GULF POWER COMPANY

2009 Annual Report

GULF POWER
A SOUTHERN COMPANY

CONTENTS
Gulf Power Company 2009 Annual Report

SUMMARY

	2009	2008	Percent Change
Financial Highlights *(in thousands)*:			
Operating revenues	**$1,302,229**	**$1,387,203**	(6.1)
Operating expenses	**1,113,567**	**1,194,514**	(6.8)
Net income after dividends on preference stock	**111,233**	**98,345**	13.1
Gross property additions	**450,421**	**390,744**	15.3
Total assets	**3,293,607**	**2,879,025**	14.4
Operating Data:			
Kilowatt-hour sales *(in thousands)*:			
Retail	**10,902,823**	**11,543,399**	(5.5)
Sales for resale - non-affiliates	**1,813,592**	**1,816,839**	(0.2)
Sales for resale – affiliates	**870,470**	**1,871,158**	(53.5)
Total	**13,586,885**	**15,231,396**	(10.8)
Customers served at year-end	**428,154**	**427,929**	0.1
Peak-hour demand, net *(in megawatts)*	**2,538**	**2,533**	0.2
Capitalization Ratios *(percent)*:			
Common stock equity	**48.3**	**46.5**	
Preference stock	**4.7**	**5.5**	
Long-term debt (excluding amounts due within one year)	**47.0**	**48.0**	
Return on Average Common Equity *(percent)*	**12.18**	**12.66**	

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Letter to Investors
Gulf Power Company 2009 Annual Report

Our commitment to the future

Investing in the future is important to all of us. We understand that our plans today help to shape the future of northwest Florida. We take that commitment seriously and are looking forward with an energy plan that is affordable, reliable, and environmentally responsible.

In December 2009, our latest investment in cleaner energy went online. The Flue Gas Desulfurization system — called the scrubber — is designed to reduce regulated emissions at our Plant Crist site near Pensacola.

This landmark project also should improve Gulf Power's impact on the area's water quality by re-using millions of gallons of treated water from the new Emerald Coast Utility Authority's advanced wastewater treatment facility, eliminating that discharge into area waterways.

In late 2009, Gulf Power began a partnership with Escambia County to produce renewable energy with a new landfill gas-to-energy facility at the Perdido Landfill. This facility, which is expected to be completed in mid-2010, will produce enough renewable energy to power more than 900 homes.

Our wind research project is another commitment -- to energy and to education. The data we are gathering at our wind tower on Navarre Beach will be used to analyze the feasibility of wind along the Gulf Coast. In addition, a local high school is integrating the wind data into their science curriculum.

The landfill gas project and the wind research project are part of our continuing effort to keep electricity affordable and reliable by exploring viable fuel sources as we seek to diversify our fuel mix. Fuel diversity should help us avoid fuel shortages and keep prices down. New technologies are key components to ensuring a clean energy future.

EarthCents programs continue to help our customers save money and energy, and are expected to help Gulf Power delay the need to build new power plants. Over the last 20 years, conservation efforts have saved enough energy to power 100,000 homes.

Gulf Power's commitment to our customers and communities remained strong in 2009. And, looking ahead, our goal is to continue to maintain financial strength and integrity, along with a strong credit quality, as we move through these challenging times.

Susan N. Story

Susan N. Story
President and Chief Executive Officer
April 1, 2010

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Gulf Power Company 2009 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, 2009.

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
President and Chief Executive Officer

Philip C. Raymond
Vice President and Chief Financial Officer

February 25, 2010

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, 2009 and 2008, 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, 2009. 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 25 to 63) present fairly, in all material respects, the financial position of Gulf Power Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Atlanta, Georgia
February 25, 2010

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 constructive regulatory environment, to maintain energy sales given the effects of the recession, and to effectively manage and secure timely recovery of rising costs. These costs include those related to projected long-term demand growth, increasingly stringent environmental standards, fuel prices, and storm restoration costs. Appropriately balancing the need to recover these increasing costs with customer prices will continue to challenge the Company for the foreseeable future.

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 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 2009 Peak Season EFOR of 2.11% 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 2009 was better than the target for these reliability measures. The performance for net income after dividends on preference stock in 2009 was below target. Net income after dividends on preference stock is the primary measure of the Company's financial performance.

The Company's 2009 results compared with its targets for some of these key indicators are reflected in the following chart:

Key Performance Indicator	2009 Target Performance	2009 Actual Performance
Customer Satisfaction	**Top quartile in customer surveys**	**Top quartile**
Peak Season EFOR	**3.00% or less**	**2.11%**
Net income after dividends on preference stock	**$112.5 million**	**$111.2 million**

See RESULTS OF OPERATIONS herein for additional information on the Company's financial performance.

Earnings

The Company's 2009 net income after dividends on preference stock was $111.2 million, an increase of $12.9 million from the previous year. In 2008, net income after dividends on preference stock was $98.3 million, an increase of $14.2 million from the previous year. In 2007, net income after dividends on preference stock was $84.1 million, an increase of $8.1 million from the previous year. The increase in net income after dividends on preference stock in 2009 was due primarily to increased allowance for funds used during construction (AFUDC) equity, which is non-taxable, and decreased interest expense, net of amounts capitalized, partially offset by unfavorable weather and a decline in sales. The increase in net income after dividends on preference stock in 2008 was due primarily to higher wholesale revenues from non-affiliates, increased AFUDC equity, and a gain on the sale of assets.

The increase in net income after dividends on preference stock 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 AFUDC equity, partially offset by non-fuel operating expenses.

RESULTS OF OPERATIONS

A condensed statement of income follows:

	Amount	Increase (Decrease) from Prior Year		
	2009	**2009**	2008	2007
		(in millions)		
Operating revenues	**$ 1,302.2**	**$ (84.9)**	$ 127.4	$ 55.9
Fuel	**573.4**	**(62.2)**	62.2	38.5
Purchased power	**92.0**	**(17.4)**	37.9	(2.3)
Other operations and maintenance	**260.3**	**(17.2)**	7.1	10.9
Depreciation and amortization	**93.4**	**8.6**	(0.8)	(3.6)
Taxes other than income taxes	**94.5**	**7.3**	4.2	3.2
Total operating expenses	**1,113.6**	**(80.9)**	110.6	46.7
Operating income	**188.6**	**(4.0)**	16.8	9.2
Total other income and (expense)	**(18.2)**	**15.8**	6.7	1.3
Income taxes	**53.0**	**(1.1)**	7.0	1.8
Net income	**117.4**	**12.9**	16.5	8.7
Dividends on preference stock	**6.2**	**-**	2.3	0.6
Net income after dividends on preference stock	**$ 111.2**	**$ 12.9**	$ 14.2	$ 8.1

Operating Revenues

Operating revenues for 2009 were $1.3 billion, a decrease of $85.0 million from the previous year. The following table summarizes the significant changes in operating revenues for the past three years:

	Amount		
	2009	2008	2007
		(in millions)	
Retail – prior year	**$ 1,120.8**	$ 1,006.3	$ 952.0
Estimated change in –			
Rates and pricing	**33.0**	6.3	2.5
Sales growth (decline)	**(5.7)**	(4.6)	5.8
Weather	**(4.5)**	3.9	1.2
Fuel and other cost recovery	**(37.0)**	108.9	44.8
Retail – current year	**1,106.6**	1,120.8	1,006.3
Wholesale revenues –			
Non-affiliates	**94.1**	97.1	83.5
Affiliates	**32.1**	107.0	113.2
Total wholesale revenues	**126.2**	204.1	196.7
Other operating revenues	**69.4**	62.3	56.8
Total operating revenues	**$ 1,302.2**	$ 1,387.2	$ 1,259.8
Percent change	**(6.1)%**	10.1%	4.6%

Retail revenues decreased $14.2 million, or 1.3%, in 2009, increased $114.4 million, or 11.4%, in 2008, and increased $54.3 million, or 5.7%, in 2007.

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 Public Service Commission (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. See "Energy Sales" below for a discussion of changes in the volume of energy sold, including changes relating to sales growth (or decline) and weather.

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 – Fuel Cost Recovery" for additional information.

Total wholesale revenues were $126.2 million in 2009, a decrease of $77.8 million, or 38.2%, compared to 2008 primarily due to decreased energy sales to affiliates at a lower cost per kilowatt-hour (KWH). Total wholesale revenues were $204.1 million in 2008, an increase of $7.4 million, or 3.7%, compared to 2007 primarily due to higher capacity revenues associated with new and existing territorial wholesale contracts with non-affiliated companies. 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 KWH supplied by lower-cost generating resources.

Wholesale revenues from sales to non-affiliates will vary depending on the market cost of available energy compared to the cost of the Company and Southern Company system-owned generation, demand for energy with the Southern Company service territory, and availability of Southern Company system generation.

