Energy. The Supreme Court issued its decision in the Duke Energy case in April 2007. On October 5, 2007, the U.S. District Court for the Northern District of Alabama issued an order in the Alabama Power case indicating a willingness to re-evaluate its previous decision in light of the Supreme Court's Duke Energy opinion. On December 21, 2007, the Eleventh Circuit vacated the district court's decision in the Alabama Power case and remanded the case back to the district court for consideration of the legal issues in light of the Supreme Court's decision in the Duke Energy case.

The Company believes it complied with applicable laws and the EPA regulations and interpretations in effect at the time the work in question took place. The Clean Air Act authorizes maximum civil penalties of $25,000 to $32,500 per day, per violation at each generating unit, depending on the date of the alleged violation. An adverse outcome in this matter could require substantial capital expenditures or affect the timing of currently budgeted capital expenditures that cannot be determined at this time and could possibly require payment of substantial penalties. Such expenditures could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

The EPA has issued a series of proposed and final revisions to its NSR regulations under the Clean Air Act, many of which have been subject to legal challenges by environmental groups and states. In June 2005, the U.S. Court of Appeals for the District of Columbia Circuit upheld, in part, the EPA's revisions to NSR regulations that were issued in December 2002 but vacated portions of those revisions addressing the exclusion of certain pollution control projects. These regulatory revisions have been adopted by the State of Florida. In March 2006, the U.S. Court of Appeals for the District of Columbia Circuit also vacated an EPA rule which sought to clarify the scope of the existing routine maintenance, repair, and replacement exclusion. The EPA has also published proposed rules clarifying the test for determining when an emissions increase subject to the NSR permitting requirements has occurred. The impact of these proposed rules will depend on adoption of the final rules by the EPA and the State of Florida's implementation of such rules, as well as the outcome of any additional legal challenges, and, therefore, cannot be determined at this time.

Carbon Dioxide Litigation

In July 2004, attorneys general from eight states, each outside of Southern Company's service territory, and the corporation counsel for New York City filed a complaint in the U.S. District Court for the Southern District of New York against Southern Company and four other electric power companies. A nearly identical complaint was filed by three environmental groups in the same court. The complaints allege that the companies' emissions of carbon dioxide, a greenhouse gas, contribute to global warming, which the plaintiffs assert is a public nuisance. Under common law public and private nuisance theories, the plaintiffs seek a judicial order (1) holding each defendant jointly and severally liable for creating, contributing to, and/or maintaining global warming and (2) requiring each of the defendants to cap its emissions of carbon dioxide and then reduce those emissions by a specified percentage each year for at least a decade. Plaintiffs have not, however, requested that damages be awarded in connection with their claims. Southern Company believes these claims are without merit and notes that the complaint cites no statutory or regulatory basis for the claims. In September 2005, the U.S. District Court for the Southern District of New York granted Southern Company's and the other defendants' motions to dismiss these cases. The plaintiffs filed an appeal to the U.S. Court of Appeals for the Second Circuit in October 2005, and no decision has been issued. The ultimate outcome of these matters cannot be determined at this time.

Environmental Statutes and Regulations

General

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; and the

Endangered Species Act. Compliance with these environmental requirements involves significant capital and operating costs, a major portion of which is expected to be recovered through existing ratemaking provisions. Through 2007, the Company had invested approximately \$422 million in capital projects to comply with these requirements, with annual totals of \$124 million, \$46 million, and \$45 million for 2007, 2006, and 2005, respectively. The Company expects that capital expenditures to assure compliance with existing and new statutes and regulations will be an additional \$317 million, \$301 million, and \$134 million for 2008, 2009, and 2010, respectively. The Company's compliance strategy is impacted by changes to existing environmental laws, statutes, and regulations, the cost, availability, and existing inventory of emission allowances, and the Company's fuel mix. Environmental costs that are known and estimable at this time are included in capital expenditures discussed under FINANCIAL CONDITION AND LIQUIDITY – "Capital Requirements and Contractual Obligations" herein.

The Florida Legislature has adopted legislation that allows a utility to petition the Florida PSC for recovery of prudent environmental compliance costs that are not being recovered through base rates or any other recovery mechanism. The legislation is discussed in Note 3 to the financial statements under "Retail Regulatory Matters – Environmental Cost Recovery." Substantially all of the costs for the Clean Air Act and other new environmental legislation discussed below are expected to be recovered through the environmental cost recovery clause.

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, or changes to existing statutes or regulations, could affect many areas of the Company's operations; however, the full impact of any such changes cannot be determined at this time.

Air Quality

Compliance with the Clean Air Act and resulting regulations has been and will continue to be a significant focus for the Company. Through 2007, the Company had spent approximately \$252 million in reducing sulfur dioxide (SO_2) and nitrogen oxide (NO_x) emissions and in monitoring emissions pursuant to the Clean Air Act. Additional controls have been announced and are currently being installed at several plants to further reduce SO_2, NO_x, and mercury emissions, maintain compliance with existing regulations, and meet new requirements.

In 2004, the EPA designated nonattainment areas under an eight-hour ozone standard. No area within the Company's service area was designated as nonattainment under the eight-hour ozone standard. Macon, Georgia, where Plant Scherer is located, was designed as nonattainment under the eight-hour ozone standard. On June 20, 2007, the EPA proposed additional revisions to the current eight-hour ozone standard which, if enacted, could result in designation of new nonattainment areas within the Company's service territory. The EPA has requested comment and is expected to publish final revisions to the standard in 2008. The impact of this decision, if any, cannot be determined at this time and will depend on subsequent legal action and/or future nonattainment designations and state regulatory plans.

During 2005, the EPA's fine particulate matter nonattainment designations became effective for several areas within Georgia. State plans for addressing the nonattainment designations under the existing standard are required by April 2008 and could require further reductions in SO_2 and NO_x emissions from power plants including plants owned in part by the Company. In September 2006, the EPA published a final rule which increased the stringency of the 24-hour average fine particulate matter air quality standard. No area within the Company's service territory has been designated as nonattainment within that standard.

The EPA issued the final Clean Air Interstate Rule (CAIR) in March 2005. This cap-and-trade rule addresses power plant SO_2 and NO_x emissions that were found to contribute to nonattainment of the eight-hour ozone and fine particulate matter standards in downwind states. Twenty-eight eastern states, including Florida, Georgia, and Mississippi, are subject to the requirements of the rule. The rule calls for additional reductions of NO_x and/or SO_2 to be achieved in two phases, 2009/2010 and 2015. The State of Florida has an EPA-approved plan to implement this rule. These reductions will be accomplished by the installation of additional emission controls at the Company's coal-fired facilities and/or by the purchase of emission allowances from a cap-and-trade program. The State of Georgia implemented the CAIR, and in June 2007, approved a "multi-pollutant rule" that will require plant specific emission controls on all but the smallest generating units in Georgia according to a schedule set forth in the rule. The rule is designed to ensure reductions in emissions of SO_2 and NO_x, and mercury in Georgia.

The Clean Air Visibility Rule (CAVR), formerly called the Regional Haze Rule, was finalized in July 2005. The goal of this rule is to restore natural visibility conditions in certain areas (primarily national parks and wilderness areas) by 2064. The rule involves (1) the application of Best Available Retrofit Technology (BART) to certain sources built between 1962 and 1977, and (2) the application of any additional emissions reductions which may be deemed necessary for each designated area to achieve reasonable progress by 2018 toward the natural conditions goal. Thereafter, for each 10-year planning period, additional emissions reductions will be required to continue to demonstrate reasonable progress in each area during that period. For power plants, the CAVR allows states to determine that the CAIR satisfies BART requirements for SO_2 and NO_x. Extensive studies were performed for each of the Company's affected units to demonstrate that additional particulate matter controls are not necessary under BART. Additional analyses will be required for one of the Company's plants in Florida. States are currently completing implementation plans that contain strategies for BART and any other measures required to achieve the first phase of reasonable progress.

The impacts of the eight-hour ozone and the fine particulate matter nonattainment designations, and the CAVR on the Company will depend on the development and implementation of rules at the state level. Therefore, the full effects of these regulations on the Company cannot be determined at this time. The Company has developed and continually updates a comprehensive environmental compliance strategy to comply with the continuing and new environmental requirements discussed above. As part of this strategy, the Company plans to install additional SO_2 and NO_x emission controls within the next several years to assure continued compliance with applicable air quality requirements.

In March 2005, the EPA published the final Clean Air Mercury Rule (CAMR), a cap-and-trade program for the reduction of mercury emissions from coal-fired power plants. The rule sets caps on mercury emissions to be implemented in two phases, 2010 and 2018, and provides for an emission allowance trading market. The final CAMR was challenged in the U.S. Court of Appeals for the District of Columbia Circuit. The petitioners alleged that the EPA was not authorized to establish a cap-and-trade program for mercury emissions and instead the EPA must establish maximum achievable control technology standards for coal-fired electric utility steam generating units. On February 8, 2008, the court issued its ruling and vacated the CAMR. The Company's overall environmental compliance strategy relies primarily on a combination of SO_2 and NOx controls to reduce mercury emissions. Any significant changes in the strategy will depend on the outcome of any appeals and/or future federal and state rulemakings. Future rulemakings could require emission reductions more stringent than required by the CAMR.

Water Quality

In July 2004, the EPA published its final technology-based regulations under the Clean Water Act for the purpose of reducing impingement and entrainment of fish, shellfish, and other forms of aquatic life at existing power plant cooling water intake structures. The rules require baseline biological information and, perhaps, installation of fish protection technology near some intake structures at existing power plants. On January 25, 2007, the U.S. Court of Appeals for the Second Circuit overturned and remanded several provisions of the rule to the EPA for revisions. Among other things, the court rejected the EPA's use of "cost-benefit" analysis and suggested some ways to incorporate cost considerations. The full impact of these regulations will depend on subsequent legal proceedings, further rulemaking by the EPA, the results of studies and analyses performed as part of the rules' implementation, and the actual requirements established by the Florida Department of Environmental Protection (FDEP) and, therefore, cannot be determined at this time.

Environmental Remediation

The Company must comply with other environmental laws and regulations that cover the handling and disposal of waste and release of hazardous substances. Under these various laws and regulations, the Company could incur substantial costs to clean up properties. The Company conducts studies to determine the extent of any required cleanup and has recognized in its financial statements the costs to clean up known sites. During the second quarter 2007, the Company increased its estimated liability for environmental remediation projects by $12.8 million as a result of changes in the cost estimates to remediate substation sites. These projects have been approved by the Florida PSC for recovery through the environmental cost recovery clause; therefore, there was no impact on the Company's net income as a result of these revised estimates. See Note 3 to the financial statements under "Environmental Matters – Environmental Remediation" for additional information.

Global Climate Issues

Federal legislative proposals that would impose mandatory requirements related to greenhouse gas emissions continue to be considered in Congress. The ultimate outcome of these proposals cannot be determined at this time; however, mandatory restrictions on the Company's greenhouse gas emissions could result in significant additional compliance costs that could affect future unit retirement and replacement decisions and results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

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

On July 13, 2007, the Governor of the State of Florida signed three executive orders addressing reduction of greenhouse gas emissions within the state, including statewide emission reduction targets beginning in 2017. Included in the orders is a directive to the Florida Secretary of Environmental Protection to develop rules adopting maximum allowable emissions levels of greenhouse gases for electric utilities, consistent with the statewide emission reduction targets, and a request to the Florida PSC to initiate rulemaking requiring utilities to produce at least 20% of their electricity from renewable sources. The impact of these orders on 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 outcome and impact of the international negotiations cannot be determined at this time. The Company continues to evaluate its future energy and emission profiles and is participating in voluntary programs to reduce greenhouse gas emissions and to help develop and advance technology to reduce emissions.

FERC Matters

Market-Based Rate Authority

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 $0.8 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 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 (including the Company), Southern Power, and Southern Company Services, Inc., as agent, under the terms of which the power pool of Southern Company is operated, (2) whether any parties to the IIC have violated the FERC's standards of conduct applicable to utility companies that are transmission providers, and (3) whether Southern Company's code of conduct defining Southern Power as a "system company" rather than a "marketing affiliate" is just and reasonable. In connection with the formation of Southern Power, the FERC authorized Southern Power's inclusion in the IIC in 2000. The FERC also previously approved Southern Company's code of conduct.

In October 2006, the FERC issued an order accepting a settlement resolving the proceeding subject to Southern Company's agreement to accept certain modifications to the settlement's terms and Southern Company notified the FERC that it accepted the modifications. The modifications largely involve functional separation and information restrictions related to marketing activities conducted on behalf of Southern Power. Southern Company filed with the FERC in November 2006 a compliance plan in connection with the order. On April 19, 2007, the FERC approved, with certain modifications, the plan submitted by Southern Company. Implementation of the plan is not expected to have a material impact on the Company's financial statements. On November 19, 2007, Southern Company notified the FERC that the plan had been implemented and the FERC division of audits subsequently began an audit pertaining to compliance implementation and related matters, which is ongoing.

PSC Matters

Fuel Cost Recovery

The Company petitions for fuel cost recovery rates to be approved by the Florida PSC on an annual basis. At December 31, 2007 and 2006, the under recovered balance was $56.6 million and $77.5 million, respectively, primarily due to lower quantity and price for power sales in 2007 and 2006, and increased costs for coal and a higher percentage of natural gas fired generation in 2006. The Company continuously monitors the under recovered fuel cost balance in light of the inherent variability in fuel costs. If the projected fuel revenue over or under recovery exceeds 10% of the projected fuel revenue applicable for the period, the Company is required to notify the Florida PSC and indicate if an adjustment to the fuel cost recovery factor is being requested. The Company filed a notice with the Florida PSC in June 2007, and no adjustment to the factor was requested.

In November 2007, the Florida PSC approved an increase of approximately 0.4% in the fuel factor for retail customers, effective with billings beginning January 2008. The fuel factors are intended to allow the Company to recover its projected 2008 fuel and purchased power costs as well as the 2007 under recovered amounts in 2008. Fuel cost recovery revenues, as recorded on the financial statements, are adjusted for differences in actual recoverable costs and amounts billed in current regulated rates. Accordingly, changing the billing factor has no significant effect on the Company's revenues or net income, but does impact annual cash flow. See Note 1 to the financial statements under "Revenues."