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:

	2009	2008	2007
		(in thousands)	
Unit power sales –			
Capacity	**$ 24,466**	$ 22,028	$ 18,073
Energy	**33,122**	33,767	36,245
Total	**57,588**	55,795	54,318
Other power sales –			
Capacity and other	**11,060**	10,890	2,397
Energy	**25,457**	30,380	26,799
Total	**36,517**	41,270	29,196
Total non-affiliated	**$ 94,105**	$ 97,065	$ 83,514

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 system company. These affiliated sales, along with purchases from affiliates, 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 $7.1 million, or 11.3%, in 2009 primarily due to other energy services and franchise fees, offset by transmission and distribution network services and timber sales. Other operating revenues increased $5.6 million, or 9.9%, in 2008 primarily due to transmission and distribution network services and other energy services. Other operating revenues increased $10.2 million, or 21.8%, in 2007 primarily due to other energy services and an increase in franchise fees. The increased revenues from other energy services did not have a material impact on earnings since they were generally offset by associated expenses. Franchise fees have no impact on net income.

Energy Sales

Changes in revenues are influenced heavily by the change in the volume of energy sold from year to year. KWH sales for 2009 and the percent change by year were as follows:

	KWHs	**Percent Change**		
	2009	**2009**	2008	2007
	(in millions)			
Residential	**5,255**	**(1.8)%**	(2.3)%	0.9%
Commercial	**3,896**	**(1.6)**	(0.3)	3.3
Industrial	**1,727**	**(21.9)**	7.9	(4.1)
Other	**25**	**8.1**	(5.1)	4.2
Total retail	**10,903**	**(5.5)**	0.2	0.8
Wholesale				
Non-affiliates	**1,813**	**(0.2)**	(18.4)	7.1
Affiliates	**870**	**(53.5)**	(35.1)	(1.8)
Total wholesale	**2,683**	**(27.2)**	(27.8)	1.9
Total energy sales	**13,586**	**(10.8)**	(8.4)	1.1

Changes in retail energy sales are comprised of changes in electricity usage by customers, changes in weather, and changes in the number of customers.

Residential energy sales decreased 1.8% in 2009 compared to 2008 primarily due to the recessionary economy. Residential energy sales decreased 2.3% in 2008 compared to 2007 primarily due to decreased customer usage as a result of a slowing economy, partially offset by more favorable weather. 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.

Commercial energy sales decreased 1.6% in 2009 compared to 2008 primarily due to the recessionary economy and a decrease in the number of customers. The change in commercial energy sales in 2008 compared to 2007 was immaterial. Commercial energy sales increased 3.3% in 2007 compared to 2006 primarily due to more favorable weather conditions and customer growth.

Industrial energy sales decreased 21.9% in 2009 compared to 2008 primarily due to increased customer co-generation due to the lower cost of natural gas in 2009, decreased demand, and a business closure due to the recessionary economy. Industrial energy sales increased 7.9% in 2008 compared to 2007 primarily due to decreased customer co-generation due to the higher cost of natural gas. 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.

Wholesale energy sales to non-affiliates decreased 0.2% in 2009, decreased 18.4% in 2008, and increased 7.1% in 2007, each compared to the prior year. The decrease in 2009 was primarily a result of the recessionary economy. The changes in 2008 and 2007 were primarily the 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 prices for oil and natural gas, 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 53.5% in 2009, 35.1% in 2008, and 1.8% in 2007, compared to prior years. The decrease in 2009 was primarily a result of the recessionary economy. The decreases in 2008 and 2007 were primarily due to the availability of lower cost generation resources at affiliated companies.

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:

	2009	2008	2007
Total generation *(millions of KWHs)*	**12,895**	14,762	16,657
Total purchased power *(millions of KWHs)*	**1,481**	1,187	798
Sources of generation *(percent)* –			
Coal	**69%**	84%	86%
Gas	**31**	16	14
Cost of fuel, generated *(cents per net KWH)* –			
Coal	**4.27**	3.58	2.86
Gas	**4.66**	8.02	6.91
Average cost of fuel, generated *(cents per net KWH)**	**4.39**	4.31	3.44
Average cost of purchased power *(cents per net KWH)*	**6.71**	9.21	8.96

*Fuel includes fuel purchased by the Company for tolling agreements where power is generated by the provider and is included in purchased power when determining the average cost of purchased power.

Total fuel and purchased power expenses were $665.4 million in 2009, a decrease of $79.6 million, or 10.7%, below the prior year costs. The net decrease in fuel and purchased power expenses was primarily due to a $53.3 million decrease related to total KWHs generated and purchased and a $26.3 million decrease in the cost of energy primarily resulting from a decrease in the average cost of natural gas. Total fuel and purchased power expenses were $745.0 million in 2008, an increase of $100.1 million, or 15.5%, above the prior year costs. The net increase in fuel and purchased power expenses was due to a $130.5 million increase in the average cost of fuel and purchased power as well as a $34.9 million increase related to KWHs purchased, offset by a $65.3 million decrease related to KWHs generated. Total fuel and purchased power expenses were $644.9 million in 2007, an increase of $36.2 million, or 5.9%, above the prior year costs. The net increase in fuel and purchased power expenses was due to a $32.6 million increase in the average cost of fuel and purchased power as well as a $10.1 million increase related to KWHs generated, offset by a $6.5 million decrease related to KWHs purchased.

Fuel expense was $573.4 million in 2009, a decrease of $62.2 million, or 9.8%, below the prior year costs. This decrease was primarily the result of a 41.9% decrease in the average cost of natural gas and a 12.6% decrease in KWHs generated as a result of lower demand, partially offset by an increase of 19.3% in the average cost of coal per KWH generated. Fuel expense was $635.6 million in 2008, an increase of $62.2 million, or 10.9%, above the prior year costs. This increase was the result of a 25.3% increase in the average cost of fuel, offset by an 11.4% decrease in KWHs generated. Fuel expense was $573.4 million in 2007, an increase of $38.5 million, or 7.2%, above the prior year costs. This increase was the result of a 5.2% increase in the average cost of fuel and a 1.9% increase in KWHs generated.

Purchased power expense was $92.0 million in 2009, a decrease of $17.4 million, or 15.9%, below the prior year costs. This decrease was primarily the result of a 27.1% decrease in the average cost per KWH purchased, offset by a 24.8% increase in the volume of KWHs purchased. Purchased power expense was $109.4 million in 2008, an increase of $37.9 million, or 53.0%, above the prior year costs. This increase was the result of a 48.8% increase in total KWHs purchased and a 2.8% increase in the average cost per net KWH. Purchased power expense was $71.5 million in 2007, a decrease of $2.3 million, or 3.1%, below the prior year costs. This decrease was the result of an 8.9% decrease in total KWHs purchased, offset by a 6.3% increase in the average cost per net KWH.

Coal prices continued to be influenced by worldwide demand from developing countries, as well as increased mining and fuel transportation costs. While coal prices reached unprecedented high levels in 2008, the recessionary economy pushed prices downward in 2009. However, the lower prices did not fully offset the higher priced coal already in inventory and under long-term contract. Demand for natural gas in the United States also was affected by the recessionary economy leading to significantly lower natural gas prices.

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 for additional information.

Other Operations and Maintenance Expenses

In 2009, other operations and maintenance expenses decreased $17.2 million, or 6.2%, compared to the prior year primarily due to a $14.4 million decrease in administrative and general expense, most of which is related to decreased storm recovery costs, and a $6.7 million decrease in power generation, most of which is related to scheduled and unscheduled maintenance and cost containment activities in an effort to offset the effects of the recessionary economy. This decrease was partially offset by a $4.8 million increase in other energy services. In 2008, other operations and maintenance expenses increased $7.1 million, or 2.6%, compared to the prior year primarily due to an $8.2 million increase in scheduled and unscheduled maintenance at generation facilities. 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.

Depreciation and Amortization

Depreciation and amortization expense increased $8.6 million, or 10.1%, in 2009 compared to the prior year primarily due to additions of environmental control projects at Plant Crist and Plant Scherer and other net additions to generation and distribution facilities. Depreciation and amortization expense decreased $0.8 million, or 0.9%, in 2008 compared to the prior year primarily as a result of a $3.8 million gain on the sale of a building. The decrease was partially offset by an increase of $3.0 million in depreciation due to net additions to generation and distribution facilities. 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.

Taxes Other Than Income Taxes

Taxes other than income taxes increased $7.3 million, or 8.3%, in 2009 compared to the prior year primarily due to a $5.6 million increase in gross receipts and franchise taxes, which have no impact on net income, and a $1.6 million increase in property taxes. Taxes other than income taxes increased $4.2 million, or 5.1%, in 2008 compared to the prior year primarily due to a $1.9 million decrease in 2007 related to the resolution of a dispute regarding property taxes in Monroe County, Georgia and a $1.9 million increase in franchise and gross receipt taxes. Taxes other than income taxes increased $3.2 million, or 4.0%, in 2007 compared to the prior year primarily due to increases in franchise and gross receipts taxes.