Environmental Cost Recovery

On August 14, 2007, the Florida PSC voted to approve a stipulation among the Company, the Office of Public Counsel, and the Florida Industrial Power Users Group regarding the Company's plan for complying with certain federal and state regulations addressing air quality. The Company's environmental compliance plan as filed on March 29, 2007 contemplated implementation of specific projects identified in the plan from 2007 through 2018. The stipulation covers all elements of the current plan that are scheduled to be implemented in the 2007 through 2011 timeframe. The Florida PSC acknowledged that the costs associated with the Company's CAIR/CAMR/CAVR compliance plan are clearly eligible for recovery through the environment cost recovery clause. See FINANCIAL CONDITION AND LIQUIDITY - "Capital Requirements and Contractual Obligations" herein, Note 3 to the financial statements under "Environmental Matters - Environmental Cost Recovery," and Note 7 to the financial statements under "Construction Program" for additional information.

Storm Damage Cost Recovery

Under authority granted by the Florida PSC, the Company maintains a reserve for property damage to cover the cost of uninsured damages from major storms to its transmission and distribution facilities, generation facilities, and other property. As of December 31, 2007, the under recovered balance in the Company's property damage reserve totaled approximately $18.6 million, which is included in current assets in the balance sheets. As of December 31, 2007, the storm-recovery costs associated with Hurricane Ivan had been fully recovered. Funds collected by the Company through its storm-recovery surcharge are now being credited to the property reserve for recovery of the storm restoration costs of $52.6 million associated with Hurricanes Dennis and Katrina that were previously charged to the reserve.

See Notes 1 and 3 to the financial statements under "Property Damage Reserve" and "Storm Damage Cost Recovery," respectively, for additional information.

Income Tax Matters

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.

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

Right of Way Litigation

In September 2007, the Company and its co-defendant in the Gadsden County litigation reached a proposed settlement agreement with the plaintiffs that, if approved by the trial court, will resolve all outstanding claims against the Company in both the Gadsden County litigation and the 2001 telecommunications company litigation. On November 7, 2007, the trial court granted preliminary approval and set forth the requirements for the trial court to make its final determination on the proposed settlement. Although the final outcome of this matter cannot now be determined, if approved the settlement is not expected to have a material effect on the financial statements of the Company. See Note 3 to the financial statements under "Right of Way Litigation" for additional information.

Other Matters

In 2004, Georgia Power and the Company entered into PPAs with Florida Power & Light Company (FP&L) and Progress Energy Florida. Under the agreements, Georgia Power and the Company will provide FP&L and Progress Energy Florida with 165 megawatts and 74 megawatts, respectively, of capacity annually from the jointly owned Plant Scherer Unit 3 for the period from June 2010 through December 2015. The contracts provide for fixed capacity payments and variable energy payments based on actual energy delivered. The Florida PSC approved the contracts in 2005.

Also in 2004, Georgia Power and the Company entered into a PPA with Flint Electric Membership Corporation. Under the agreement, Georgia Power and the Company will provide Flint Electric Membership Corporation with 75 megawatts of capacity annually from the jointly owned Plant Scherer Unit 3 for the period from June 2010 through December 2019. The contract provides for fixed capacity payments and variable energy payments based on actual energy delivered.

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

Electric Utility Regulation

The Company is subject to retail regulation by the Florida PSC and wholesale regulation by the FERC. These regulatory agencies set the rates the Company is permitted to charge customers based on allowable costs. As a result, the Company applies Financial Accounting Standards Board (FASB) Statement No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), which requires the financial statements to reflect the effects of rate regulation. Through the ratemaking process, the regulators may require the inclusion of costs or revenues in periods different than when they would be recognized by a non-regulated company. This treatment may result in the deferral of expenses and the recording of related regulatory assets based on anticipated future recovery through rates or the deferral of gains or creation of liabilities and the recording of related regulatory liabilities. The application of SFAS No. 71 has a further effect on the Company's financial statements as a result of the estimates of allowable costs used in the ratemaking process. These estimates may differ from those actually incurred by the Company; therefore, the accounting estimates inherent in specific costs such as depreciation and pension and postretirement benefits have less of a direct impact on the Company's results of operations than they would on a non-regulated company.

As reflected in Note 1 to the financial statements, significant regulatory assets and liabilities have been recorded. Management reviews the ultimate recoverability of these regulatory assets and liabilities based on applicable regulatory guidelines and accounting principles generally accepted in the United States. However, adverse legislative, judicial, or regulatory actions could materially impact the amounts of such regulatory assets and liabilities and could adversely impact the Company's financial statements.

Contingent Obligations

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.

Unbilled Revenues

Revenues related to the sale of electricity are recorded when electricity is delivered to customers. However, the determination of KWH sales to individual customers is based on the reading of their meters, which is performed on a systematic basis throughout the month. At the end of each month, amounts of electricity delivered to customers, but not yet metered and billed, are estimated. Components of the unbilled revenue estimates include total KWH territorial supply, total KWH billed, estimated total electricity lost in delivery, and customer usage. These components can fluctuate as a result of a number of factors including weather, generation patterns, and power delivery volume and other operational constraints. These factors can be unpredictable and can vary from historical trends. As a result, the overall estimate of unbilled revenues could be significantly affected, which could have a material impact on the Company's results of operations.

New Accounting Standards

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.

Pensions and Other Postretirement Plans

On December 31, 2006, the Company adopted FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158), which requires recognition of the funded status of its defined benefit postretirement plans in the balance sheets. Additionally, SFAS No. 158 will require the Company to change the measurement date for its defined benefit postretirement plan assets and obligations from September 30 to December 31 beginning with the year ending December 31, 2008. See Note 2 to the financial statements for additional information.

Fair Value Measurement

The FASB issued FASB Statement No. 157, "Fair Value Measurements" (SFAS No. 157) in September 2006. SFAS No. 157 provides guidance on how to measure fair value where it is permitted or required under other accounting pronouncements. SFAS No. 157 also requires additional disclosures about fair value measurements. 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.

FINANCIAL CONDITION AND LIQUIDITY

Overview

The Company's financial condition remained stable at December 31, 2007. Net cash flow from operating activities totaled $217.0 million, $143.4 million, and $152.7 million for 2007, 2006, and 2005, respectively. The $73.6 million increase in net cash flows in 2007 was due primarily to increased cash inflows for fuel cost recovery. The $9.3 million decrease in net cash flows in 2006 was due primarily to increased payments related to income taxes and fuel. The $8.2 million increase in net cash flows in 2005 was due primarily to the recovery of Hurricane Ivan restoration costs. Net cash used for investing activities totaled $239.3 million due to gross property additions to utility plant. Funds for the Company's property additions were provided by operating activities, capital contributions, and other financing activities. Net cash provided from financing activities totaled $20.2 million in 2007, compared to $24.7 million in 2006. See the statements of cash flows for additional information.

Significant balance sheet changes in 2007 included a $97.2 million increase in common stockholder's equity primarily due to the issuance of 800,000 shares of common stock to Southern Company, without par value, and realized proceeds of $80 million. Other significant balance sheet changes in 2007 included a net increase of $162.1 million in property, plant, and equipment, the issuance of $45 million in preference stock, and the issuance of $85 million in long-term debt, partially offset by the redemption of $41.2 million in long-term debt payable to affiliated trusts.

The Company's ratio of common equity to total capitalization, including short-term debt, was 45.3% in 2007, 42.1% in 2006, and 43.0% in 2005. See Note 6 to the financial statements for additional information.

The Company has received investment grade ratings from the major rating agencies with respect to its debt and preference stock.

Sources of Capital

The Company plans to obtain the funds required for construction and other purposes from sources similar to those used in the past, which were primarily from operating cash flows, securities issuances, term loans, and short-term indebtedness. However, the type and timing of any future financings, if needed, will depend on market conditions, regulatory approval, and other factors.

Security issuances are subject to regulatory approval by the Florida PSC pursuant to its rules and regulations. 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 Florida PSC, as well as the amounts, if any, registered under the 1933 Act, are continuously monitored and appropriate filings are made to ensure flexibility in the capital markets.

The Company obtains financing separately without credit support from any affiliate. See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information. The Southern Company system does not maintain a centralized cash or money pool. Therefore, funds of the Company are not commingled with funds of any other company.

To meet short-term cash needs and contingencies, the Company has various internal and external sources of liquidity. At the beginning of 2008, the Company had approximately $5.3 million of cash and cash equivalents, along with $125 million of unused committed lines of credit with banks to meet its short-term cash needs. These bank credit arrangements will expire during 2008. The Company plans to renew these lines of credit during 2008. In addition, the Company has substantial cash flow from operating activities and access to the capital markets including commercial paper programs to meet liquidity needs. See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information.

The Company may also meet short-term cash needs through a Southern Company subsidiary organized to issue and sell commercial paper and extendible commercial notes at the request and for the benefit of the Company and the other traditional operating companies. Proceeds from such issuances for the benefit of the Company are loaned directly to the Company and are not commingled with proceeds from such issuances for the benefit of any other traditional operating company. There is no cross affiliate credit support. At December 31, 2007, the Company had $40.8 million of commercial paper outstanding. In addition, the Company had $3.8 million in notes payable outstanding to General Electric.

Financing Activities

During 2007, the Company issued $85 million of senior notes and $45 million of preference stock. The proceeds were used to repay a portion of short-term indebtedness and for other general corporate purposes, including the Company's continuous construction program.

On January 19, 2007, the Company issued to Southern Company 800,000 shares of the Company's common stock, without par value, and realized proceeds of $80 million. The proceeds were used to repay a portion of the Company's short-term indebtedness and for other general corporate purposes.

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- or Baa3, or below. Generally, collateral may be provided for by a Southern Company guaranty, letter of credit, or cash. These contracts are primarily for physical electricity purchases and sales. At December 31, 2007, the maximum potential collateral requirements at a BBB- or Baa3 rating were approximately \$23 million. The maximum potential collateral requirements at a rating below BBB- or Baa3 were approximately \$46 million.

The Company, along with all members of the Southern Company power pool, is party to certain derivative agreements that could require collateral and/or accelerated payment in the event of a credit rating change to below investment grade for Alabama Power and/or Georgia Power. These agreements are primarily for natural gas and power price risk management activities. At December 31, 2007, the Company's total exposure to these types of agreements was approximately \$15 million.

Market Price Risk

Due to cost-based rate regulation, the Company has limited exposure to market volatility in interest rates, commodity fuel prices, and prices of electricity. To manage the volatility attributable to these exposures, the Company nets the exposures to take advantage of natural offsets and enters into various derivative transactions for the remaining exposures pursuant to the Company's policies in areas such as counterparty exposure and risk management practices. Company policy is that derivatives are to be used primarily for hedging purposes and mandates strict adherence to all applicable risk management policies. Derivative positions are monitored using techniques including but not limited to market valuation, value at risk, stress testing, and sensitivity analysis.

To mitigate residual risks relative to movements in electricity prices, the Company enters into fixed-price contracts for the purchase and sale of electricity through the wholesale electricity market and, to a lesser extent, into financial hedge contracts for natural gas purchases. The Company has implemented a fuel-hedging program with the approval of the Florida PSC.

Of the Company's remaining \$144.6 million of variable interest rate exposure, approximately \$141 million relates to tax-exempt auction rate pollution control bonds. Recent weakness in the auction markets has resulted in higher interest rates. The Company has sent notice of conversion related to \$37 million of these auction rate securities to alternative interest rate determination methods and plans to remarket all remaining auction rate securities in a timely manner. None of the securities are insured or backed by letters of credit that would require approval of a guarantor or security provider. It is not expected that the higher rates as a result of the weakness in the auction markets will be material.

The weighted average interest rate on \$144.6 million variable long-term debt that has not been hedged at January 1, 2008 was 4.50%. If the Company sustained a 100 basis point change in interest rates for all variable rate long-term debt, the change would affect annualized interest expense by approximately \$1.4 million at January 1, 2008. See Notes 1 and 6 to the financial statements under "Financial Instruments" for additional information.

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

	Changes in Fair Value	
	2007	2006
	(in thousands)	
Contracts beginning of year	**$ (7,186)**	$ 11,526
Contracts realized or settled	**6,640**	8,363
New contracts at inception	**-**	-
Changes in valuation techniques	**-**	-
Current period changes(a)	**344**	(27,075)
Contracts end of year	**$ (202)**	$ (7,186)

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

	Source of 2007 Year-End Valuation Prices		
	Total Fair Value	Maturity	
		Year 1	1-3 Years
	(in thousands)		
Actively quoted	**$ (305)**	**$ (1,151)**	**$ 846**
External sources	**103**	**103**	**-**
Models and other methods	**-**	**-**	**-**
Contracts end of year	**$ (202)**	**$ (1,048)**	**$ 846**

Unrealized gains and losses from mark-to-market adjustments on derivative contracts related to the Company's fuel hedging programs are recorded as regulatory assets and liabilities. Realized gains and losses from these programs are included in fuel expense and are recovered through the Company's fuel cost recovery clause. Gains and losses on derivative contracts that are not designated as hedges are recognized in the statements of income as incurred. At December 31, 2007, the fair value gains/(losses) of energy-related derivative contracts were reflected in the financial statements as follows:

	Amounts
	(in thousands)
Regulatory assets, net	**$ (202)**
Net income	**-**
Total fair value	**$ (202)**

Unrealized (losses) recognized in income were not material in 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 Moody's and Standard & Poor'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. See Notes 1 and 6 to the financial statements under "Financial Instruments" for additional information.

Capital Requirements and Contractual Obligations

The construction program of the Company is currently estimated to be $410 million in 2008, $426 million in 2009, and $245 million in 2010. Environmental expenditures included in these estimated amounts are $317 million in 2008, $301 million in 2009, and $134 million in 2010. Actual construction costs may vary from these estimates because of changes in such factors 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. In addition, there can be no assurance that costs related to capital expenditures will be fully recovered.

The Company does not have any new generating capacity under construction. Construction of new transmission and distribution facilities and capital improvements, including those needed to meet environmental standards for the Company's existing generation, transmission, and distribution facilities, is ongoing.

The Company has entered into two PPAs, one of which is with Southern Power, for a total of approximately 487 megawatts annually from June 2009 through May 2014. The PPAs were the result of a competitive request for proposals process initiated by the Company in January 2006 to address the anticipated need for additional capacity beginning in 2009. On May 11, 2007, the Florida PSC issued an order approving both PPAs for purposes of cost recovery through the Company's purchased power capacity clause. The PPA with Southern Power was approved by the FERC on July 13, 2007.

As discussed in Note 2 to the financial statements, the Company provides postretirement benefits to substantially all employees and funds trusts to the extent required by the FERC and the Florida PSC.

Other funding requirements related to obligations associated with scheduled maturities of long-term debt, as well as the related interest, derivative obligations, preference stock dividends, leases, and other purchase commitments are as follows. See Notes 1, 6, and 7 to the financial statements for additional information.

Contractual Obligations

	2008	2009-2010	2011-2012	After 2012	Total
			(in thousands)		
Long-term debt[(a)] –					
Principal	$ -	$ -	$ -	$ 747,555	$ 747,555
Interest	38,788	77,576	77,576	500,354	694,294
Other derivative obligations[(b)]	4,065	23	-	-	4,088
Preference stock dividends[(c)]	6,203	12,405	12,405	-	31,013
Operating leases	3,388	4,204	1,114	2,793	11,499
Purchase commitments[(d)] –					
Capital[(e)]	410,190	670,703	-	-	1,080,893
Limestone[(f)]	-	5,699	11,829	46,319	63,847
Coal	221,177	164,150	-	-	385,327
Natural gas[(g)]	116,163	153,940	40,618	169,540	480,261
Purchased power	-	50,643	53,788	30,988	135,419
Long-term service agreements[(h)]	6,111	14,771	16,867	31,293	69,042
Postretirement benefits trust[(i)]	60	40	-	-	100
Total	$ 806,145	$ 1,154,154	$ 214,197	$ 1,528,842	$ 3,703,338

(a) All amounts are reflected based on final maturity dates. The Company plans to continue to retire higher-cost securities and replace these obligations with lower-cost capital if market conditions permit. Variable rate interest obligations are estimated based on rates as of January 1, 2008, as reflected in the statements of capitalization.

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

(c) Preference stock does not mature; therefore, amounts are provided for the next five years only.

(d) 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 $270 million, $260 million, and $250 million, respectively.

(e) The Company forecasts capital expenditures over a three-year period. Amounts represent current estimates of total expenditures. At December 31, 2007, significant purchase commitments were outstanding in connection with the construction program.

(f) As part of the Company's program to reduce sulfur dioxide emissions from certain of its coal plants, the Company is constructing certain equipment and has entered into various long-term commitments for the procurement of limestone to be used in such equipment.

(g) Natural gas purchase commitments are based on various indices at the time of delivery. Amounts reflected have been estimated based on the New York Mercantile Exchange future prices at December 31, 2007.

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

(i) The Company forecasts postretirement trust contributions over a three-year period. No contributions related to the Company's pension trust are currently expected during this period. See Note 2 to the financial statements for additional information related to the pension and postretirement plans, including estimated benefit payments. Certain benefit payments will be made through the related trusts. Other benefit payments will be made from the Company's corporate assets.

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 retail rates, storm damage cost recovery and repairs, fuel cost recovery, environmental regulations and expenditures, earnings growth, access to sources of capital, projections for postretirement benefit trust contributions, financing activities, completion of construction projects, impacts of adoption of new accounting rules, and estimated construction and other expenditures. In some cases, forward-looking statements can be identified by terminology such as "may," "will," "could," "should," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "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 and the EPA civil actions against the Company;
- 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;
- ability to control costs;
- investment performance of the Company's employee benefit plans;
- advances in technology;
- state and federal rate regulations and the impact of pending and future rate cases and negotiations, including rate actions relating to fuel and storm restoration cost recovery;
- 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.

STATEMENTS OF INCOME
For the Years Ended December 31, 2007, 2006, and 2005
Gulf Power Company 2007 Annual Report

	2007	2006	2005
		(in thousands)	
Operating Revenues:			
Retail revenues	**$1,006,329**	$952,038	$864,859
Wholesale revenues --			
Non-affiliates	**83,514**	87,142	84,346
Affiliates	**113,178**	118,097	91,352
Other revenues	**56,787**	46,637	43,065
Total operating revenues	**1,259,808**	1,203,914	1,083,622
Operating Expenses:			
Fuel	**573,354**	534,921	415,789
Purchased power --			
Non-affiliates	**11,994**	16,288	29,995
Affiliates	**59,499**	57,536	68,402
Other operations	**201,768**	192,375	176,620
Maintenance	**68,672**	67,144	73,150
Depreciation and amortization	**85,613**	89,170	85,002
Taxes other than income taxes	**82,992**	79,808	76,387
Total operating expenses	**1,083,892**	1,037,242	925,345
Operating Income	**175,916**	166,672	158,277
Other Income and (Expense):			
Interest income	**5,348**	5,228	3,804
Interest expense, net of amounts capitalized	**(44,680)**	(44,133)	(40,317)
Other income (expense), net	**(1,502)**	(3,185)	(813)
Total other income and (expense)	**(40,834)**	(42,090)	(37,326)
Earnings Before Income Taxes	**135,082**	124,582	120,951
Income taxes	**47,083**	45,293	44,981
Net Income	**87,999**	79,289	75,970
Dividends on Preferred and Preference Stock	**3,881**	3,300	761
Net Income After Dividends on Preferred and Preference Stock	**$ 84,118**	$ 75,989	$ 75,209

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

STATEMENTS OF CASH FLOWS

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

Gulf Power Company 2007 Annual Report

	2007	2006	2005
		(in thousands)	
Operating Activities:			
Net income	**$ 87,999**	$ 79,289	$ 75,970
Adjustments to reconcile net income			
to net cash provided from operating activities --			
Depreciation and amortization	**90,694**	94,466	90,890
Deferred income taxes	**(10,818)**	1,170	33,161
Pension, postretirement, and other employee benefits	**6,062**	3,319	375
Stock option expense	**1,141**	1,005	-
Tax benefit of stock options	**344**	211	3,502
Hedge settlements	**3,030**	(5,399)	-
Other, net	**(9,448)**	6,931	3,958
Changes in certain current assets and liabilities --			
Receivables	**10,302**	(36,795)	(46,248)
Fossil fuel stock	**5,025**	(31,297)	(11,740)
Materials and supplies	**(2,625)**	(2,330)	3,785
Prepaid income taxes	**7,177**	(7,060)	31,898
Property damage cost recovery	**25,103**	24,544	20,045
Other current assets	**(632)**	(955)	3,453
Accounts payable	**(555)**	13,876	(72,532)
Accrued taxes	**4,773**	(455)	6,847
Accrued compensation	**(1,322)**	(3,251)	311
Other current liabilities	**732**	6,165	9,011
Net cash provided from operating activities	**216,982**	143,434	152,686
Investing Activities:			
Property additions	**(241,538)**	(154,377)	(143,171)
Cost of removal net of salvage	**(9,408)**	(4,564)	(8,504)
Construction payables	**10,817**	3,309	(8,806)
Other	**803**	(8,779)	(440)
Net cash used for investing activities	**(239,326)**	(164,411)	(160,921)
Financing Activities:			
Increase (decrease) in notes payable, net	**(75,821)**	30,981	39,465
Proceeds --			
Senior notes	**85,000**	110,000	60,000
Common stock issued to parent	**80,000**	-	-
Preferred and preference stock	**45,000**	-	55,000
Gross excess tax benefit of stock options	**799**	423	-
Capital contributions from parent company	**4,174**	26,140	(94)
Redemptions --			
Pollution control bonds	**-**	(12,075)	-
First mortgage bonds	**-**	(25,000)	(30,000)
Other long-term debt	**-**	-	(100,000)
Preferred and preference stock	**-**	-	(4,236)
Other long-term debt	**(41,238)**	(30,928)	-
Payment of preferred and preference stock dividends	**(3,300)**	(3,300)	(761)
Payment of common stock dividends	**(74,100)**	(70,300)	(68,400)
Other	**(348)**	(1,285)	(3,721)
Net cash provided from (used for) financing activities	**20,166**	24,656	(52,747)
Net Change in Cash and Cash Equivalents	**(2,178)**	3,679	(60,982)
Cash and Cash Equivalents at Beginning of Year	**7,526**	3,847	64,829
Cash and Cash Equivalents at End of Year	**$ 5,348**	$ 7,526	$ 3,847
Supplemental Cash Flow Information:			
Cash paid during the period for --			
Interest (net of $1,048, $160, and $515 capitalized, respectively)	**$35,237**	$37,297	$35,786
Income taxes (net of refunds)	**39,228**	54,533	(27,912)

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

BALANCE SHEETS
At December 31, 2007 and 2006
Gulf Power Company 2007 Annual Report

Assets	**2007**	2006
	(in thousands)	
Current Assets:		
Cash and cash equivalents	**$ 5,348**	$ 7,526
Receivables --		
Customer accounts receivable	**63,227**	56,489
Unbilled revenues	**39,000**	38,287
Under recovered regulatory clause revenues	**58,435**	79,235
Other accounts and notes receivable	**7,162**	9,015
Affiliated companies	**19,377**	15,302
Accumulated provision for uncollectible accounts	**(1,711)**	(1,279)
Fossil fuel stock, at average cost	**71,012**	76,036
Materials and supplies, at average cost	**45,763**	35,306
Property damage cost recovery	**18,585**	28,771
Other regulatory assets	**10,220**	15,977
Other	**14,878**	14,259
Total current assets	**351,296**	374,924
Property, Plant, and Equipment:		
In service	**2,678,952**	2,574,517
Less accumulated provision for depreciation	**931,968**	901,564
	1,746,984	1,672,953
Construction work in progress	**150,870**	62,815
Total property, plant, and equipment	**1,897,854**	1,735,768
Other Property and Investments	**4,563**	14,846
Deferred Charges and Other Assets:		
Deferred charges related to income taxes	**17,847**	17,148
Prepaid pension costs	**107,151**	69,895
Other regulatory assets	**97,492**	110,077
Other	**22,784**	17,831
Total deferred charges and other assets	**245,274**	214,951
Total Assets	**$2,498,987**	$2,340,489

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

BALANCE SHEETS

At December 31, 2007 and 2006

Gulf Power Company 2007 Annual Report

Liabilities and Stockholder's Equity	**2007**	2006
	(in thousands)	
Current Liabilities:		
Notes payable	**$ 44,625**	$120,446
Accounts payable --		
Affiliated	**39,375**	44,375
Other	**56,823**	49,979
Customer deposits	**24,885**	21,363
Accrued taxes --		
Income taxes	**30,026**	29,771
Other	**10,577**	15,033
Accrued interest	**7,698**	7,645
Accrued compensation	**15,096**	16,932
Other regulatory liabilities	**6,027**	9,029
Other	**32,023**	30,975
Total current liabilities	**267,155**	345,548
Long-term Debt (See accompanying statements)	**740,050**	696,098
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	**240,101**	237,862
Accumulated deferred investment tax credits	**12,988**	14,721
Employee benefit obligations	**74,021**	73,922
Other cost of removal obligations	**172,876**	165,410
Other regulatory liabilities	**82,741**	46,485
Other	**79,802**	72,533
Total deferred credits and other liabilities	**662,529**	610,933
Total Liabilities	**1,669,734**	1,652,579
Preferred and Preference Stock (See accompanying statements)	**97,998**	53,887
Common Stockholder's Equity (See accompanying statements)	**731,255**	634,023
Total Liabilities and Stockholder's Equity	**$2,498,987**	$2,340,489
Commitments and Contingent Matters (See notes)		

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

STATEMENTS OF CAPITALIZATION
At December 31, 2007 and 2006
Gulf Power Company 2007 Annual Report

	2007	2006	**2007**	2006
	(in thousands)		*(percent of total)*	
Long Term Debt:				
Long-term debt payable to affiliated trusts --				
5.60% due 2042	**-**	41,238		
Long-term notes payable --				
4.35% to 5.90% due 2013-2044	**590,000**	505,000		
Total long-term notes payable	**590,000**	505,000		
Other long-term debt --				
Pollution control revenue bonds --				
4.80% due September 1, 2028	**13,000**	13,000		
Variable rates (3.79% to 5.10% at 1/1/08) due 2022-2037	**144,555**	144,555		
Total other long-term debt	**157,555**	157,555		
Unamortized debt discount	**(7,505)**	(7,695)		
Total long-term debt (annual interest requirement -- $38.8 million)	**740,050**	696,098	**47.2%**	50.3%
Preferred and Preference Stock:				
Authorized - 2007: 20,000,000 shares--preferred stock				
- 2007: 10,000,000 shares--preference stock				
- 2006: 20,000,000 shares--preferred stock				
- 2006: 10,000,000 shares--preference stock				
Outstanding - $100 par or stated value -- 6% preference stock	**53,886**	53,887		
-- 6.45% preference stock	**44,112**	-		
- 2007: 1,000,000 shares (non-cumulative)				
- 2006: 550,000 shares (non-cumulative)				
Total preferred and preference stock				
(annual dividend requirement -- $6.2 million)	**97,998**	53,887	**6.2**	3.9
Common Stockholder's Equity:				
Common stock, without par value --				
Authorized - 2007: 20,000,000 shares				
- 2006: 20,000,000 shares				
Outstanding - 2007: 1,792,717 shares				
- 2006: 992,717 shares	**118,060**	38,060		
Paid-in capital	**435,008**	428,592		
Retained earnings	**181,986**	171,968		
Accumulated other comprehensive income (loss)	**(3,799)**	(4,597)		
Total common stockholder's equity	**731,255**	634,023	**46.6**	45.8
Total Capitalization	**$1,569,303**	$1,384,008	**100.0%**	100.0%

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

STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

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

Gulf Power Company 2007 Annual Report

	Common Stock	Paid-In Capital	Retained Earnings	Other Comprehensive Income (Loss)	Total
			(in thousands)		
Balance at December 31, 2004	$38,060	$397,396	$159,581	$ (2,865)	$592,172
Net income after dividends on preferred stock	-	-	75,209	-	75,209
Capital contributions from parent company	-	3,408	-	-	3,408
Other comprehensive income (loss)	-	-	-	55	55
Cash dividends on common stock	-	-	(68,400)	-	(68,400)
Other	-	11	(111)	-	(100)
Balance at December 31, 2005	38,060	400,815	166,279	(2,810)	602,344
Net income after dividends on preferred and preference stock	-	-	75,989	-	75,989
Capital contributions from parent company	-	27,777	-	-	27,777
Other comprehensive income (loss)	-	-	-	(3,112)	(3,112)
Adjustment to initially apply FASB Statement No. 158, net of tax	-	-	-	1,325	1,325
Cash dividends on common stock	-	-	(70,300)	-	(70,300)
Balance at December 31, 2006	**38,060**	**428,592**	**171,968**	**(4,597)**	**634,023**
Net income after dividends on preference stock	**-**	**-**	**84,118**	**-**	**84,118**
Issuance of common stock	**80,000**	**-**	**-**	**-**	**80,000**
Capital contributions from parent company	**-**	**6,458**	**-**	**-**	**6,458**
Other comprehensive income (loss)	**-**	**-**	**-**	**798**	**798**
Cash dividends on common stock	**-**	**-**	**(74,100)**	**-**	**(74,100)**
Other	**-**	**(42)**	**-**	**-**	**(42)**
Balance at December 31, 2007	**$118,060**	**$435,008**	**$181,986**	**$(3,799)**	**$731,255**

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

STATEMENTS OF COMPREHENSIVE INCOME

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

Gulf Power Company 2007 Annual Report

	2007	2006	2005
		(in thousands)	
Net income after dividends on preferred and preference stock	**$84,118**	$75,989	$75,209
Other comprehensive income (loss):			
Qualifying hedges:			
Changes in fair value, net of tax of $232, $(2,082), and $-, respectively	**371**	(3,317)	-
Reclassification adjustment for amounts included in net income, net of tax of $269, $140, and $126, respectively	**427**	224	201
Pension and other postretirement benefit plans:			
Change in additional minimum pension liability, net of tax of $-, $(13), and $(91), respectively	**-**	(19)	(146)
Total other comprehensive income (loss)	**798**	(3,112)	55
Comprehensive Income	**$84,916**	$72,877	$75,264

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Gulf Power Company (the Company) is a wholly owned subsidiary of Southern Company, which is the parent company of four traditional operating companies, Southern Power Company (Southern Power), Southern Company Services, Inc. (SCS), Southern Communications Services, Inc. (SouthernLINC Wireless), Southern Company Holdings, Inc. (Southern Holdings), Southern Nuclear Operating Company, Inc. (Southern Nuclear), and other direct and indirect subsidiaries. The traditional operating companies, Alabama Power, Georgia Power, the Company, and Mississippi Power, are vertically integrated utilities providing electric service in four Southeastern states. The Company provides retail service to customers in northwest Florida and to wholesale customers in the Southeast. Southern Power constructs, acquires, and manages generation assets and sells electricity at market-based rates in the wholesale market. SCS, the system service company, provides, at cost, specialized services to Southern Company and the subsidiary companies. SouthernLINC Wireless provides digital wireless communications services to the traditional operating companies and also markets these services to the public and provides fiber cable services within the Southeast. Southern Holdings is an intermediate holding company subsidiary for Southern Company's investments in synthetic fuels and leveraged leases and various other energy-related businesses. The investments in synthetic fuels ended on December 31, 2007. Southern Nuclear operates and provides services to Southern Company's nuclear power plants.