Allowance for Funds Used During Construction Equity

AFUDC equity increased $13.8 million, or 138.8%, in 2009 compared to the prior year primarily due to construction of environmental control projects at Plant Crist and Plant Scherer. AFUDC equity increased $7.6 million, or 319.9%, in 2008 compared to the prior year primarily due to construction of environmental control projects at Plant Crist and Plant Scherer. AFUDC equity increased $2.0 million, or 554.0%, in 2007 compared to the prior year primarily due to construction of an environmental control project at Plant Crist. 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.

Interest Income

Interest income decreased $2.7 million, or 86.6%, in 2009 compared to the prior year primarily due to decreases in interest received related to the recovery of financing costs associated with the fuel clause. Interest income decreased $2.2 million, or 41%, in 2008 primarily as a result of lower variable interest rates charged against the under recovered fuel balance and a decrease in the property damage reserve balance. Interest income increased $0.1 million, or 2.3%, in 2007 compared to the prior year 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. See FUTURE EARNINGS POTENTIAL – "PSC Matters – Fuel Cost Recovery" herein and Note 3 to the financial statements under "Retail Regulatory Matters – Fuel Cost Recovery" for additional information.

Interest Expense, Net of Amounts Capitalized

Interest expense, net of amounts capitalized decreased $4.7 million, or 11.0%, in 2009 compared to the prior year as the result of an increase in capitalization of AFUDC debt related to the construction of environmental control projects at Plant Crist and Plant Scherer. Interest expense, net of amounts capitalized decreased $1.6 million, or 3.5%, in 2008 compared to the prior year as the result of an increase in capitalization of AFUDC debt related to the construction of environmental control projects and the redemption of $41.2 million of long-term debt payable to an affiliated trust in 2007. These decreases were offset by the issuance of a $110 million term loan agreement in 2008. Interest expense, net of amounts capitalized increased $0.5 million, or 1.2%, in 2007 compared to the prior year and was not material.

Income Taxes

Income taxes decreased $1.1 million, or 2.0%, in 2009, compared to the prior year primarily due to the tax benefit associated with an increase in AFUDC, which is non-taxable, partially offset by higher earnings before taxes. Income taxes increased $7.0 million, or 14.9%, in 2008, compared to the prior year primarily due to higher earnings before income taxes and a decrease in the federal production activities deduction, partially offset by the tax benefit associated with an increase in AFUDC, which is non-taxable. Income taxes increased $1.8 million, or 4.0%, in 2007, compared to the prior year primarily as a result of higher earnings before income taxes. See Note 5 to the financial statements under "Effective Tax Rate" for additional information.

Effects of Inflation

The Company is subject to rate regulation that is generally based on the recovery of historical and projected costs. The effects of inflation can create an economic loss since the recovery of costs could be in dollars that have less purchasing power. Any adverse effect of inflation on the Company's results of operations has not been substantial.

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 wholesale electricity sales, 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 Company's ability to maintain a constructive regulatory environment that continues to allow for the recovery of prudently incurred costs during a time of increasing costs. Future earnings in the near term will depend, in part, upon maintaining 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 or decline in the Company's service area. Recessionary conditions have negatively impacted sales and are expected to continue to have a negative impact, particularly to industrial and commercial customers. The timing and extent of the economic recovery will impact future earnings.

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 Company (Alabama Power) and Georgia Power Company (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. These actions were filed concurrently with the issuance of notices of violation of the NSR provisions to the Company with respect to the Company's Plant Crist. After Alabama Power was dismissed from the original action, the EPA filed a separate action in January 2001 against Alabama Power in the U.S. District Court for the Northern District of Alabama. In these lawsuits, the EPA alleges that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power and Georgia Power, including one facility co-owned by the Company. The civil actions request penalties and injunctive relief, including an order requiring installation of the best available control technology at the affected units. The original action, now solely 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 a portion of the Alabama Power lawsuit relating to the alleged NSR violations at Plant Miller. In July 2008, the U.S. District Court for the Northern District of Alabama granted partial summary judgment in favor of Alabama Power with respect to its other affected units regarding the proper legal test for determining whether projects are routine maintenance, repair, and replacement and therefore are excluded from NSR permitting. The decision did not resolve the case, which remains ongoing.

The Company believes that 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 $37,500 per day, per violation at each generating unit, depending on the date of the alleged violation. An adverse outcome 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

New York Case

In July 2004, three environmental groups and attorneys general from eight states, each outside of Southern Company's service territory, and the corporation counsel for New York City filed complaints in the U.S. District Court for the Southern District of New York against Southern Company and four other electric power companies. 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. The 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, on September 21, 2009, the U.S. Court of Appeals for the Second Circuit reversed the district court's ruling, vacating the dismissal of the plaintiffs' claim, and remanding the case to the district court. On November 5, 2009, the defendants, including Southern Company, sought rehearing en banc, and the court's ruling is subject to potential appeal. Therefore, the ultimate outcome of these matters cannot be determined at this time.

Kivalina Case

In February 2008, the Native Village of Kivalina and the City of Kivalina filed a suit in the U.S. District Court for the Northern District of California against several electric utilities (including Southern Company), several oil companies, and a coal company. The plaintiffs are the governing bodies of an Inupiat village in Alaska. The plaintiffs contend that the village is being destroyed by erosion allegedly caused by global warming that the plaintiffs attribute to emissions of greenhouse gases by the defendants. The plaintiffs assert claims for public and private nuisance and contend that some of the defendants have acted in concert and are therefore jointly and severally liable for the plaintiffs' damages. The suit seeks damages for lost property values and for the cost of relocating the village, which is alleged to be $95 million to $400 million. Southern Company believes that these claims are without merit and notes that the complaint cites no statutory or regulatory basis for the claims. On September 30, 2009, the U.S. District Court for the

Northern District of California granted the defendants' motions to dismiss the case based on lack of jurisdiction and ruled the claims were barred by the political question doctrine and by the plaintiffs' failure to establish the standard for determining that the defendants' conduct caused the injury alleged. On November 5, 2009, the plaintiffs filed an appeal with the U.S. Court of Appeals for the Ninth Circuit challenging the district court's order dismissing the case. The ultimate outcome of this matter cannot be determined at this time.

Other Litigation

Common law nuisance claims for injunctive relief and property damage allegedly caused by greenhouse gas emissions have become more frequent, and courts have recently determined that private parties and states have standing to bring such claims. For example, on October 16, 2009, the U.S. Court of Appeals for the Fifth Circuit reversed the U.S. District Court for the Southern District of Mississippi's dismissal of private party claims against certain oil, coal, chemical, and utility companies alleging damages as a result of Hurricane Katrina. In reversing the dismissal, the U.S. Court of Appeals for the Fifth Circuit held that plaintiffs have standing to assert their nuisance, trespass, and negligence claims and none of these claims are barred by the political question doctrine. The Company is not currently a party to this litigation but was named as a defendant in an amended complaint which was rendered moot in August 2007 by the U.S. District Court for the Southern District of Mississippi when such court dismissed the original matter. The ultimate outcome of this matter 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; the Endangered Species Act; and related federal and state regulations. 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 2009, the Company had invested approximately $1.1 billion in capital projects to comply with these requirements, with annual totals of $343 million, $296 million, and $124 million for 2009, 2008, and 2007, respectively. The Company expects that capital expenditures to assure compliance with existing and new statutes and regulations will be an additional $113 million, $195 million, and $194 million for 2010, 2011, and 2012, respectively. The Company's compliance strategy can be affected by changes to existing environmental laws, statutes, and regulations; the cost, availability, and existing inventory of emissions 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 any new federal or state legislation or regulations related to global climate change, air quality, coal combustion byproducts, including coal ash, or other environmental and health concerns could also significantly affect the Company. Although new or revised environmental legislation or regulations could affect many areas of the Company's operations, 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 2009, the Company had spent approximately $834 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 are scheduled to be installed at several plants to further reduce air emissions, maintain compliance with existing regulations, and meet new requirements.

The EPA regulates ground level ozone through implementation of an eight-hour ozone air quality standard. No area within the Company's service area is currently designated as nonattainment under the eight-hour ozone standard. In March 2008, however, the

EPA issued a final rule establishing a more stringent eight-hour ozone standard, and on January 6, 2010, the EPA proposed further reductions in the standard. The EPA is expected to finalize the revised standard in August 2010 and require state implementation plans for any nonattainment areas by December 2013. The revised eight-hour ozone standard is expected to result in designation of new nonattainment areas within the Company's service territory.