The equity method is used for subsidiaries in which the Company has significant influence but does not control and for variable interest entities where the Company is not the primary beneficiary.

The Company is subject to regulation by the Federal Energy Regulatory Commission (FERC) and the Florida Public Service Commission (PSC). The Company follows accounting principles generally accepted in the United States and complies with the accounting policies and practices prescribed by its regulatory commissions. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates, and the actual results may differ from those estimates.

Reclassifications

Certain prior years' data presented in the financial statements have been reclassified to conform to current year presentation. These reclassifications had no effect on total assets, net income, or cash flows. For presentation purposes, the balance sheets and the statements of cash flows have been modified to combine "Long-term Debt Payable to Affiliate Trusts" into "Long-term Debt." Correspondingly, the statements of income were modified to report "Interest expense to affiliate trusts" together with "Interest expense, net of amounts capitalized."

Affiliate Transactions

The Company has an agreement with SCS under which the following services are rendered to the Company at direct or allocated cost: 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 operations. Costs for these services amounted to $73 million, $59 million, and $54 million during 2007, 2006, and 2005, respectively. 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.

The Company has agreements with Georgia Power and Mississippi Power under which the Company owns a portion of Plant Scherer and Plant Daniel, respectively. Georgia Power operates Plant Scherer and Mississippi Power operates Plant Daniel. The Company reimbursed Georgia Power $5.1 million, $8.0 million, and $4.3 million and Mississippi Power $23.1 million, $19.7 million, and $19.5 million in 2007, 2006, and 2005, respectively, for its proportionate share of related expenses. See Note 4 and Note 7 under "Operating Leases" for additional information.

The Company provides incidental services to and receives such services from other Southern Company subsidiaries which are generally minor in duration and amount. However, with the hurricane damage experienced in 2005, assistance provided to aid in storm restoration, including Company labor, contract labor, and materials, caused an increase in these activities. The total amount of storm restoration provided to Mississippi Power was $11.1 million in 2005. The Company received storm restoration assistance from other Southern Company subsidiaries totaling $5.8 million in 2005. These activities were billed at cost.

The traditional operating companies, including the Company, and Southern Power 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. See Note 7 under "Fuel Commitments" for additional information.

In 2007, the Company purchased equipment from Georgia Power and Southern Power. The purchase price was $4.0 million and $7.9 million, respectively, and is included in property, plant and equipment in the balance sheets.

Regulatory Assets and Liabilities

The Company is subject to the provisions of Financial Accounting Standards Board (FASB) Statement No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71). Regulatory assets represent probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be credited to customers through the ratemaking process. Regulatory assets and (liabilities) reflected in the balance sheets at December 31 relate to:

	2007	2006	Note
	(in thousands)		
Environmental remediation	**$ 66,923**	$ 57,230	(a)
Loss on reacquired debt	**17,378**	18,584	(b)
Vacation pay	**7,411**	5,795	(c)
Deferred charges related to income taxes	**17,847**	17,148	(d)
Fuel-hedging assets	**1,657**	8,031	(e)
Underfunded retiree benefit plans	**14,602**	17,968	(f)
Other assets	**1,548**	3,319	(g)
Under recovered regulatory clause revenues	**56,628**	77,480	(g)
Property damage reserve	**18,585**	45,654	(h)
Asset retirement obligations	**(4, 570)**	(3,313)	(d)
Other cost of removal obligations	**(172,876)**	(165,410)	(d)
Deferred income tax credits	**(15,331)**	(17,935)	(d)
Fuel-hedging liabilities	**(1,455)**	(845)	(e)
Over recovered regulatory clause revenues	**(5,233)**	(8,139)	(g)
Other liabilities	**(1,715)**	(1,804)	(g)
Overfunded retiree benefit plans	**(60,464)**	(23,478)	(f)
Total	**$ (59,065)**	$ 30,285	

Note: The recovery and amortization periods for these regulatory assets and (liabilities) are as follows:

(a) Recovered through the environmental cost recovery clause when the remediation is performed.

(b) Recovered over the remaining life of the original issue, which may range up to 40 years.

(c) Recorded as earned by employees and recovered as paid, generally within one year.

(d) Asset retirement and removal liabilities are recovered, deferred charges related to income tax assets are recovered, and deferred charges related to income tax liabilities are amortized over the related property lives, which may range up to 65 years. Asset retirement and removal liabilities will be settled and trued up following completion of the related activities.

(e) Fuel-hedging assets and liabilities are recognized over the life of the underlying hedged purchase contracts, which generally do not exceed three years. Upon final settlement, costs are recovered through the fuel cost recovery clause.

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

(g) Recorded and recovered or amortized as approved by the Florida PSC.

(h) Recorded and recovered or amortized as approved by the Florida PSC. Storm cost recovery surcharge ends in June 2009.

In the event that a portion of the Company's operations is no longer subject to the provisions of SFAS No. 71, the Company would be required to write off related regulatory assets and liabilities that are not specifically recoverable through regulated rates. In addition, the Company would be required to determine if any impairment to other assets, including plant assets, exists and write down the assets, if impaired, to their fair values. All regulatory assets and liabilities are reflected in rates.

Revenues

Energy and other revenues are recognized as services are provided. Unbilled revenues related to retail sales are accrued at the end of each fiscal period. Wholesale capacity revenues are generally recognized on a levelized basis over the appropriate contract period. The Company's retail electric rates include provisions to adjust billings for fluctuations in fuel costs, the energy component of purchased power costs, and certain other costs. The Company continuously monitors the under recovered fuel cost balance in light of the inherent variability in fuel costs. The Company is required to notify the Florida PSC if the projected fuel revenue over or under recovery exceeds 10% of the projected fuel revenue applicable for the period and indicate if an adjustment to the fuel cost recovery factor is being requested. The Company filed a notice with the Florida PSC in June 2007 and no adjustment to the factor was requested. The Company has similar retail cost recovery clauses for energy conservation costs, purchased power capacity costs, and environmental compliance costs. Revenues are adjusted for differences between these actual costs and amounts billed in current regulated rates. Under or over recovered regulatory clause revenues are recorded in the balance sheets and are recovered or returned to customers through adjustments to the billing factors. Annually, the Company petitions for recovery of projected costs including any true-up amount from prior periods, and approved rates are implemented each January. In November 2007, the Florida PSC approved billing factors for 2008 intended to allow the Company to recover projected 2008 costs as well as refund or collect the 2007 over or under recovered amounts in 2008.

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

Fuel Costs

Fuel costs are expensed as the fuel is used.

Property, Plant, and Equipment

Property, plant, and equipment is stated at original cost less regulatory disallowances and impairments. Original cost includes: materials; labor; minor items of property; appropriate administrative and general costs; payroll-related costs such as taxes, pensions, and other benefits; and the interest capitalized and/or cost of funds used during construction.

The Company's property, plant, and equipment consisted of the following at December 31:

	2007	2006
	(in thousands)	
Generation	**$ 1,390,635**	$ 1,347,881
Transmission	**282,408**	270,658
Distribution	**873,642**	831,494
General	**128,704**	120,666
Plant acquisition adjustment	**3,563**	3,818
Total plant in service	**$ 2,678,952**	$ 2,574,517

The cost of replacements of property, exclusive of minor items of property, is capitalized. The cost of maintenance, repairs, and replacement of minor items of property is charged to maintenance expense as incurred or performed.

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. Investment tax credits utilized are deferred and amortized to income over the average life of the related property. Taxes that are collected from customers on behalf of governmental agencies to be remitted to these agencies are presented net on the statements of income. In accordance with FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), 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.

Depreciation and Amortization

Depreciation of the original cost of utility plant in service is provided primarily by using composite straight-line rates, which approximated 3.4% in 2007, 3.7% in 2006, and 3.8% in 2005. Depreciation studies are conducted periodically to update the composite rates. These studies are approved by the Florida PSC. When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its original cost, together with the cost of removal, less salvage, is charged to accumulated depreciation. For other property dispositions, the applicable cost and accumulated depreciation is removed from the balance sheet accounts and a gain or loss is recognized. Minor items of property included in the original cost of the plant are retired when the related property unit is retired.

Asset Retirement Obligations and Other Costs of Removal

Asset retirement obligations are computed as the present value of the ultimate costs for an asset's future retirement and are recorded in the period in which the liability is incurred. The costs are capitalized as part of the related long-lived asset and depreciated over the asset's useful life. The Company has received an order from the Florida PSC allowing the continued accrual of other future retirement costs for long-lived assets that the Company does not have a legal obligation to retire. Accordingly, the accumulated removal costs for these obligations will continue to be reflected in the balance sheets as a regulatory liability.

The liability recognized to retire long-lived assets primarily relates to the Company's combustion turbines at its Pea Ridge facility, various landfill sites, and a barge unloading dock. In connection with the adoption of FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47), the Company also recorded additional asset retirement obligations (and assets) of $9.1 million, primarily related to asbestos removal, ash ponds, and disposal of polychlorinated biphenyls in certain transformers. The Company also has identified retirement obligations related to certain transmission and distribution facilities, certain wireless communication towers, and certain structures authorized by the United States Army Corps of Engineers. However, liabilities for the removal of these assets have not been recorded because the range of time over which the Company may settle these obligations is unknown and cannot be reasonably estimated. The Company will continue to recognize in the statements of income allowed removal costs in accordance with its regulatory treatment. Any differences between costs recognized under FASB Statement No. 143 "Accounting for Asset Retirement Obligations" and FIN 47 and those reflected in rates are recognized as either a regulatory asset or liability, as ordered by the Florida PSC, and are reflected in the balance sheets.

Details of the asset retirement obligations included in the balance sheets are as follows:

	2007	2006
	(in thousands)	
Balance beginning of year	**$ 12,718**	$ 15,298
Liabilities incurred	**503**	-
Liabilities settled	**(484)**	-
Accretion	**619**	785
Cash flow revisions	**(1,414)**	(3,365)
Balance end of year	**$ 11,942**	$ 12,718

Allowance for Funds Used During Construction (AFUDC)

In accordance with regulatory treatment, the Company records AFUDC, which represents the estimated debt and equity costs of capital funds that are necessary to finance the construction of new regulated facilities. While cash is not realized currently from such allowance, it increases the revenue requirement over the service life of the plant through a higher rate base and higher depreciation expense. The equity component of AFUDC is not included in calculating taxable income. For the years 2007, 2006, and 2005, the average annual AFUDC rate was 7.48%. AFUDC, net of taxes, as a percentage of net income after dividends on preferred and preference stock was 3.59%, 0.61%, and 1.97%, respectively, for 2007, 2006, and 2005.

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 an impairment has occurred is based on either a specific regulatory disallowance or an estimate of undiscounted future cash flows attributable to the assets, as compared with the carrying value of the assets. If an impairment has occurred, the amount of the impairment recognized is determined by either the amount of regulatory disallowance or by estimating the fair value of the assets and recording a loss if the carrying value is greater than the fair value. For assets identified as held for sale, the carrying value is compared to the estimated fair value less the cost to sell in order to determine if an impairment loss is required. Until the assets are disposed of, their estimated fair value is re-evaluated when circumstances or events change.

Property Damage Reserve

The Company accrues for the cost of repairing damages from major storms and other uninsured property damages, including uninsured damages to transmission and distribution facilities, generation facilities, and other property. The cost of such damages is charged to the reserve. The Florida PSC approved annual accrual to the property damage reserve is $3.5 million, with a target level for the reserve between $25.1 million and $36.0 million. The Florida PSC also authorized the Company to make additional accruals above the $3.5 million at the Company's discretion. The Company accrued total expenses of $3.5 million in 2007, $6.5 million in 2006, and $9.5 million in 2005. At December 31, 2007, the unrecovered balance in the property damage reserve totaled approximately $18.6 million. See Note 3 under "Retail Regulatory Matters – Storm Damage Cost Recovery" for additional information regarding the surcharge mechanism approved by the Florida PSC to replenish these reserves.

Injuries and Damages Reserve

The Company is subject to claims and suits arising in the ordinary course of business. As permitted by the Florida PSC, the Company accrues for the uninsured costs of injuries and damages by charges to income amounting to $1.6 million annually. The Florida PSC has also given the Company the flexibility to increase its annual accrual above $1.6 million to the extent the balance in the reserve does not exceed $2 million and to defer expense recognition of liabilities greater than the balance in the reserve. The cost of settling claims is charged to the reserve. The injuries and damages reserve was $2.2 million and $2.0 million at December 31, 2007 and 2006, respectively, and is included in Current Liabilities in the balance sheets. Liabilities in excess of the reserve balance of $0.8 million and $1.7 million at December 31, 2007 and 2006, respectively, are included in Deferred Credits and Other Liabilities in the balance sheets. Corresponding regulatory assets of $0.8 million and $1.6 million at December 31, 2007 and 2006, respectively, are included in Current Assets in the balance sheets. At December 31, 2007 and 2006, respectively, none and $0.1 million are included in Deferred Charges and Other Assets in the balance sheets.

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 cost of transmission, distribution, and generating plant materials. Materials are charged to inventory when purchased and then expensed or capitalized to plant, as appropriate, when installed.

Fuel Inventory

Fuel inventory includes the average costs of oil, coal, natural gas, and emission allowances. Fuel is charged to inventory when purchased and then expensed as used. Emission allowances granted by the Environmental Protection Agency (EPA) are included in inventory at zero cost.

Stock Options

Southern Company provides non-qualified stock options to a large segment of the Company's employees ranging from line management to executives. Prior to January 1, 2006, the Company accounted for options granted in accordance with Accounting

Principles Board Opinion No. 25; thus, no compensation expense was recognized because the exercise price of all options granted equaled the fair market value on the date of the grant.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), "Share-Based Payment" (SFAS No. 123(R)), using the modified prospective method. Under that method, compensation cost for the years ended December 31, 2007 and 2006 was recognized as the requisite service was rendered and included: (a) compensation cost for the portion of share-based awards granted prior to and that were outstanding as of January 1, 2006, for which the requisite service had not been rendered, based on the grant-date fair value of those awards as calculated in accordance with the original provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation" and (b) compensation cost for all share-based awards granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

The compensation cost and tax benefit related to the grant and exercise of Southern Company stock options to the Company's employees are recognized in the Company's financial statements with a corresponding credit to equity, representing a capital contribution from Southern Company.

For the Company, the adoption of SFAS No. 123(R) has resulted in a reduction in earnings before income taxes and net income of \$1.1 million and \$0.7 million, respectively, for the year ended December 31, 2007 and \$1.0 million and \$0.6 million, respectively, for the year ended December 31, 2006. Additionally, SFAS No. 123(R) requires the gross excess tax benefit from stock option exercises to be reclassified as a financing cash flow as opposed to an operating cash flow; the reduction in operating cash flows and the increase in financing cash flows for the years ended December 31, 2007 and 2006 was \$0.8 million and \$0.4 million, respectively.

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

2005	**As Reported**	**Options Impact After Tax**	**Pro Forma**
		(in thousands)	
Net income	$ 75,209	$ (586)	$ 74,623

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

The estimated fair values of stock options granted in 2007, 2006, and 2005 were derived using the Black-Scholes stock option pricing model. Expected volatility was based on historical volatility of Southern Company's stock over a period equal to the expected term. The Company used historical exercise data to estimate the expected term that represents the period of time that options granted to employees are expected to be outstanding. The risk-free rate was based on the U.S. Treasury yield curve in effect at the time of grant that covers the expected term of the stock options. The following table shows the assumptions used in the pricing model and the weighted average grant-date fair value of stock options granted:

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

Financial Instruments

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 or are recoverable through the Florida PSC-approved hedging program. This results in the deferral of related gains and losses in other comprehensive income or regulatory assets and liabilities, respectively, until the hedged transactions occur. Any ineffectiveness arising from cash flow hedges is recognized currently in net income. Other derivative contracts 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.

Other financial instruments for which the carrying amounts did not equal fair values at December 31 were as follows:

	Carrying Amount	Fair Value
	(in thousands)	
Long-term debt:		
2007	**$ 740,050**	**$ 725,885**
2006	696,098	682,641

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, and prior to the adoption of SFAS No.158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158) the minimum pension liability, less income taxes and reclassifications for amounts included in net income.

Variable Interest Entities

The primary beneficiary of a variable interest entity must consolidate the related assets and liabilities. The Company had established certain wholly-owned trusts to issue preferred securities. The Company is not considered the primary beneficiary of the trusts. Therefore, the investments in these trusts were reflected as Other Investments for the Company, and the related loans from the trusts were included in Long-term Debt in the balance sheets. In November 2007, the Company redeemed $41.2 million of its Series E Junior Subordinated Notes and the related trust preferred and common securities of Gulf Power Capital Trust IV. As of December 31, 2007, the Company no longer had any outstanding trust preferred securities. See Note 6 under "Long-Term Debt Payable to Affiliated Trusts" for additional information.

2. RETIREMENT BENEFITS

The Company has a defined benefit, trusteed, pension plan covering substantially all employees. The plan is funded in accordance with requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA). No contributions to the plan are expected for the year ending December 31, 2008. The Company also provides a defined benefit pension plan for a selected group of management and highly compensated employees. Benefits under this non-qualified plan are funded on a cash basis. In addition, the Company provides certain medical care and life insurance benefits for retired employees through other postretirement benefit plans. The Company funds related trusts to the extent required by the FERC. For the year ending December 31, 2008, postretirement trust contributions are expected to total approximately $60,000.

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

Pension Plans

The total accumulated benefit obligation for the pension plans was $230 million in 2007 and $242 million in 2006. Changes during the year in the projected benefit obligations and fair value of plan assets were as follows:

	2007	2006
	(in thousands)	
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 246,569**	$ 248,026
Service cost	**6,835**	6,980
Interest cost	**14,519**	13,359
Benefits paid	**(11,625)**	(11,034)
Plan amendments	**1,698**	385
Actuarial (gain) loss	**(6,215)**	(11,147)
Balance at end of year	**251,781**	246,569
Change in plan assets		
Fair value of plan assets at beginning of year	**305,525**	280,366
Actual return on plan assets	**51,159**	35,511
Employer contributions	**682**	682
Benefits paid	**(11,625)**	(11,034)
Fair value of plan assets at end of year	**345,741**	305,525
Funded status at end of year	**93,960**	58,956
Fourth quarter contributions	**149**	147
Prepaid pension asset, net	**$ 94,109**	$ 59,103

At December 31, 2007, the projected benefit obligations for the qualified and non-qualified pension plans were $238.6 million and $13.2 million, respectively. All plan assets are related to the qualified pension plan.

Pension plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the Internal Revenue Code of 1986, as amended (Internal Revenue Code). The Company's investment policy covers a diversified mix of assets, including equity and fixed income securities, real estate, and private equity. Derivative instruments are used primarily as hedging tools but may also be used to gain efficient exposure to the various asset classes. The Company primarily minimizes the risk of large losses through diversification but also monitors and manages other aspects of risk. The actual composition of the Company's pension plan assets as of the end of the year, along with the targeted mix of assets, is presented below:

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

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

	2007	2006
	(in thousands)	
Prepaid pension costs	**$ 107,151**	$ 69,895
Other regulatory assets	**6,561**	5,091
Current liabilities, other	**(639)**	(585)
Other regulatory liabilities	**(60,464)**	(23,478)
Employee benefit obligations	**(12,403)**	(10,207)

Presented below are the amounts included in regulatory assets and regulatory liabilities at December 31, 2007 and 2006 related to the defined benefit pension plans that had not yet been recognized in net periodic pension cost along with the estimated amortization of such amounts for 2008.

	Prior Service Cost	Net (Gain)/ Loss
	(in thousands)	
Balance at December 31, 2007:		
Regulatory assets	**$ 1,900**	**$ 4,661**
Regulatory liabilities	**9,932**	**(70,396)**
Total	**$ 11,832**	**$ (65,735)**
Balance at December 31, 2006:		
Regulatory assets	$ 401	$ 4,690
Regulatory liabilities	11,153	(34,631)
Total	$ 11,554	$ (29,941)
Estimated amortization in net periodic pension cost in 2008:		
Regulatory assets	$ 258	$ 334
Regulatory liabilities	1,220	-
Total	$ 1,478	$ 334

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

	Regulatory Assets	Regulatory Liabilities
	(in thousands)	
Beginning balance	$ 5,091	$ (23,478)
Net (gain)/loss	313	(35,765)
Change in prior service costs	1,698	-
Reclassification adjustments:		
Amortization of prior service costs	(199)	(1,221)
Amortization of net gain	(342)	-
Total reclassification adjustments	(541)	(1,221)
Total change	1,470	(36,986)
Ending balance	$ 6,561	$ (60,464)

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

	2007	2006	2005
		(in thousands)	
Service cost	**$ 6,835**	$ 6,980	$ 6,317
Interest cost	**14,519**	13,358	12,866
Expected return on plan assets	**(21,934)**	(20,727)	(20,816)
Recognized net (gain)/loss	**342**	463	350
Net amortization	**1,419**	1,313	502
Net periodic pension cost (income)	**$ 1,181**	$ 1,387	$ (781)

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

Future benefit payments reflect expected future service and are estimated based on assumptions used to measure the projected benefit obligation for the pension plans. At December 31, 2007, estimated benefit payments were as follows:

	Benefit Payments
	(in thousands)
2008	$ 12,283
2009	12,603
2010	13,097
2011	14,775
2012	15,479
2013 to 2017	94,245

Other Postretirement Benefits

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

	2007	2006
	(in thousands)	
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 73,985**	$ 73,280
Service cost	**1,351**	1,424
Interest cost	**4,330**	3,940
Benefits paid	**(3,586)**	(3,728)
Actuarial (gain) loss	**(2,430)**	(1,124)
Retiree drug subsidy	**259**	193
Balance at end of year	**73,909**	73,985
Change in plan assets		
Fair value of plan assets at beginning of year	**17,640**	16,434
Actual return on plan assets	**2,934**	1,951
Employer contributions	**2,363**	3,583
Benefits paid	**(3,327)**	(4,328)
Fair value of plan assets at end of year	**19,610**	17,640
Funded status at end of year	**(54,299)**	(56,345)
Fourth quarter contributions	**872**	932
Accrued liability	**$ (53,427)**	$ (55,413)

Other postretirement benefit plan assets are managed and invested in accordance with all applicable requirements, including ERISA and the Internal Revenue Code. The Company's investment policy covers a diversified mix of assets, including equity and fixed income securities, real estate, and private equity. Derivative instruments are used primarily as hedging tools but may also be used to gain efficient exposure to the various asset classes. The Company primarily minimizes the risk of large losses through diversification but also monitors and manages other aspects of risk. The actual composition of the Company's other postretirement benefit plan assets as of the end of the year, along with the targeted mix of assets, is presented below:

	Target	**2007**	2006
Domestic equity	35%	**37%**	37%
International equity	23	**23**	22
Fixed income	18	**17**	19
Real estate	15	**16**	15
Private equity	9	**7**	7
Total	100%	**100%**	100%

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

	2007	2006
	(in thousands)	
Other regulatory assets	**$ 8,040**	$ 12,877
Current liabilities, other	**(511)**	(448)
Employee benefit obligations	**(52,916)**	(54,965)

Presented below are the amounts included in regulatory assets at December 31, 2007 and 2006 related to the other postretirement benefit plans that have not yet been recognized in net periodic postretirement benefit cost along with the estimated amortization of such amounts for the next fiscal year.

	Prior Service Cost	**Net (Gain)/Loss**	**Transition Obligation**
		(in thousands)	
Balance at December 31, 2007:			
Regulatory assets	**$ 3,619**	**$ 2,544**	**$ 1,877**
Balance at December 31, 2006:			
Regulatory assets	$ 3,965	$ 6,678	$ 2,234
Estimated amortization as net periodic postretirement benefit cost in 2008:			
Regulatory assets	$ 346	$ -	$ 356

The change in the balance of regulatory assets related to the other postretirement benefit plans for the year ended December 31, 2007 is presented in the following table:

	Regulatory Assets
	(in thousands)
Beginning balance	**$ 12,877**
Net gain	**(4,045)**
Change in prior service costs	**-**
Reclassification adjustments:	
Amortization of transition obligation	**(356)**
Amortization of prior service costs	**(346)**
Amortization of net gain	**(90)**
Total reclassification adjustments	**(792)**
Total change	**(4,837)**
Ending balance	**$ 8,040**

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

	2007	2006	2005
	(in thousands)		
Service cost	**$ 1,351**	$ 1,424	$ 1,357
Interest cost	**4,330**	3,940	3,892
Expected return on plan assets	**(1,320)**	(1,264)	(1,202)
Net amortization	**792**	857	735
Net postretirement cost	**$ 5,153**	$ 4,957	$ 4,782

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Medicare Act) provides a 28% prescription drug subsidy for Medicare eligible retirees. The effect of the subsidy reduced the Company's expenses for the years ended December 31, 2007, 2006, and 2005 by approximately $1.5 million, $1.7 million, and $1.1 million, respectively, and is expected to have a similar impact on future expenses.

Future benefit payments, including prescription drug benefits, reflect expected future service and are estimated based on assumptions used to measure the APBO for the postretirement plans. Estimated benefit payments are reduced by drug subsidy receipts expected as a result of the Medicare Act as follows:

	Benefit Payments	**Subsidy Receipts**	**Total**
		(in thousands)	
2008	$ 4,075	$ (331)	$ 3,744
2009	4,403	(381)	4,022
2010	4,749	(444)	4,305
2011	5,145	(500)	4,645
2012	5,436	(570)	4,866
2013 to 2017	30,652	(3,997)	26,655

Actuarial Assumptions

The weighted average rates assumed in the actuarial calculations used to determine both the benefit obligations as of the measurement date and the net periodic costs for the pension and other postretirement benefit plans for the following year are presented below. Net periodic benefit costs were calculated in 2004 for the 2005 plan year using a discount rate of 5.75%.

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

The Company determined the long-term rate of return based on historical asset class returns and current market conditions, taking into account the diversification benefits of investing in multiple asset classes.

An additional assumption used in measuring the APBO was a weighted average medical care cost trend rate of 9.75% for 2008, decreasing gradually to 5.25% through the year 2015 and remaining at that level thereafter. An annual increase or decrease in the assumed medical care cost trend rate of 1% would affect the APBO and the service and interest cost components at December 31, 2007 as follows:

	1 Percent Increase	**1 Percent Decrease**
	(in thousands)	
Benefit obligation	**$ 4,139**	**$ 3,548**
Service and interest costs	**307**	**246**

Employee Savings Plan

The Company also sponsors a 401(k) defined contribution plan covering substantially all employees. The Company provides an 85% matching contribution up to 6% of an employee's base salary. Prior to November 2006, the Company matched employee contributions at a rate of 75% up to 6% of the employee's base salary. Total matching contributions made to the plan for 2007, 2006, and 2005 were $3.5 million, $3.0 million, and $2.9 million, respectively.

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 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.