During 2005, the EPA's annual fine particulate matter nonattainment designations became effective for several areas within Georgia. State plans for addressing the nonattainment designations for this standard could require further reductions in SO_2 and NO_x emissions from power plants, including plants owned in part by the Company. On December 8, 2009, the EPA also proposed revisions to the National Ambient Air Quality Standard for SO_2. The EPA is expected to finalize the revised SO_2 standard in June 2010.

Twenty-eight eastern states, including the States of Florida, Georgia, and Mississippi, are subject to the requirements of the Clean Air Interstate Rule (CAIR). The rule calls for additional reductions of NO_x and/or SO_2 to be achieved in two phases, 2009/2010 and 2015. In July 2008 and December 2008, the U.S. Court of Appeals for the District of Columbia Circuit issued decisions invalidating certain aspects of CAIR, but left CAIR compliance requirements in place while the EPA develops a revised rule. The States of Florida, Georgia, and Mississippi have completed plans to implement CAIR, and emissions reductions are being accomplished by the installation of emissions controls at the Company's coal-fired facilities and/or by the purchase of emissions allowances. The EPA is expected to issue a proposed CAIR replacement rule in July 2010.

The Clean Air Visibility Rule was finalized in July 2005, with a goal of restoring natural visibility conditions in certain areas (primarily national parks and wilderness areas) by 2064. The rule involves the application of Best Available Retrofit Technology (BART) to certain sources built between 1962 and 1977, and any additional emissions reductions necessary for each designated area to achieve reasonable progress toward the natural conditions goal by 2018 and for each ten-year period thereafter. For power plants, the Clean Air Visibility Rule allows states to determine that CAIR satisfies BART requirements for SO_2 and NO_x, and no additional controls beyond CAIR are anticipated to be necessary at the Company's facilities. States have completed or are currently completing implementation plans for BART compliance and other measures required to achieve the first phase of reasonable progress.

The EPA is currently developing a Maximum Achievable Control Technology (MACT) rule for coal and oil-fired electric generating units, which will likely address numerous Hazardous Air Pollutants, including mercury. In March 2005, the EPA issued the Clean Air Mercury Rule (CAMR), a cap and trade program for the reduction of mercury emissions from coal-fired power plants. In February 2008, the U.S. Court of Appeals for the District of Columbia Circuit vacated the CAMR. In a separate proceeding in the U.S. District Court for the District of Columbia, the EPA entered into a proposed consent decree that requires the EPA to issue a proposed MACT rule by March 16, 2011, and a final rule by November 16, 2011.

The impacts of the eight-hour ozone standards, the fine particulate matter nonattainment designations, and future revisions to CAIR, the SO_2 standard, the Clean Air Visibility Rule, and the MACT rule for electric generating units on the Company cannot be determined at this time and will depend on the specific provisions of the final rules, resolution of any legal challenges, and the development and implementation of rules at the state level. However, these additional regulations 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.

The Company has developed and continually updates a comprehensive environmental compliance strategy to assess compliance obligations associated 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 emissions controls within the next several years to ensure continued compliance with applicable air quality requirements.

Water Quality

In July 2004, the EPA published final regulations under the Clean Water Act to reduce impingement and entrainment of fish, shellfish, and other forms of aquatic life at existing power plant cooling water intake structures. The use of cost-benefit analysis in the rule was ultimately appealed to the U.S. Supreme Court. On April 1, 2009, the U.S. Supreme Court held that the EPA could consider costs in arriving at its standards and in providing variances from those standards for existing intake structures. The EPA is now in the process of revising the regulations. While the U.S. Supreme Court's decision may ultimately result in greater flexibility for demonstrating compliance with the standards, the full scope of the regulations will depend on further rulemaking by the EPA and the actual requirements established by state regulatory agencies and, therefore, cannot be determined at this time.

On December 28, 2009, the EPA announced its determination that revision of the current effluent guidelines for steam electric power plants is warranted and proposed a plan to adopt such revisions by 2013. New wastewater treatment requirements are expected and may result in the installation of additional controls on certain Company facilities. The impact of revised guidelines will depend on the studies conducted in connection with the rulemaking, as well as the specific requirements of the final rule, 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 releases 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. Included in this amount are costs associated with remediation of the Company's substation sites. These projects have been approved by the Florida PSC for recovery through the environmental cost recovery clause; therefore, there is no impact to the Company's net income as a result of these liabilities. The Company may be liable for some or all required cleanup costs for additional sites that may require environmental remediation. See Note 3 to the financial statements under "Environmental Matters – Environmental Remediation" for additional information.

Coal Combustion Byproducts

The EPA is currently evaluating whether additional regulation of coal combustion byproducts is merited under federal solid and hazardous waste laws. The EPA has collected information from the electric utility industry on surface impoundment safety and conducted on-site inspections at three Southern Company system facilities as part of its evaluation. The Company has a routine and robust inspection program in place to ensure the integrity of its coal ash surface impoundments. The EPA is expected to issue a proposal regarding additional regulation of coal combustion byproducts in early 2010. The impact of these additional regulations on the Company will depend on the specific provisions of the final rule and cannot be determined at this time. However, additional regulation of coal combustion byproducts could have a significant impact on the Company's management, beneficial use, and disposal of such byproducts and 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.

Global Climate Issues

Federal legislative proposals that would impose mandatory requirements related to greenhouse gas emissions, renewable energy standards, and energy efficiency standards continue to be considered in Congress, and the reduction of greenhouse gas emissions has been identified as a high priority by the current Administration. On June 26, 2009, the American Clean Energy and Security Act of 2009 (ACES), which would impose mandatory greenhouse gas restrictions through implementation of a cap and trade program, a renewable energy standard, and other measures, was passed by the House of Representatives. ACES would require reductions of greenhouse gas emissions on a national basis to a level that is 17% below 2005 levels by 2020, 42% below 2005 levels by 2030, and 83% below 2005 levels by 2050. In addition, ACES would provide for renewable energy standards of 6% by 2012 and 20% by 2020. Similar legislation is being considered by the Senate. The financial and operational impact of such legislation, if enacted, will depend on a variety of factors. These factors include the specific greenhouse gas emissions limits or renewable energy requirements, the timing of implementation of these limits or requirements, the level of emissions allowances allocated and the level that must be purchased, the purchase price of emissions allowances, the development and commercial availability of technologies for renewable energy and for the reduction of emissions, the degree to which offsets may be used for compliance, provisions for cost containment (if any), the impact on coal and natural gas prices, and cost recovery through regulated rates. There can be no assurance that any legislation will be enacted or as to the ultimate form of any legislation. Additional or alternative legislation may be adopted as well.

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. On December 15, 2009, the EPA published a final determination, which became effective on January 14, 2010, that certain greenhouse gas emissions from new motor vehicles endanger public health and welfare due to climate change. On September 28, 2009, the EPA published a proposed rule regulating greenhouse gas emissions from new motor vehicles under the Clean Air Act. The EPA has stated that once this rule is effective, it will cause carbon dioxide and other greenhouse gases to become regulated pollutants under the Prevention of Significant Deterioration (PSD) preconstruction permit program and the Title V operating permit program, which both apply to power plants. As a result, the construction of new facilities or the major modification of existing facilities could trigger the requirement for a PSD permit and the installation of the best available control technology for carbon dioxide and other greenhouse gases. The EPA also published a proposed rule governing how these programs would be applied to stationary sources, including power plants, on October 27, 2009. The EPA has stated that it expects to finalize these proposed rules in March

2010. The ultimate outcome of the endangerment finding and these proposed rules cannot be determined at this time and will depend on additional regulatory action and any legal challenges.

International climate change negotiations under the United Nations Framework Convention on Climate Change also continue. A nonbinding agreement was announced during the most recent round of negotiations in December 2009 that included a pledge from both developed and developing countries to reduce their greenhouse gas emissions. The outcome and impact of the international negotiations cannot be determined at this time.

Although the outcome of federal, state, or international initiatives cannot be determined at this time, mandatory restrictions on the Company's greenhouse gas emissions or requirements relating to renewable energy or energy efficiency on the federal or state level are likely to result in significant additional compliance costs, including significant capital expenditures. These costs could affect future unit retirement and replacement decisions, and could result in the retirement of a significant number of coal-fired generating units. See Item 1 – BUSINESS – "Rate Matters – Integrated Resource Planning" for additional information. Also, additional compliance costs and costs related to unit retirements could affect results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates. Further, higher costs that are recovered through regulated rates could contribute to reduced demand for electricity, which could negatively impact results of operations, cash flows, and financial condition.