Environmental Matters

New Source Review Actions

In November 1999, the EPA brought a civil action in the U.S. District Court for the Northern District of Georgia against certain Southern Company subsidiaries, including Alabama Power and Georgia Power, alleging that these subsidiaries had violated the New Source Review (NSR) provisions of the Clean Air Act and related state laws at certain coal-fired generating facilities. Through subsequent amendments and other legal procedures, the EPA filed a separate action in January 2001 against Alabama Power in the U.S. District Court for the Northern District of Alabama after Alabama Power was dismissed from the original action. In these lawsuits, the EPA alleged that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power and Georgia Power. The civil actions request penalties and injunctive relief, including an order requiring the installation of the best available control technology at the affected units. The EPA concurrently issued notices of violation relating to the Company's Plant Crist and a unit partially owned by the Company at Plant Scherer. See Note 4 to the financial statements for information on the Company's ownership interest in Plant Scherer Unit 3. In early 2000, the EPA filed a motion to amend its complaint to add the allegations in the notices of violation and to add the Company as a defendant. However, in March 2001, the court denied the motion based on lack of jurisdiction, and the EPA has not refiled. The action against Georgia Power has been administratively closed since the spring of 2001, and none of the parties has sought to reopen the case.

The plaintiffs appealed the district court's decision to the U.S. Court of Appeals for the Eleventh Circuit, and the appeal was stayed by the Appeals Court pending the U.S. Supreme Court's decision in a similar case against Duke Energy. The Supreme Court issued its decision in the Duke Energy case in April 2007. On October 5, 2007, the U.S. District Court for the Northern District of Alabama issued an order in the Alabama Power case indicating a willingness to re-evaluate its previous decision in light of the Supreme Court's Duke Energy opinion. On December 21, 2007, the Eleventh Circuit vacated the district court's decision in the Alabama Power case and remanded the case back to the district court for consideration of the legal issues in light of the Supreme Court's decision in Duke Energy case.

The Company believes it complied with applicable laws and the EPA regulations and interpretations in effect at the time the work in question took place. The Clean Air Act authorizes maximum civil penalties of $25,000 to $32,500 per day, per violation at each generating unit, depending on the date of the alleged violation. An adverse outcome in this matter could require substantial capital expenditures or affect the timing of currently budgeted capital expenditures that cannot be determined at this time and could possibly require payment of substantial penalties. Such expenditures could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates.

Carbon Dioxide Litigation

In July 2004, attorneys general from eight states, each outside of Southern Company's service territory, and the corporation counsel for New York City filed a complaint in the U.S. District Court for the Southern District of New York against Southern Company and four other electric power companies. A nearly identical complaint was filed by three environmental groups in the same court. The complaints allege that the companies' emissions of carbon dioxide, a greenhouse gas, contribute to global warming, which the plaintiffs assert is a public nuisance. Under common law public and private nuisance theories, the plaintiffs seek a judicial order (1) holding each defendant jointly and severally liable for creating, contributing to, and/or maintaining global warming and (2) requiring each of the defendants to cap its emissions of carbon dioxide and then reduce those emissions by a specified percentage each year for at least a decade. Plaintiffs have not, however, requested that damages be awarded in connection with their claims. Southern Company believes these claims are without merit and notes that the complaint cites no statutory or regulatory basis for the claims. In September 2005, the U.S. District Court for the Southern District of New York granted Southern Company's and the other defendants' motions to dismiss these cases. The plaintiffs filed an appeal to the U.S. Court of Appeals for the Second Circuit in October 2005 and no decision has been issued. The ultimate outcome of these matters cannot be determined at this time.

Environmental Remediation

The Company must comply with other environmental laws and regulations that cover the handling and disposal of waste and releases of hazardous substances. Under these various laws and regulations, the Company may also incur substantial costs to clean up properties. The Company received authority from the Florida PSC to recover approved environmental compliance costs through the environmental cost recovery clause. The Florida PSC reviews costs and adjusts rates up or down annually.

At December 31, 2007 and 2006, the Company's liability for the estimated costs of environmental remediation projects for known sites was \$66.9 million and \$57.2 million, respectively. During the second quarter 2007, the Company increased its estimated liability for environmental remediation projects by \$12.8 million as a result of changes in the cost estimates to remediate substation sites. These estimated costs relate to new regulations and more stringent site closure criteria by the Florida Department of Environmental Protection (FDEP) for impacts to groundwater from herbicide applications at the Company's substations. The schedule for completion of the remediation projects will be subject to FDEP approval. These projects have been approved by the Florida PSC for recovery through the environmental cost recovery clause. Therefore, the Company has recorded \$1.8 million in Current Assets and Current Liabilities and \$65.1 million in Deferred Charges and Other Assets and Deferred Credits and Other Liabilities representing the future recoverability of these costs.

The final outcome of these matters cannot now be determined. However, based on the currently known conditions at these sites and the nature and extent of the Company's activities relating to these sites, management does not believe that the Company's additional liabilities, if any, at these sites would be material to the 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 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 and Southern Power to charge cost-based rates for certain wholesale sales in the Southern Company retail service territory, which may be lower than negotiated market-based rates, and could also result in refunds of up to \$0.8 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 Company's generation fleet is operated under the Intercompany Interchange Contract (IIC), as approved by the FERC. In May 2005, the FERC initiated a new proceeding to examine (1) the provisions of the IIC among the traditional operating companies (including the Company), Southern Power, and SCS, as agent, under the terms of which the power pool of Southern Company is operated, (2) whether any parties to the IIC have violated the FERC's standards of conduct applicable to utility companies that are transmission providers, and (3) whether Southern Company's code of conduct defining Southern Power as a "system company" rather than a "marketing affiliate" is just and reasonable. In connection with the formation of Southern Power, the FERC authorized Southern Power's inclusion in the IIC in 2000. The FERC also previously approved Southern Company's code of conduct.

In October 2006, the FERC issued an order accepting a settlement resolving the proceeding subject to Southern Company's agreement to accept certain modifications to the settlement's terms and Southern Company notified the FERC that it accepted the modifications. The modifications largely involve functional separation and information restrictions related to marketing activities conducted on behalf of Southern Power. Southern Company filed with the FERC in November 2006 a compliance plan in connection with the order. On April 19, 2007, the FERC approved, with certain modifications, the plan submitted by Southern Company. Implementation of the plan is not expected to have a material impact on the Company's financial statements. On November 19, 2007 Southern Company notified the FERC that the plan had been implemented and the FERC division of audits subsequently began an audit pertaining to compliance implementation and related matters, which is ongoing.

Right of Way Litigation

Southern Company and certain of its subsidiaries, including the Company, Mississippi Power, and Southern Telecom, Inc. (a subsidiary of SouthernLINC Wireless), have been named as defendants in numerous lawsuits brought by landowners since 2001. The plaintiffs' lawsuits claim that defendants may not use, or sublease to third parties, some or all of the fiber optic communications lines on the rights of way that cross the plaintiffs' properties, and that such actions exceed the easements or other property rights held by defendants. The plaintiffs assert claims for, among other things, trespass and unjust enrichment, and seek compensatory and punitive damages and injunctive relief. The Company's management believes that it has complied with applicable laws and that the plaintiffs' claims are without merit.

In November 2003, the Second Circuit Court in Gadsden County, Florida, ruled in favor of the plaintiffs on their motion for partial summary judgment concerning liability in one such lawsuit brought by landowners regarding the installation and use of fiber optic cable over the Company rights of way located on the landowners' property. Subsequently, the plaintiffs sought to amend their complaint and asked the court to enter a final declaratory judgment and to enter an order enjoining the Company from allowing expanded general telecommunications use of the fiber optic cables that are the subject of this litigation. In January 2005, the trial court granted in part the plaintiffs' motion to amend their complaint and denied the requested declaratory and injunctive relief. In November 2005, the trial court ruled in favor of the plaintiffs and against the Company on their respective motions for partial summary judgment. In that same order, the trial court also denied the Company's motion to dismiss certain claims. The Company filed an appeal to the Florida First District Court of Appeals in December 2005. In October 2006, the Florida First District Court of Appeal issued an order dismissing the Company's December 2005 appeal on the basis that the trial court's order was a non-final order and therefore not subject to review on appeal at this time. The case was returned to the trial court for further proceedings. The parties reached agreement on a proposed settlement plan that was subject to approval by the trial court. On November 7, 2007, the trial court granted preliminary approval and set forth the requirements for the trial court to make its final determination on the proposed settlement. Although the final outcome of this matter cannot now be determined, if approved the settlement is not expected to have a material effect on the financial statements of the Company.

In addition, in late 2001, certain subsidiaries of Southern Company, including the Company, Alabama Power, Georgia Power, Mississippi Power, and Southern Telecom, Inc. (a subsidiary of SouthernLINC Wireless), were named as defendants in a lawsuit brought by a telecommunications company that uses certain of the defendants' rights of way. This lawsuit alleges, among other things, that the defendants are contractually obligated to indemnify, defend, and hold harmless the telecommunications company from any liability that may be assessed against it in pending and future right of way litigation. The Company believes that the plaintiff's claims are without merit. In the fall of 2004, the trial court stayed the case until resolution of the underlying landowner litigation discussed above. In January 2005, the Georgia Court of Appeals dismissed the telecommunications company's appeal of the trial court's order for lack of jurisdiction. An adverse outcome in this matter, combined with an adverse outcome against the telecommunications company in one or more of the right of way lawsuits, could result in substantial judgments; however, the final outcome of these matters cannot now be determined.

Property Tax Dispute

The Monroe County Board of Tax Assessors (Monroe Board) had issued assessments reflecting substantial increases in the ad valorem tax valuation of the Company's 6.25% ownership interest in Plant Scherer, which is located in Monroe County, Georgia (Monroe County) for tax years 2003 through 2007. Georgia Power and the Company pursued administrative appeals in Monroe County and filed notices of arbitration for all disputed years. The outcome of the litigation is discussed below.

In November 2004, Georgia Power filed suit, on its behalf, against the Monroe Board in the Superior Court of Monroe County. The Company requested injunctive relief prohibiting Monroe County and the Monroe Board from unlawfully changing the value of Plant Scherer and ultimately collecting additional ad valorem taxes from Georgia Power. In December 2005, the court granted Monroe County's motion for summary judgment. Georgia Power filed an appeal of the Superior Court's decision to the Georgia Supreme Court.

On March 30, 2007, the Georgia Court of Appeals reversed the trial court and ruled that the Monroe Board had exceeded its legal authority and remanded the case for entry of an injunction prohibiting the Monroe Board from collecting taxes based on its independent valuation of Plant Scherer. On July 16, 2007, the Georgia Supreme Court agreed to hear the Monroe Board's requested review of this decision. On January 8, 2008, the Georgia Supreme Court upheld the appeals court decision preventing Monroe County from reassessing the fair market value of Plant Scherer as filed in the tax years 2003, 2004, 2005, 2006, and 2007. This litigation is now concluded.

Retail Regulatory Matters

Environmental Cost Recovery

The Florida Legislature adopted legislation for an environmental cost recovery clause, which allows an electric utility to petition the Florida PSC for recovery of prudent environmental compliance costs that are not being recovered through base rates or any other recovery mechanism. Such environmental costs include operation and maintenance expense, emission allowance expense, depreciation, and a return on invested capital. This legislation also allows recovery of costs incurred as a result of an agreement between the Company and the FDEP for the purpose of ensuring compliance with ozone ambient air quality standards adopted by the EPA. On August 14, 2007, the Florida PSC voted to approve a stipulation among the Company, the Office of Public Counsel, and the Florida Industrial Power Users Group regarding the Company's plan for complying with certain federal and state regulations addressing air quality. The Company's environmental compliance plan as filed on March 29, 2007 contemplates implementation of specific projects identified in the plan from 2007 through 2018. The stipulation covers all elements of the current plan that are scheduled to be implemented in the 2007 through 2011 timeframe. The Florida PSC acknowledged that the costs associated with the Company's Clean Air Interstate Rule/Clean Air Mercury Rule/Clean Air Visibility Rule compliance plan are eligible for recovery through the environmental cost recovery clause. During 2007, 2006, and 2005, the Company recorded environmental cost recovery clause revenues of $43.6 million, $40.9 million, and $26.3 million, respectively. Annually, the Company seeks recovery of projected costs including any true-up amounts from prior periods. At December 31, 2007, the over recovered balance was $1.6 million primarily due to operations and maintenance expenses being less than anticipated.

Storm Damage Cost Recovery

Under authority granted by the Florida PSC, the Company maintains a reserve for property damage to cover the cost of uninsured damages from major storms to its transmission and distribution facilities, generation facilities, and other property.

Hurricanes Dennis and Katrina hit the Gulf Coast of Florida in July 2005 and August 2005, respectively, damaging portions of the Company's service area. In September 2004, Hurricane Ivan hit the Gulf Coast of Florida, causing substantial damage within the Company's service area. In 2005, the Florida PSC issued an order that approved a stipulation and settlement between the Company and several consumer groups and thereby authorized the recovery of the Company's storm damage costs related to Hurricane Ivan through a two-year surcharge that began in April 2005.

In July 2006, the Florida PSC issued an order (2006 Order) approving a stipulation and settlement between the Company and several consumer groups that resolved all matters relating to the Company's request for recovery of incurred costs for storm-recovery activities and the replenishment of the Company's property damage reserve. The 2006 Order provided for an extension of the storm-recovery surcharge then being collected by the Company for an additional 27 months, expiring in June 2009.

Pursuant to the 2006 Order, the funds resulting from the extension of the surcharge were first credited to the unrecovered balance of storm-recovery costs associated with Hurricane Ivan until these costs were fully recovered. The funds are now being credited to the property reserve for recovery of the storm restoration costs of $52.6 million associated with Hurricanes Dennis and Katrina that were previously charged to the reserve. Should revenues collected by the Company through the extension of the storm-recovery surcharge exceed the storm restoration costs associated with Hurricanes Dennis and Katrina, the excess revenues will be credited to the reserve.

The annual accrual to the reserve of $3.5 million and the Company's limited discretionary authority to make additional accruals to the reserve will continue as previously approved by the Florida PSC. The Company made discretionary accruals to the reserve of $3 million and $6 million in 2006 and 2005, respectively. The Company made no discretionary accruals to the reserve in 2007.

According to the 2006 Order, in the case of future storms, if the Company incurs cumulative costs for storm-recovery activities in excess of $10 million during any calendar year, the Company will be permitted to file a streamlined formal request for an interim surcharge. Any interim surcharge would provide for the recovery, subject to refund, of up to 80% of the claimed costs for storm-recovery activities. The Company would then petition the Florida PSC for full recovery through a final or non-interim surcharge or other cost recovery mechanism.

See Note 1 under "Property Damage Reserve" for additional information.

4. JOINT OWNERSHIP AGREEMENTS

The Company and Mississippi Power jointly own Plant Daniel Units 1 and 2, which together represent capacity of 1,000 megawatts (MW). Plant Daniel is a generating plant located in Jackson County, Mississippi. In accordance with the operating agreement, Mississippi Power acts as the Company's agent with respect to the construction, operation, and maintenance of these units.