In 2008, the total carbon dioxide emissions from the fossil fuel-fired electric generating units owned by the Company were approximately 14 million metric tons. The preliminary estimate of carbon dioxide emissions from these units in 2009 is approximately 11 million metric tons. The level of carbon dioxide emissions from year to year will be dependent on the level of generation and mix of fuel sources, which is determined primarily by demand, the unit cost of fuel consumed, and the availability of generating units.

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

PSC Matters

General

The Company's rates and charges for service to retail customers are subject to the regulatory oversight of the Florida PSC. The Company's rates are a combination of base rates and several separate cost recovery clauses for specific categories of costs. These separate cost recovery clauses address such items as fuel and purchased energy costs, purchased power capacity costs, energy conservation, and demand side management programs, and the costs of compliance with environmental laws and regulations. Costs not addressed through one of the specific cost recovery clauses are recovered through the Company's base rates.

On November 2, 2009, the Florida PSC approved the Company's annual rate requests for its purchased power capacity, energy conservation, and environmental compliance cost recovery factors for 2010. On December 1, 2009, the Florida PSC approved the Company's annual rate request for its 2010 fuel cost recovery factor, which includes both fuel and purchased energy cost. The net effect of the approved changes to the Company's cost recovery factors for 2010 is a 3.9% rate increase for residential customers using 1,000 KWHs per month. Revenues for all cost recovery clauses, 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 Notes 1 and 3 to the financial statements under "Revenues" and "Retail Regulatory Matters – Fuel Cost Recovery," respectively.

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, 2009 and 2008, the under recovered balance was $2.4 million and $96.7 million, respectively. The change in 2009 was primarily due to an increase in the 2009 fuel cost recovery factors and resulting revenue collected in the period and a higher percentage of natural gas-fired generation which cost less than projected. The Company continuously monitors the over or under recovered fuel cost balance in light of the inherent variability in fuel costs. If the projected fuel cost 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.

Purchased Power Capacity Recovery

The Florida PSC allows the Company to recover its costs for capacity purchased from other power producers under power purchase agreements (PPAs) through a separate cost recovery component or factor in the Company's retail energy rates. Like the other specific cost recovery factors included in the Company's retail energy rates, the rates for purchased capacity are set annually on a calendar year basis. When the Company enters into a new PPA, it is reviewed and approved by the Florida PSC for cost recovery purposes. As of December 31, 2009 and 2008, the Company had an over recovered purchased power capacity balance of approximately $1.5 million and $0.3 million, respectively, which is included in other regulatory liabilities, current in the balance sheets.

In March 2009, the Company entered into a PPA (the Agreement) with Shell Energy North America (US), L.P. (Shell) conditioned on subsequent review and approval of the Company's participation by the Florida PSC. The Florida PSC approved the Agreement through an order that became final in October 2009. As a result, the Agreement became effective on November 1, 2009. The Agreement will terminate on May 24, 2023, unless terminated earlier in accordance with its terms. Under the terms of the Agreement, the Company will be entitled to all of the capacity and energy from an approximately 885 MW combined cycle power plant (the Plant) located in Autauga County, Alabama that is owned and operated by Tenaska Alabama II Partners, L.P. (Tenaska). Shell is entitled to all of the capacity and energy from the Plant under a 20-year Energy Conversion Agreement between Shell and Tenaska that expires on May 24, 2023. Payments under the Agreement will be material. However, these costs have been approved by the Florida PSC for recovery through the Company's fuel clause and purchased power capacity clause; therefore, no material impact is expected on the Company's net income. See FINANCIAL CONDITION AND LIQUIDITY – "Capital Requirements and Contractual Obligations" herein and Note 7 to the financial statements under "Fuel and Purchased Power Commitments" for additional information.

Environmental Cost Recovery

In August 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 in March 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. On April 1, 2009, the Company filed an update to the plan, which was approved by the Florida PSC on November 2, 2009. The Florida PSC acknowledged that the costs associated with the Company's CAIR and Clean Air Visibility Rule compliance plans are eligible for recovery through the environmental cost recovery clause. Annually, the Company seeks recovery of projected costs including any true-up amounts from prior periods. At December 31, 2009 and 2008, the over recovered environmental balance was approximately $11.7 million and $71 thousand, respectively, which is included in other regulatory liabilities, current in the balance sheets. See FINANCIAL CONDITION AND LIQUIDITY – "Capital Requirements and Contractual Obligations" herein, Note 3 to the financial statements under "Retail Regulatory Matters – Environmental Cost Recovery," and Note 7 to the financial statements under "Construction Program" for additional information.

Legislation

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA). Major tax incentives in the ARRA include an extension of bonus depreciation and multiple renewable energy incentives, which could have a significant impact on the future cash flow and net income of the Company. The Company's cash flow reduction to 2009 tax payments as a result of the bonus depreciation provisions of the ARRA was approximately $19 million. On December 8, 2009, President Obama announced proposals to accelerate job growth that include an extension of the bonus depreciation provision for the ARRA for 2010, which could have a significant impact on the future cash flow and net income of the Company.

On October 27, 2009, Southern Company and its subsidiaries received notice that an award of $165 million had been granted, of which $15.5 million relates to the Company, under the ARRA grant application for transmission and distribution automation and modernization projects pending final negotiations. The Company continues to assess the other financial implications of the ARRA.

The U.S. House of Representatives and the U.S. Senate have passed separate bills related to healthcare reform. Both bills include a provision that would make Medicare Part D subsidy reimbursements taxable. If enacted into law, this provision could have a significant negative impact on the Company's net income. See Note 2 to the financial statements under "Other Postretirement Benefits" for additional information.

The ultimate impact of these matters cannot be determined at this time.

Income Tax Matters

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 Section 199 of the Internal Revenue Code of 1986, as amended. 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 the years 2007 through 2009, and a 9% rate thereafter. See Note 5 to the financial statements under "Effective Tax Rate" for additional information.

Other Matters

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 such as regulation of air emissions and water discharges. 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 and other claims for damages caused by alleged exposure to hazardous materials, and common law nuisance claims for injunctive relief and property damage allegedly caused by greenhouse gas and other emissions, 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 accounting standards which require 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 the accounting standards 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, in accordance with generally accepted accounting principles (GAAP), records reserves for those matters where a non-tax-related loss is considered probable and reasonably estimable and records a tax asset or liability if it is more likely than not that a tax position will be sustained. 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, coal combustion byproducts, including coal ash, control of toxic substances, hazardous and solid wastes, and other environmental matters.
- Changes in existing income tax regulations or changes in IRS or state revenue department interpretations of existing regulations.
- Identification of additional sites that require environmental remediation or the filing of other complaints in which 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 new or existing matters through the legislative process, the court systems, the IRS, state revenue departments, the FERC, or the EPA.

Unbilled Revenues

Revenues related to the retail 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.

Pension and Other Postretirement Benefits

The Company's calculation of pension and other postretirement benefits expense is dependent on a number of assumptions. These assumptions include discount rates, health care cost trend rates, expected long-term return on plan assets, mortality rates, expected salary and wage increases, and other factors. Components of pension and other postretirement benefits expense include interest and service cost on the pension and other postretirement benefit plans, expected return on plan assets and amortization of certain unrecognized costs and obligations. Actual results that differ from the assumptions utilized are accumulated and amortized over future periods and, therefore, generally affect recognized expense and the recorded obligation in future periods. While the Company believes that the assumptions used are appropriate, differences in actual experience or significant changes in assumptions would affect its pension and other postretirement benefits costs and obligations.

Key elements in determining the Company's pension and other postretirement benefit expense in accordance with GAAP are the expected long-term return on plan assets and the discount rate used to measure the benefit plan obligations and the periodic benefit plan expense for future periods. The expected long-term return on postretirement benefit plan assets is based on the Company's investment strategy, historical experience, and expectations for long-term rates of return that considers external actuarial advice. The Company determines the long-term return on plan assets by applying the long-term rate of expected returns on various asset classes to the Company's target asset allocation. The Company discounts the future cash flows related to its postretirement benefit plans using a single-point discount rate developed from the weighted average of market-observed yields for high quality fixed income securities with maturities that correspond to expected benefit payments.

A 25 basis point change in any significant assumption would result in a $0.8 million or less change in total benefit expense and a $12 million or less change in projected obligations.

New Accounting Standards

Variable Interest Entities

In June 2009, the Financial Accounting Standards Board issued new guidance on the consolidation of variable interest entities, which replaces the quantitative-based risks and rewards calculation for determining whether an enterprise is the primary beneficiary in a variable interest entity with an approach that is primarily qualitative, requires ongoing assessments of whether an enterprise is the primary beneficiary of a variable interest entity, and requires additional disclosures about an enterprise's involvement in variable interest entities. The Company adopted this new guidance effective January 1, 2010, with no material impact on its financial statements.

FINANCIAL CONDITION AND LIQUIDITY

Overview

The Company's financial condition remained stable at December 31, 2009. Throughout the turmoil in the financial markets, the Company has maintained adequate access to capital without drawing on any of its bank credit arrangements used to support its commercial paper program and variable rate pollution control revenue bonds. The Company intends to continue to monitor its access to short-term and long-term capital markets as well as its bank credit arrangements to meet future capital and liquidity needs. Market rates for committed credit increased in 2009, and the Company may continue to be subject to higher costs as its existing facilities are replaced or renewed. Total committed credit fees for the Company average less than ¾ of 1% per year. See "Sources of Capital" and "Financing Activities" herein for additional information.

The Company's investments in pension trust funds remained stable in value as of December 31, 2009. The Company expects that the earliest that cash may have to be contributed to the pension trust fund is 2012 and such contribution could be significant. The projections of the amount vary significantly depending on key variables including future trust fund performance and cannot be determined at this time.

Net cash provided from operating activities totaled $194.2 million, $147.9 million, and $217.0 million for 2009, 2008, and 2007, respectively. The $46.3 million increase in net cash provided from operating activities in 2009 was primarily due to a $134.5 million reduction in accounts receivable related to fuel cost, partially offset by a $40.5 million decrease in deferred income taxes and a $38.4 million increase in fuel inventory. The $69.1 million decrease in net cash provided from operating activities in 2008 was due primarily to a $61.0 million increase in cash used for the under recovered regulatory clause related to fuel. The $73.6 million increase in net cash provided from operating activities in 2007 was due primarily to increased cash inflows for fuel cost recovery.

Net cash used for investing activities totaled $468.4 million, $348.7 million, and $239.3 million for 2009, 2008, and 2007, respectively. The increases in cash used for investing activities were primarily due to gross property additions to utility plant of $450.4 million, $390.7 million, and $239.3 million for 2009, 2008, and 2007, respectively. 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 $279.4 million, $198.8 million, and $20.2 million for 2009, 2008, and 2007, respectively. The $80.6 million increase in net cash provided from financing activities in 2009 was due primarily to $258.4 million in debt issuances and cash raised from a common stock sale, partially offset by a $157.0 million decrease in notes payable. The $178.6 million increase in net cash provided from financing activities in 2008 was due primarily to the issuance of $110 million in long-term debt and $50 million in short-term debt, and a $49.1 million change in commercial paper cash flows in 2008. The increase was partially offset by the issuance of $85 million in senior notes in 2007. The $4.5 million decrease in net cash provided from financing activities in 2007 was due primarily to a $105.6 million change in commercial paper cash flows and a $25.0 million decrease in senior note proceeds. These decreases were partially offset by the issuance of $80 million in common stock and $45 million in preference stock in 2007.

Significant balance sheet changes in 2009 include an increase of $374.1 million in total property, plant, and equipment, primarily related to environmental control projects; the issuance of $140.0 million in senior notes; the issuance of common stock to Southern Company for $135.0 million; the issuance of $130.4 million of pollution control revenue bonds, with a related restricted cash balance of $6.3 million; an increase in fossil fuel stock of $75.5 million; an increase in customer accounts receivable and unbilled revenues of $6.4 million; and a $94.4 million decrease in under recovered regulatory clause revenues primarily related to fuel.

The Company's ratio of common equity to total capitalization, including short-term debt, was 43.4% in 2009, 42.9% in 2008, and 45.3% in 2007. See Note 6 to the financial statements for additional information.

The Company has received investment grade credit ratings from the major rating agencies with respect to its debt and preference stock. See SELECTED FINANCIAL AND OPERATING DATA and "Credit Rating Risk" herein for additional information regarding the Company's security ratings.

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, security 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.

The Company's current liabilities frequently exceed current assets because of the continued use of short-term debt as a funding source to meet cash needs which can fluctuate significantly due to the seasonality of the business. To meet short-term cash needs and contingencies, the Company has various internal and external sources of liquidity. At December 31, 2009, the Company had approximately $9 million of cash and cash equivalents, along with $220 million of unused committed lines of credit with banks to meet its short-term cash needs. These bank credit arrangements will expire in 2010 and $70 million contain provisions allowing one-year term loans executable at expiration. The Company plans to renew these lines of credit during 2010 prior to their expiration. In addition, the Company has substantial cash flow from operating activities and access to the capital markets, including a commercial paper program, 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 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. The obligations of each company under these arrangements are several; there is no cross affiliate credit support. At December 31, 2009, the Company had $88.9 million of commercial paper outstanding. At December 31, 2009, the Company also had $1.4 million in notes payable outstanding related to other energy services contracts.

Financing Activities

In 2009, the Company issued $140 million of senior notes and incurred obligations related to the issuance of $130.4 million of pollution control revenue bonds. In addition, the Company issued to Southern Company 1,350,000 shares of the Company's common stock, without par value, and realized proceeds of $135 million. On January 25, 2010, the Company issued to Southern Company 500,000 shares of the Company's common stock, without par value, and realized proceeds of $50 million. The proceeds were used to repay a portion of the Company's short-term debt, to fund construction of certain environmental projects, and for other general corporate purposes, including the Company's continuous construction program.

The Company also entered into forward starting interest rate swaps during 2009 totaling $100 million to mitigate exposure to interest rate changes related to anticipated debt issuances. The swaps have been designated as cash flow hedges.

In addition to any financings that may be necessary to meet capital requirements, contractual obligations, and storm-recovery, the Company plans to continue, when economically feasible, a program to retire higher-cost securities and replace these obligations with lower-cost capital if market conditions permit.

Credit Rating Risk

The Company does not have any credit arrangements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. There are certain contracts that could require collateral, but not accelerated payment, in the event of a credit rating change to BBB- and/or Baa3 or below. These contracts are for physical electricity purchases and sales, fuel transportation and storage, emissions allowances, and energy price risk management. At December 31, 2009, the maximum potential collateral requirements under these contracts at a BBB- and/or Baa3 rating were approximately $130 million. At December 31, 2009, the maximum potential collateral requirements under these contracts at a rating below BBB- and/or Baa3 were approximately $547 million. Included in these amounts are certain agreements that could require collateral in the event that one or more Southern Company system power pool participants has a credit rating change to below investment grade. Generally, collateral may be provided by a Southern Company guaranty, letter of credit, or cash. Additionally, any credit rating downgrade could impact the Company's ability to access capital markets, particularly the short-term debt market.

On September 2, 2009, Moody's Investors Service (Moody's) affirmed the credit ratings of the Company's senior unsecured notes and commercial paper of A2/P-1, respectively, and revised the rating outlook to negative. On September 4, 2009, Fitch Ratings, Inc. affirmed the Company's senior unsecured notes and commercial paper ratings of A/F1, respectively, and maintained a stable rating outlook for the Company. On October 6, 2009, Standard and Poor's Rating Services, a division of The McGraw-Hill Companies, Inc. (S&P) affirmed the credit ratings of the Company's senior unsecured notes and its short-term credit rating of A/A-1, respectively, and maintained its stable rating outlook.

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, where possible, 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 per the guidelines of the Florida PSC.

The weighted average interest rate on $319 million variable rate long-term debt at January 1, 2010 was 0.45%. 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 $3 million at January 1, 2010. See Note 1 to the financial statements under "Financial Instruments" and Note 10 to the financial statements for additional information.

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

	2009 Changes	2008 Changes
	Fair Value	
	(in thousands)	
Contracts outstanding at the beginning of the period, assets (liabilities), net	**$ (31,161)**	$ (202)
Contracts realized or settled	**41,683**	(7,960)
Current period changes[a]	**(24,209)**	(22,999)
Contracts outstanding at the end of the period, assets (liabilities), net	**$ (13,687)**	$ (31,161)

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

The change in the fair value positions of the energy-related derivative contracts for the year-ended December 31, 2009 was an increase of $17.5 million, substantially all of which is due to natural gas positions. The change is attributable to both the volume of million British thermal units (mmBtu) and prices of natural gas. At December 31, 2009, the Company had a net hedge volume of 11.0 million mmBtu with a weighted average contract cost approximately $1.26 per mmBtu above market prices, and 14.2 million mmBtu at December 31, 2008 with a weighted average contract cost approximately $2.24 per mmBtu above market prices. Natural gas settlements are recovered through the fuel cost recovery clause.

At December 31, the net fair value of energy-related derivative contracts by hedge designation was reflected in the financial statements as assets/ (liabilities) as follows:

Asset (Liability) Derivatives	**2009**	2008
	(in thousands)	
Regulatory hedges	**$(13,699)**	$(31,161)
Not designated	**12**	-
Total fair value	**$(13,687)**	$(31,161)

Energy-related derivative contracts designated as regulatory hedges are related to the Company's fuel hedging program, where gains and losses are initially recorded as regulatory liabilities and assets, respectively, and then are included in fuel expense as they are recovered through the fuel cost recovery clause. Gains and losses on energy-related derivative contracts that are not designated or fail to qualify as hedges are recognized in the statements of income as incurred.