The Company and Georgia Power jointly own the 818 MW capacity Plant Scherer Unit 3. Plant Scherer is a generating plant located near Forsyth, Georgia. In accordance with the operating agreement, Georgia Power acts as the Company's agent with respect to the construction, operation, and maintenance of the unit.

The Company's pro rata share of expenses related to both plants is included in the corresponding operating expense accounts in the statements of income.

At December 31, 2007, the Company's percentage ownership and its investment in these jointly owned facilities were as follows:

	Plant Scherer Unit 3 (coal)	**Plant Daniel Units 1 & 2 (coal)**
	(in thousands)	
Plant in service	**$ 191,418[a]**	**$ 254,045**
Accumulated depreciation	**94,466**	**140,984**
Construction work in progress	**23,046**	**344**
Ownership	**25%**	**50%**

(a) Includes net plant acquisition adjustment of $3.6 million.

5. INCOME TAXES

Southern Company files a consolidated federal income tax return and combined State of Mississippi and State of Georgia income tax returns. Under a joint consolidated income tax allocation agreement, each subsidiary's current and deferred tax expense is computed on a stand-alone basis. In accordance with 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
		(in thousands)	
Federal –			
Current	**$ 51,321**	$ 40,472	$ 11,330
Deferred	**(9,431)**	(470)	26,693
	41,890	40,002	38,023
State –			
Current	**6,581**	3,651	490
Deferred	**(1,388)**	1,640	6,468
	5,193	5,291	6,958
Total	**$ 47,083**	$ 45,293	$ 44,981

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
	(in thousands)	
Deferred tax liabilities–		
Accelerated depreciation	**$ 260,720**	$ 245,147
Fuel recovery clause	**22,934**	31,380
Pension benefits and employee benefit obligations	**38,109**	23,888
Property reserve	**6,624**	17,612
Regulatory assets associated with employee benefit obligations	**9,206**	10,940
Regulatory assets associated with asset retirement obligations	**4,837**	5,151
Other	**3,316**	6,492
Total	**345,746**	340,610
Deferred tax assets–		
Federal effect of state deferred taxes	**$ 13,168**	$ 13,713
Post retirement benefits	**16,371**	15,082
Pension benefits	**11,880**	13,310
Other comprehensive loss	**2,386**	2,887
Regulatory liabilities associated with employee benefit obligations	**23,192**	9,057
Asset retirement obligations	**4,837**	5,151
Other	**12,126**	13,777
Total	**83,960**	72,977
Net deferred tax liabilities	**261,786**	267,633
Less current portion, net	**(21,685)**	(29,771)
Accumulated deferred income taxes in the balance sheets	**$ 240,101**	$ 237,862

At December 31, 2007, the tax-related regulatory assets to be recovered from customers were $17.8 million. These assets are attributable to tax benefits flowed through to customers in prior years and to taxes applicable to capitalized allowance for funds used during construction. At December 31, 2007, the tax-related regulatory liabilities to be credited to customers were $15.3 million. These liabilities are attributable to deferred taxes previously recognized at rates higher than the current enacted tax law and to unamortized investment tax credits.

In accordance with regulatory requirements, deferred investment tax credits are amortized over the lives of the related property with such amortization normally applied as a credit to reduce depreciation in the statements of income. Credits amortized in this manner amounted to $1.7 million in 2007, $1.8 million in 2006, and $1.9 million in 2005. At December 31, 2007, all investment tax credits available to reduce federal income taxes payable had been utilized.

Effective Tax Rate

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

	2007	2006	2005
Federal statutory rate	**35.0%**	35.0%	35.0%
State income tax, net of federal deduction	**2.5**	2.8	3.7
Non-deductible book depreciation	**0.4**	0.5	0.7
Difference in prior years' deferred and current tax rate	**(0.6)**	(0.8)	(0.8)
Production activities deduction	**(3.9)**	(1.0)	(0.4)
Other, net	**1.5**	(0.1)	(1.0)
Effective income tax rate	**34.9%**	36.4%	37.2%

The American Jobs Creation Act of 2004 created a tax deduction for a portion of income attributable to United States production activities as defined in Internal Revenue Code Section 199 (production activities deduction). The deduction is equal to a stated percentage of qualified production activities income. The percentage is phased in over the years 2005 through 2010 with a 3% rate applicable to the years 2005 and 2006, a 6% rate applicable for years 2007 through 2009, and a 9% rate applicable for all years after 2009. The increase from 3% in 2006 to 6% in 2007 was one of several factors that increased the Company's 2007 deduction by $4 million over the 2006 deduction. The resulting additional tax benefit was over $1 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 $0.7 million, resulting in a balance of $0.9 million as of December 31, 2007.

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

	2007
	(thousands)
Unrecognized tax benefits as of adoption	**$ 211**
Tax positions from current periods	**469**
Tax positions from prior periods	**207**
Reductions due to settlements	**-**
Reductions due to expired statute of limitations	**-**
Balance at end of year	**$ 887**

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

	2007
	(thousands)
Tax positions impacting the effective tax rate	**$ 887**
Tax positions not impacting the effective tax rate	**-**
Balance at end of year	**$ 887**

Accrued interest for unrecognized tax benefits:

	2007
	(thousands)
Interest accrued as of adoption	**$ 5**
Interest accrued during the year	**53**
Balance at end of year	**$ 58**

The Company classifies interest on tax uncertainties as interest expense. Net interest accrued for the year ended December 31, 2007 was $58 thousand. 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 statute of limitations has expired, for years prior to 2002.

It is reasonably possible that the amount of the unrecognized benefit with respect to certain of 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

Long-Term Debt Payable to Affiliated Trusts

The Company has formed certain wholly owned trust subsidiaries for the purpose of issuing preferred securities. The proceeds of the related equity investments and preferred security sales were loaned back to the Company through the issuance of junior subordinated notes which constitute substantially all of the assets of these trusts and are reflected in the balance sheets as Long-term Debt. The Company considers that the mechanisms and obligations relating to the preferred securities issued for its benefit, taken together, constitute a full and unconditional guarantee by it of the trusts' payment obligations with respect to these securities. During 2007, the Company redeemed its last remaining series, which totaled $41.2 million. See Note 1 under "Variable Interest Entities" for additional information on the accounting treatment for these trusts and the related securities.

Outstanding Classes of Capital Stock

The Company currently has preferred stock, Class A preferred stock, preference stock, and common stock authorized. The Company's preferred stock and Class A preferred stock, without preference between classes, rank senior to the Company's preference stock and common stock with respect to payment of dividends and voluntary or involuntary dissolution. No shares of preferred stock or Class A preferred stock were outstanding at December 31, 2007. The Company's preference stock ranks senior to the common stock with respect to the payment of dividends and voluntary or involuntary dissolution. Certain series of the preference stock are subject to redemption at the option of the Company on or after a specified date (typically 5 or 10 years after the date of issuance) at a redemption price equal to 100% of the liquidation amount of the preference stock. In addition, one series of the preference stock may be redeemed earlier at a redemption price equal to 100% of the liquidation amount plus a make-whole premium based on the present value of the liquidation amount and future dividends.

On January 19, 2007, the Company issued to Southern Company 800,000 shares of the Company's common stock, without par value, and realized proceeds of $80 million. The proceeds were used to repay a portion of the Company's short-term indebtedness and for other general corporate purposes.

Dividend Restrictions

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

Pollution Control Bonds

Pollution control obligations represent loans to the Company from public authorities of funds derived from sales by such authorities of revenue bonds issued to finance pollution control facilities. The Company is required to make payments sufficient for the authorities to meet principal and interest requirements of such bonds totaling $157.6 million.

Assets Subject to Lien

In January 2007, the Company's first mortgage bond indenture was discharged. As a result, there are no longer any first mortgage liens on the Company's property and the Company no longer has to comply with the covenants and restrictions of the first mortgage bond indenture. The Company has granted a lien on its property at Plant Daniel in connection with the issuance of two series of pollution control bonds with an outstanding principal amount of $41 million.

There are no agreements or other arrangements among the affiliated companies under which the assets of one company have been pledged or otherwise made available to satisfy obligations of Southern Company or any of its subsidiaries.

Bank Credit Arrangements

At the beginning of 2008, the Company had $125 million of lines of credit with banks subject to renewal each year, all of which remained unused. Of the $125 million, $121 million provides liquidity support for the Company's commercial paper program and $4 million of variable rate pollution control bonds. In connection with these credit lines, the Company has agreed to pay commitment fees.

Certain credit arrangements contain covenants that limit the level of indebtedness to capitalization to 65%, as defined in the arrangements. At December 31, 2007, the Company was in compliance with these covenants.

In addition, certain credit arrangements contain cross default provisions to other indebtedness that would trigger an event of default if the Company defaulted on indebtedness over a specified threshold. The cross default provisions are restricted only to indebtedness of the Company. The Company is currently in compliance with all such covenants.

The Company borrows primarily through a commercial paper program that has the liquidity support of committed bank credit arrangements. The Company may also borrow through various other arrangements with banks and through an extendible commercial note program. At December 31, 2007, the Company had $40.8 million of commercial paper and no extendible commercial notes outstanding. At December 31, 2006, the Company had $80.4 million of commercial paper and $40 million of bank notes outstanding. During 2007, the peak amount outstanding for short term debt was $147.4 million and the average amount outstanding was $47.5 million. The average annual interest rate on commercial paper was 5.33%.

Financial Instruments

The Company enters into energy-related derivatives to hedge exposures to electricity, gas, and other fuel price changes. However, due to cost-based rate regulations, the Company has limited exposure to market volatility in commodity fuel prices and prices of electricity. The Company has implemented fuel-hedging programs with the approval of the Florida PSC. The Company enters into hedges of forward electricity sales. There was no material ineffectiveness recorded in earnings in 2007, 2006, and 2005.

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

	Amounts *(in thousands)*
Regulatory assets, net	**$ (202)**
Net income	**-**
Total fair value	**$ (202)**

The fair value gains or losses for cash flow hedges that are recoverable through the regulatory fuel clauses are recorded as regulatory assets and liabilities and are recognized in earnings at the same time the hedged items affect earnings. The Company has energy-related hedges in place up to and including 2010.

The Company also enters into derivatives to hedge exposure to interest rate changes. Derivatives related to forecasted transactions are accounted for as cash flow hedges. The derivatives employed as hedging instruments are structured to minimize ineffectiveness. As such, no material ineffectiveness has been recorded in earnings for any period presented. The hedges will be terminated at the time the underlying debt is issued.

At December 31, 2007 the Company had the following interest rate derivatives accounted for as cash flow hedges:

Notional Amount	Variable Rate Received	Weighted Average Fixed Rate Paid	Hedge Maturity Date	Fair Value Gain (Loss) December 31, 2007
(in millions)				*(in millions)*
$80	3-month LIBOR	5.10%	July 2018	$(2.4)

In 2007, the Company terminated interest rate derivatives, at the same time the related debt was issued, with a notional value of $85 million at a gain of $3.0 million. The hedge cost will be amortized over a 10-year period. For the years 2007, 2006, and 2005, approximately $0.7 million, $0.4 million, and $0.3 million, respectively, of pre-tax losses were reclassified from other comprehensive income to interest expense. For 2008, pre-tax losses of approximately $0.7 million are expected to be reclassified from other comprehensive income to interest expense. The Company has net losses that are being amortized through 2017.

7. COMMITMENTS

Construction Program

The Company is engaged in a continuous construction program, the cost of which is currently estimated to total $410 million in 2008, $426 million in 2009, and $245 million in 2010. The construction program is subject to periodic review and revision, and actual construction costs may vary from the above estimates because of numerous factors. These factors include changes in business conditions; acquisition of additional generating assets; revised load growth estimates; changes in environmental regulations; changes in FERC rules and regulations; increasing costs of labor, equipment, and materials; and cost of capital. At December 31, 2007, significant purchase commitments were outstanding in connection with the ongoing construction program.

Included in the amounts above are $317 million in 2008, $301 million in 2009, and $134 million in 2010 for environmental expenditures. The Company does not have any new generating capacity under construction. Construction of new transmission and distribution facilities and other capital improvements, including those needed to meet environmental standards for the Company's existing generation, transmission, and distribution facilities, are ongoing.

Long-Term Service Agreements

The Company has a Long-Term Service Agreement (LTSA) with General Electric (GE) for the purpose of securing maintenance support for combined cycle generating facility. The LTSA provides that GE will perform all planned inspections on the covered equipment, which generally includes the cost of all labor and materials. GE is also obligated to cover the costs of unplanned maintenance on the covered equipment subject to limits and scope specified in the LTSA.

In general, the LTSA is in effect through two major inspection cycles of the unit. Scheduled payments to GE, which are subject to price escalation, are made at various intervals based on actual operating hours of the unit. Total remaining payments to GE under the LTSA for facilities owned are currently estimated at $69.0 million over the remaining life of the LTSA, which is currently estimated to be up to 9 years. However, the LTSA contains various cancellation provisions at the option of the Company.

Payments made under the LTSA prior to the performance of any planned inspections are recorded as prepayments. These amounts are included in Current Assets and Deferred Charges and Other Assets in the balance sheets. Inspection costs are capitalized or charged to expense based on the nature of the work performed.

Limestone Commitments

As part of the Company's program to reduce sulfur dioxide emissions from certain of its coal plants, the Company is constructing certain equipment and has entered into various long-term commitments for the procurement of limestone to be used in such equipment. Contracts are structured with tonnage minimums and maximums in order to account for changes in coal burn and sulfur content. The Company has a minimum contractual obligation of 0.8 million tons equating to approximately $63.8 million through 2019. Estimated expenditures over the next five years are none in 2008 and 2009, $5.7 million in 2010, $5.8 million in 2011, and $6.0 million in 2012. Limestone costs are expected to be recovered through the environmental cost recovery clause.

Fuel and Purchased Power Commitments

To supply a portion of the fuel requirements of the generating plants, the Company has entered into various long-term commitments for the procurement of fossil fuel. In most cases, these contracts contain provisions for price escalations, minimum purchase levels, and other financial commitments. Coal commitments include forward contract purchases for sulfur dioxide emission allowances. Natural gas purchase commitments contain fixed volumes with prices based on various indices at the time of delivery. Amounts included in the chart below represent estimates based on New York Mercantile Exchange future prices at December 31, 2007. Also, the Company has entered into various long-term commitments for the purchase of capacity and electricity.

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

	Commitments		
	Purchased Power*	Natural Gas	Coal
		(in thousands)	
2008	$ -	$ 116,163	$ 221,177
2009	23,832	101,442	100,266
2010	26,811	52,498	63,884
2011	26,861	20,298	-
2012	26,927	20,320	-
2013 and thereafter	30,988	169,540	-
Total	$ 135,419	$ 480,261	$ 385,327

*Included above is $76 million in obligations with affiliated companies.