Unrealized pre-tax gains and losses from energy-related derivative contracts recognized in income were not material for any year presented.

The maturities of the energy-related derivative contracts and the level of the fair value hierarchy in which they fall at December 31, 2009 are as follows:

	December 31, 2009 Fair Value Measurements			
	Total	Maturity		
	Fair Value	Year 1	Years 2&3	Years 4&5
	(in thousands)			
Level 1	**$ -**	**$ -**	**$ -**	**$ -**
Level 2	**(13,687)**	**(9,288)**	**(4,264)**	**(135)**
Level 3	**-**	**-**	**-**	**-**
Fair value of contracts outstanding at end of period	**$ (13,687)**	**$ (9,288)**	**$ (4,264)**	**$ (135)**

The Company uses over-the-counter contracts that are not exchange traded but are fair valued using prices which are actively quoted, and thus fall into Level 2. See Note 9 to the financial statements for further discussion on fair value measurement.

The Company is exposed to market price risk in the event of nonperformance by counterparties to the derivative energy contracts. The Company only enters into agreements and material transactions with counterparties that have investment grade credit ratings by Moody's and S&P 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 Note 1 to the financial statements under "Financial Instruments" and Note 10 to the financial statements for additional information.

Capital Requirements and Contractual Obligations

The construction program of the Company is currently estimated to be $271.4 million in 2010, $350.2 million in 2011, and $418.5 million in 2012. Environmental expenditures included in these estimated amounts are $113.4 million in 2010, $194.8 million in 2011, and $194.2 million in 2012. The construction programs are subject to periodic review and revision, and actual construction costs may vary from these estimates because of numerous factors. These factors include: changes in business conditions; revised load growth estimates; storm impacts; changes in environmental statutes and regulations; changes in FERC rules and regulations; Florida PSC approvals; changes in legislation; the cost and efficiency of construction labor, equipment, and materials; project scope and design changes; and the cost of capital. In addition, there can be no assurance that costs related to capital expenditures will be fully recovered.

In addition, 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, 7, and 10 to the financial statements for additional information.

Contractual Obligations

	2010	2011-2012	2013-2014	After 2014	Uncertain Timing[d]	Total
			(in thousands)			
Long-term debt[a] –						
Principal	$ 140,000	$ 110,000	$ 135,000	$ 740,441	$ -	$1,125,441
Interest	41,237	80,746	77,388	464,144	-	663,515
Energy-related derivative obligations[b]	9,442	4,264	183	-	-	13,889
Preference stock dividends[c]	6,203	12,405	12,405	-	-	31,013
Operating leases	14,525	20,539	12,793	1,613	-	49,470
Unrecognized tax benefits and interest[d]	-	-	-	-	1,729	1,729
Purchase commitments[e] –						
Capital[f]	271,419	768,706	-	-	-	1,040,125
Limestone[g]	6,043	12,543	13,178	35,938	-	67,702
Coal	515,241	75,561	-	-	-	590,802
Natural gas[h]	112,080	137,566	101,176	130,889	-	481,711
Purchased power[i]	39,432	82,474	97,317	659,261	-	878,484
Long-term service agreements[j]	6,315	13,303	13,977	25,583	-	59,178
Postretirement benefits trust[k]	54	107	-	-	-	161
Total	$1,161,991	$1,318,214	$ 463,417	$2,057,869	$1,729	$5,003,220

(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, 2010, as reflected in the statements of capitalization.

(b) For additional information, see Notes 1 and 10 to the financial statements.

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

(d) The timing related to the realization of $1.7 million in unrecognized tax benefits and interest payments in individual years beyond 12 months cannot be reasonably and reliably estimated due to uncertainties in the timing of the effective settlement of tax positions. See Note 5 to the financial statements for additional information.

(e) The Company generally does not enter into non-cancelable commitments for other operations and maintenance expenditures. Total other operations and maintenance expenses for 2009, 2008, and 2007 were $260 million, $277 million, and $270 million, respectively.

(f) The Company forecasts capital expenditures over a three-year period. Amounts represent current estimates of total expenditures. At December 31, 2009, significant purchase commitments were outstanding in connection with the construction program.

(g) As part of the Company's program to reduce sulfur dioxide emissions from its coal plants, the Company has entered into various long-term commitments for the procurement of limestone to be used in flue gas desulfurization equipment.

(h) 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, 2009.

(i) The capacity-related costs associated with PPAs are recovered through the purchased power capacity costs recovery clause. See Notes 3 and 7 to the financial statements for additional information.

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

(k) The Company forecasts postretirement trust contributions over a three-year period. The Company expects that the earliest that cash may have to be contributed to the pension trust fund is 2012 and such contribution could be significant. The projections of the amount vary significantly depending on key variables, including future trust fund performance, and cannot be determined at this time; therefore, no amounts related to the pension trust fund are included in the table. 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 2009 Annual Report contains forward-looking statements. Forward-looking statements include, among other things, statements concerning retail sales, retail rates, storm damage cost recovery and repairs, fuel cost recovery and other rate actions, environmental regulations and expenditures, earnings growth, access to sources of capital, projections for postretirement benefit trust contributions, financing activities, start and completion of construction projects, impacts of adoption of new accounting rules, impact of the American Recovery and Reinvestment Act of 2009, impact of healthcare legislation, if any, estimated sales and purchases under new power sale and purchase agreements, 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, particulate matter, or coal combustion byproducts 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 and recovery from the recent recession, population, and business growth (and declines), and the effects of energy conservation measures;
- available sources and costs of fuels;
- effects of inflation;
- ability to control costs and avoid cost overruns during the development and construction of facilities;
- 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 other cost recovery mechanisms;
- 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 and to perform as required;
- the ability to obtain new short- and long-term contracts with wholesale customers;
- 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 influenzas, or other similar occurrences;
- the direct or indirect effects on the Company's business resulting from incidents affecting the U.S. electric grid or operation of generating resources;
- 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, 2009, 2008, and 2007

Gulf Power Company 2009 Annual Report

	2009	2008	2007
		(in thousands)	
Operating Revenues:			
Retail revenues	**$1,106,568**	$1,120,766	$1,006,329
Wholesale revenues, non-affiliates	**94,105**	97,065	83,514
Wholesale revenues, affiliates	**32,095**	106,989	113,178
Other revenues	**69,461**	62,383	56,787
Total operating revenues	**1,302,229**	1,387,203	1,259,808
Operating Expenses:			
Fuel	**573,407**	635,634	573,354
Purchased power, non-affiliates	**23,706**	29,590	11,994
Purchased power, affiliates	**68,276**	79,750	59,499
Other operations and maintenance	**260,274**	277,478	270,440
Depreciation and amortization	**93,398**	84,815	85,613
Taxes other than income taxes	**94,506**	87,247	82,992
Total operating expenses	**1,113,567**	1,194,514	1,083,892
Operating Income	**188,662**	192,689	175,916
Other Income and (Expense):			
Allowance for equity funds used during construction	**23,809**	9,969	2,374
Interest income	**423**	3,155	5,348
Interest expense, net of amounts capitalized	**(38,358)**	(43,098)	(44,680)
Other income (expense), net	**(4,075)**	(4,064)	(3,876)
Total other income and (expense)	**(18,201)**	(34,038)	(40,834)
Earnings Before Income Taxes	**170,461**	158,651	135,082
Income taxes	**53,025**	54,103	47,083
Net Income	**117,436**	104,548	87,999
Dividends on Preference Stock	**6,203**	6,203	3,881
Net Income After Dividends on Preference Stock	**$111,233**	$ 98,345	$ 84,118

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

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2009, 2008, and 2007
Gulf Power Company 2009 Annual Report