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

SCS may enter into various types of wholesale energy and natural gas contracts acting as an agent for the Company and all of the other Southern Company traditional operating companies and Southern Power. Under these agreements, each of the traditional operating companies and Southern Power may be jointly and severally liable. The creditworthiness of Southern Power is currently inferior to the creditworthiness of the traditional operating companies. Accordingly, Southern Company has entered into keep-well agreements with the Company and each of the other traditional operating companies to ensure the Company will not subsidize or be responsible for any costs, losses, liabilities, or damages resulting from the inclusion of Southern Power 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 $4.7 million, $4.9 million, and $3.0 million, for 2007, 2006, and 2005, respectively. Included in these lease expenses are railcar lease costs which are charged to fuel inventory and are allocated to fuel expense as the fuel is used. These expenses are then recovered through the Company's fuel cost recovery clause. The Company's share of the lease costs charged to fuel inventories was $4.4 million in 2007, $4.6 million in 2006, and $3.0 million in 2005. The Company includes any step rents, escalations, and lease concessions in its computation of minimum lease payments, which are recognized on a straight-line basis over the minimum lease term.

At December 31, 2007, estimated minimum rental commitments for noncancelable operating leases were as follows:

	Minimum Lease Payments		
	Rail Cars	Other	Total
		(in thousands)	
2008	$ 3,049	$ 339	$ 3,388
2009	1,913	251	2,164
2010	1,912	128	2,040
2011	553	-	553
2012	561	-	561
2013 and thereafter	2,793	-	2,793
Total	$ 10,781	$ 718	$ 11,499

The Company and Mississippi Power jointly entered into operating lease agreements for aluminum railcars for the transportation of coal to Plant Daniel. The Company has the option to purchase the railcars at the greater of lease termination value or fair market value or to renew the leases at the end of each lease term. The Company and Mississippi Power also have separate lease agreements for other railcars that do not include purchase options.

In addition to railcar leases, the Company has other operating leases for fuel handling equipment at Plant Daniel. The Company's share of these leases was charged to fuel handling expense in the amount of $0.3 million in 2007. The Company's annual lease payments for 2008 to 2010 will average approximately $0.2 million.

8. STOCK OPTION PLAN

Southern Company provides non-qualified stock options to a large segment of the Company's employees ranging from line management to executives. As of December 31, 2007, there were 289 current and former employees of the Company participating in the stock option plan. The maximum number of shares of Southern Company common stock that may be issued under this plan may not exceed 40 million. The prices of options granted to date have been at the fair market value of the shares on the dates of grant. Options granted to date become exercisable pro rata over a maximum period of three years from the date of grant. The Company generally recognizes stock option expense on a straight-line basis over the vesting period which equates to the requisite service period; however, for employees who are eligible for retirement the total cost is expensed at the grant date. Options outstanding will expire no later than 10 years after the date of grant, unless terminated earlier by the Southern Company Board of Directors in accordance with the stock option plan. For certain stock option awards a change in control will provide accelerated vesting.

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

	Shares Subject to Option	Weighted Average Exercise Price
Outstanding at December 31, 2006	1,198,521	$ 28.77
Granted	257,967	36.42
Exercised	(229,584)	25.41
Cancelled	(1,549)	32.76
Outstanding at December 31, 2007	**1,225,355**	**$ 31.01**
Exercisable at December 31, 2007	**787,812**	**$ 28.78**

The number of stock options vested, and expected to vest in the future, as of December 31, 2007 was not significantly different from the number of stock options outstanding at December 31, 2007 as stated above. As of December 31, 2007, the weighted average remaining contractual term for the options outstanding and options exercisable was 6.4 years and 5.2 years, respectively, and the aggregate intrinsic value for the options outstanding and options exercisable was $9.5 million and $7.9 million, respectively.

As of December 31, 2007, there was $0.5 million of total unrecognized compensation cost related to stock option awards not yet vested. That cost is expected to be recognized over a weighted average period of approximately 10 months.

The total intrinsic value of options exercised during the years ended December 31, 2007, 2006, and 2005 was $3.0 million, $1.6 million, and $4.4 million, respectively. The actual tax benefit realized by the Company for the tax deductions from stock option exercises for the years ended December 31, 2007, 2006, and 2005 totaled $1.1 million, $0.6 million, and $1.7 million, respectively.

9. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial data for 2007 and 2006 are as follows:

Quarter Ended	Operating Revenues	Operating Income	Net Income After Dividends on Preference Stock
		(in thousands)	
March 2007	**$ 296,233**	**$ 40,775**	**$ 18,863**
June 2007	**298,394**	**45,017**	**21,275**
September 2007	**376,556**	**64,999**	**34,163**
December 2007	**288,625**	**25,125**	**9,817**
March 2006	$ 263,042	$ 31,079	$ 12,402
June 2006	292,722	47,062	22,038
September 2006	373,030	66,511	34,577
December 2006	275,120	22,020	6,972

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

SELECTED FINANCIAL AND OPERATING DATA 2003-2007

Gulf Power Company 2007 Annual Report

	2007	2006	2005	2004	2003
Operating Revenues (in thousands)	**$1,259,808**	$1,203,914	$1,083,622	$960,131	$877,697
Net Income after Dividends on Preferred and Preference Stock (in thousands)	**$84,118**	$75,989	$75,209	$68,223	$69,010
Cash Dividends on Common Stock (in thousands)	**$74,100**	$70,300	$68,400	$70,000	$70,200
Return on Average Common Equity (percent)	**12.32**	12.29	12.59	11.83	12.42
Total Assets (in thousands)	**$2,498,987**	$2,340,489	$2,175,797	$2,111,877	$1,839,053
Gross Property Additions (in thousands)	**$239,337**	$147,086	$142,583	$161,205	$99,284
Capitalization (in thousands):					
Common stock equity	**$ 731,255**	$634,023	$602,344	$592,172	$561,358
Preferred and preference stock	**97,998**	53,887	53,891	4,098	4,236
Mandatorily redeemable preferred securities	**-**	-	-	-	70,000
Long-term debt	**740,050**	696,098	616,554	623,155	515,827
Total (excluding amounts due within one year)	**$1,569,303**	$1,384,008	$1,272,789	$1,219,425	$1,151,421
Capitalization Ratios (percent):					
Common stock equity	**46.6**	45.8	47.3	48.6	48.8
Preferred and preference stock	**6.2**	3.9	4.2	0.3	0.4
Mandatorily redeemable preferred securities	**-**	-	-	-	6.1
Long-term debt	**47.2**	50.3	48.5	51.1	44.7
Total (excluding amounts due within one year)	**100.0**	100.0	100.0	100.0	100.0
Security Ratings:					
First Mortgage Bonds -					
Moody's	**-**	-	A1	A1	A1
Standard and Poor's	**-**	-	A+	A+	A+
Fitch	**-**	-	A+	A+	A+
Preferred Stock/ Preference Stock -					
Moody's	**Baa1**	Baa1	Baa1	Baa1	Baa1
Standard and Poor's	**BBB+**	BBB+	BBB+	BBB+	BBB+
Fitch	**A-**	A-	A-	A-	A-
Unsecured Long-Term Debt -					
Moody's	**A2**	A2	A2	A2	A2
Standard and Poor's	**A**	A	A	A	A
Fitch	**A**	A	A	A	A
Customers (year-end):					
Residential	**373,036**	364,647	354,466	343,151	341,935
Commercial	**53,838**	53,466	53,398	51,865	51,169
Industrial	**298**	295	298	285	285
Other	**491**	484	479	473	473
Total	**427,663**	418,892	408,641	395,774	393,862
Employees (year-end)	**1,324**	1,321	1,335	1,336	1,337

	2007	2006	2005	2004	2003
Operating Revenues (in thousands):					
Residential	**$ 537,668**	$510,995	$465,346	$401,382	$381,464
Commercial	**329,651**	305,049	273,114	232,928	218,928
Industrial	**135,179**	132,339	123,044	99,420	95,702
Other	**3,831**	3,655	3,355	3,140	3,080
Total retail	**1,006,329**	952,038	864,859	736,870	699,174
Wholesale - non-affiliates	**83,514**	87,142	84,346	73,537	76,767
Wholesale - affiliates	**113,178**	118,097	91,352	110,264	63,268
Total revenues from sales of electricity	**1,203,021**	1,157,277	1,040,557	920,671	839,209
Other revenues	**56,787**	46,637	43,065	39,460	38,488
Total	**$1,259,808**	$1,203,914	$1,083,622	$960,131	$877,697
Kilowatt-Hour Sales (in thousands):					
Residential	**5,477,111**	5,425,491	5,319,630	5,215,332	5,101,099
Commercial	**3,970,892**	3,843,064	3,735,776	3,695,471	3,614,255
Industrial	**2,048,389**	2,136,439	2,160,760	2,113,027	2,146,956
Other	**24,496**	23,886	22,730	22,579	22,479
Total retail	**11,520,888**	11,428,880	11,238,896	11,046,409	10,884,789
Sales for resale - non-affiliates	**2,227,026**	2,079,165	2,295,850	2,256,942	2,504,211
Sales for resale - affiliates	**2,884,440**	2,937,735	1,976,368	3,124,788	2,438,874
Total	**16,632,354**	16,445,780	15,511,114	16,428,139	15,827,874
Average Revenue Per Kilowatt-Hour (cents):					
Residential	**9.82**	9.42	8.75	7.70	7.48
Commercial	**8.30**	7.94	7.31	6.30	6.06
Industrial	**6.60**	6.19	5.69	4.71	4.46
Total retail	**8.73**	8.33	7.70	6.67	6.42
Wholesale	**3.85**	4.09	4.11	3.42	2.83
Total sales	**7.23**	7.04	6.71	5.60	5.30
Residential Average Annual Kilowatt-Hour Use Per Customer	**14,755**	15,032	15,181	15,096	15,064
Residential Average Annual Revenue Per Customer	**$1,448**	$1,416	$1,328	$1,162	$1,126
Plant Nameplate Capacity Ratings (year-end) (megawatts)	**2,659**	2,659	2,712	2,712	2,786
Maximum Peak-Hour Demand (megawatts):					
Winter	**2,215**	2,195	2,124	2,061	2,494
Summer	**2,626**	2,479	2,433	2,421	2,269
Annual Load Factor (percent)	**55.0**	57.9	57.7	57.1	54.6
Plant Availability Fossil-Steam (percent)	**93.4**	91.3	89.7	92.4	90.7
Source of Energy Supply (percent):					
Coal	**81.8**	82.5	79.7	77.9	78.7
Gas	**13.6**	12.4	13.1	14.4	11.9
Purchased power -					
From non-affiliates	**1.6**	1.9	2.8	4.5	3.2
From affiliates	**3.0**	3.2	4.4	3.2	6.2
Total	**100.0**	100.0	100.0	100.0	100.0

Directors

Susan N. Story
President and Chief Executive Officer
Gulf Power Company
Pensacola, Florida. Elected 2003

C. LeDon Anchors
Attorney at Law
Anchors Smith Grimsley
A Professional Limited Company
Fort Walton Beach, Florida. Elected 2001

William C. Cramer, Jr.
President
Tommy Thomas Chevrolet, Inc.
Panama City, Florida. Elected 2002

Fred C. Donovan, Sr.
Chairman and Chief Executive Officer
Baskerville-Donovan, Inc.
Pensacola, Florida. Elected 1991

William A. Pullum
Broker/President
Bill Pullum Realty, Inc.
Navarre, Florida. Elected 2001

Winston E. Scott
Vice President, Deputy General Manager
Engineering and Science Contract Group
Jacobs Engineering
Houston, Texas. Elected 2003

Officers

Susan N. Story
President and Chief Executive Officer
25 Years of Service

Francis M. Fisher, Jr. (1)
Vice President – Customer Operations
36 Years of Service

P. Bernard Jacob
Vice President – Customer Operations
25 Years of Service

Ronnie R. Labrato (2)
Vice President and Chief Financial Officer
28 Years of Service

Penny M. Manuel (3)
Vice President – Sr. Production Officer
25 Years of Service

Theodore J. McCullough (4)
Vice President – Sr. Production Officer
21 Years of Service

Philip C. Raymond (5)
Vice President and Chief Financial Officer
17 Years of Service

Bentina C. Terry
Vice President – External Affairs and
Corporate Services
7 Years of Service

Connie J. Erickson
Comptroller
5 Years of Service

Susan D. Ritenour
Secretary and Treasurer
26 Years of Service

Terry A. Davis
Assistant Secretary and Assistant Treasurer
21 Years of Service

Robert A. Bell (6)
Vice President
34 Years of Service

Marsha S. Johnson (5)
Vice President
21 Years of Service

E. Wayne Boston
Assistant Secretary and Assistant Treasurer
37 Years of Service

(1) Retired effective May 1, 2007.
(2) Resigned effective April 1, 2008.
Transferred to Southern Company Services.
(3) Resigned effective August 11, 2007.
Transferred to Southern Company Services.
(4) Elected effective August 11, 2007.
(5) Elected effective April 1, 2008.
(6) Retired effective April 1, 2008.

General
This annual report is submitted for general information. It is not intended for use in connection with any sale or purchase of, or any solicitation of offers to buy or sell, securities.

Profile
The Company produces and delivers electricity as an integrated utility to both retail and wholesale customers within the State of Florida. The Company sells electricity to approximately 428,000 customers within its service area of approximately 7,500 square miles in the Florida panhandle. In 2007, retail energy sales accounted for 69 percent of the Company's total sales of 16.6 billion kilowatt-hours.

The Company is a wholly owned subsidiary of The Southern Company, which is the parent company of four traditional operating companies, a wholesale generation subsidiary, and other direct and indirect subsidiaries. There is no established public trading market for the Company's common stock.

Registrar, Transfer Agent, and Dividend Paying Agent
Preference Stock
Southern Company Services, Inc.
Stockholder Services
P.O. Box 54250
Atlanta, GA 30308-0250
(800) 554-7626

Trustee, Registrar, and Interest Paying Agent
All series of Senior Notes
The Bank of New York
Global Trust Administration
101 Barclay Street, 8 West
New York, New York 10286

All of the outstanding shares of the Company's preference stock are registered in the name of Cede & Co., as nominee for The Depository Trust Company.

Form 10-K
A copy of Form 10-K as filed with the Securities and Exchange Commission will be provided upon written request to the office of the Corporate Secretary at the mailing address below:

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500 Bayfront Parkway
Pensacola, FL 32520
(850) 444-6111

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Gulf Power Company
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