	2009	2008	2007
		(in thousands)	
Operating Activities:			
Net income	**$117,436**	$ 104,548	$ 87,999
Adjustments to reconcile net income			
to net cash provided from operating activities --			
Depreciation and amortization, total	**99,564**	93,607	90,694
Deferred income taxes	**(16,545)**	23,949	(10,818)
Allowance for equity funds used during construction	**(23,809)**	(9,969)	(2,374)
Pension, postretirement, and other employee benefits	**1,769**	1,585	6,062
Stock based compensation expense	**933**	765	1,141
Tax benefit of stock options	**17**	215	344
Hedge settlements	**-**	(5,220)	3,030
Other, net	**(5,190)**	(5,149)	(7,072)
Changes in certain current assets and liabilities --			
-Receivables	**83,245**	(49,886)	10,301
-Fossil fuel stock	**(75,145)**	(36,765)	5,025
-Materials and supplies	**(1,642)**	8,927	(2,625)
-Prepaid income taxes	**(6,355)**	(416)	7,177
-Property damage cost recovery	**10,746**	26,143	25,103
-Other current assets	**(204)**	(307)	(632)
-Accounts payable	**7,890**	(4,561)	(556)
-Accrued taxes	**(2,404)**	(6,511)	4,773
-Accrued compensation	**(6,330)**	570	(1,322)
-Other current liabilities	**10,255**	6,417	732
Net cash provided from operating activities	**194,231**	147,942	216,982
Investing Activities:			
Property additions	**(421,309)**	(377,790)	(241,538)
Investment in restricted cash from pollution control revenue bonds	**(49,188)**	-	-
Distribution of restricted cash from pollution control revenue bonds	**42,841**	-	-
Cost of removal net of salvage	**(9,751)**	(8,713)	(9,408)
Construction payables	**(23,603)**	37,244	10,817
Other investing activities	**(7,426)**	576	803
Net cash used for investing activities	**(468,436)**	(348,683)	(239,326)
Financing Activities:			
Increase (decrease) in notes payable, net	**(49,599)**	107,438	(75,820)
Proceeds --			
Common stock issued to parent	**135,000**	-	80,000
Capital contributions from parent company	**22,032**	75,324	4,174
Gross excess tax benefit of stock options	**51**	298	799
Preference stock	**-**	-	45,000
Pollution control revenue bonds	**130,400**	37,000	-
Senior notes	**140,000**	-	85,000
Other long-term debt issuances	**-**	110,000	-
Redemptions --			
Pollution control revenue bonds	**-**	(37,000)	-
Senior notes	**(1,214)**	(1,300)	-
Other long-term debt	**-**	-	(41,238)
Payment of preference stock dividends	**(6,203)**	(6,057)	(3,300)
Payment of common stock dividends	**(89,300)**	(81,700)	(74,100)
Other financing activities	**(1,728)**	(5,167)	(349)
Net cash provided from financing activities	**279,439**	198,836	20,166
Net Change in Cash and Cash Equivalents	**5,234**	(1,905)	(2,178)
Cash and Cash Equivalents at Beginning of Year	**3,443**	5,348	7,526
Cash and Cash Equivalents at End of Year	**$ 8,677**	$ 3,443	$ 5,348
Supplemental Cash Flow Information:			
Cash paid during the period for --			
Interest (net of $9,489, $3,973 and $1,048 capitalized, respectively)	**$40,336**	$39,956	$35,237
Income taxes (net of refunds)	**73,889**	40,176	39,228
Non-cash decrease in notes payable related to energy services	**(8,309)**	-	-

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

BALANCE SHEETS
At December 31, 2009 and 2008
Gulf Power Company 2009 Annual Report

Assets	**2009**	2008
	(in thousands)	
Current Assets:		
Cash and cash equivalents	**$ 8,677**	$ 3,443
Restricted cash and cash equivalents	**6,347**	-
Receivables --		
Customer accounts receivable	**64,257**	69,531
Unbilled revenues	**60,414**	48,742
Under recovered regulatory clause revenues	**4,285**	98,644
Other accounts and notes receivable	**4,107**	7,201
Affiliated companies	**7,503**	8,516
Accumulated provision for uncollectible accounts	**(1,913)**	(2,188)
Fossil fuel stock, at average cost	**183,619**	108,129
Materials and supplies, at average cost	**38,478**	36,836
Other regulatory assets, current	**19,172**	38,908
Prepaid expenses	**44,760**	20,363
Other current assets	**3,634**	5,292
Total current assets	**443,340**	443,417
Property, Plant, and Equipment:		
In service	**3,430,503**	2,785,561
Less accumulated provision for depreciation	**1,009,807**	971,464
Plant in service, net of depreciation	**2,420,696**	1,814,097
Construction work in progress	**159,499**	391,987
Total property, plant, and equipment	**2,580,195**	2,206,084
Other Property and Investments	**15,923**	15,918
Deferred Charges and Other Assets:		
Deferred charges related to income taxes	**39,018**	24,220
Other regulatory assets, deferred	**190,971**	170,836
Other deferred charges and assets	**24,160**	18,550
Total deferred charges and other assets	**254,149**	213,606
Total Assets	**$3,293,607**	$2,879,025

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

BALANCE SHEETS

At December 31, 2009 and 2008

Gulf Power Company 2009 Annual Report

Liabilities and Stockholder's Equity	**2009**	2008
	(in thousands)	
Current Liabilities:		
Securities due within one year	**$140,000**	$ -
Notes payable	**90,331**	148,239
Accounts payable --		
Affiliated	**47,421**	50,304
Other	**80,184**	90,381
Customer deposits	**32,361**	28,017
Accrued taxes --		
Accrued income taxes	**1,955**	39,983
Other accrued taxes	**7,297**	11,855
Accrued interest	**10,222**	8,959
Accrued compensation	**9,337**	15,667
Other regulatory liabilities, current	**22,416**	4,602
Liabilities from risk management activities	**9,442**	26,928
Other current liabilities	**20,092**	29,047
Total current liabilities	**471,058**	453,982
Long-Term Debt (See accompanying statements)	**978,914**	849,265
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	**297,405**	254,354
Accumulated deferred investment tax credits	**9,652**	11,255
Employee benefit obligations	**109,271**	97,389
Other cost of removal obligations	**191,248**	180,325
Other regulatory liabilities, deferred	**41,399**	28,597
Other deferred credits and liabilities	**92,370**	83,768
Total deferred credits and other liabilities	**741,345**	655,688
Total Liabilities	**2,191,317**	1,958,935
Preference Stock (See accompanying statements)	**97,998**	97,998
Common Stockholder's Equity (See accompanying statements)	**1,004,292**	822,092
Total Liabilities and Stockholder's Equity	**$3,293,607**	$2,879,025
Commitments and Contingent Matters (See notes)		

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

STATEMENTS OF CAPITALIZATION
At December 31, 2009 and 2008
Gulf Power Company 2009 Annual Report

	2009	2008	2009	2008
	(in thousands)		*(percent of total)*	
Long Term Debt:				
Long-term notes payable --				
4.35% due 2013	**60,000**	60,000		
4.90% due 2014	**75,000**	75,000		
5.25% to 5.90% due 2016-2044	**452,486**	453,700		
Variable rates (0.35% at 1/1/10) due 2010	**140,000**	-		
Variable rates (0.68% at 1/1/10) due 2011	**110,000**	110,000		
Total long-term notes payable	**837,486**	698,700		
Other long-term debt --				
Pollution control revenue bonds --				
1.50% to 6.00% due 2022-2039	**218,625**	153,625		
Variable rates (0.25% to 0.28% at 1/1/10) due 2022-2039	**69,330**	3,930		
Total other long-term debt	**287,955**	157,555		
Unamortized debt discount	**(6,527)**	(6,990)		
Total long-term debt (annual interest requirement -- $41.2 million)	**1,118,914**	849,265		
Less amount due within one year	**140,000**	-		
Long-term debt excluding amount due within one year	**978,914**	849,265	**47.0%**	48.0%
Preferred and Preference Stock:				
Authorized - 20,000,000 shares--preferred stock				
- 10,000,000 shares--preference stock				
Outstanding - $100 par or stated value -- 6% preference stock	**53,886**	53,886		
-- 6.45% preference stock	**44,112**	44,112		
- 1,000,000 shares (non-cumulative)				
Total preference stock (annual dividend requirement -- $6.2 million)	**97,998**	97,998	**4.7**	5.5
Common Stockholder's Equity:				
Common stock, without par value --				
Authorized - 20,000,000 shares				
Outstanding - 2009: 3,142,717 shares				
Outstanding - 2008: 1,792,717 shares	**253,060**	118,060		
Paid-in capital	**534,577**	511,547		
Retained earnings	**219,117**	197,417		
Accumulated other comprehensive income (loss)	**(2,462)**	(4,932)		
Total common stockholder's equity	**1,004,292**	822,092	**48.3**	46.5
Total Capitalization	**$2,081,204**	$1,769,355	**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, 2009, 2008, and 2007
Gulf Power Company 2009 Annual Report

	Number of Common Shares Issued	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
			(in thousands)			
Balance at December 31, 2006	993	$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	800	80,000	-	-	-	80,000
Capital contributions from parent company	-	-	6,457	-	-	6,457
Other comprehensive income (loss)	-	-	-	-	798	798
Cash dividends on common stock	-	-	-	(74,100)	-	(74,100)
Other	-	-	(41)	-	-	(41)
Balance at December 31, 2007	1,793	118,060	435,008	181,986	(3,799)	731,255
Net income after dividends on preference stock	-	-	-	98,345	-	98,345
Capital contributions from parent company	-	-	76,539	-	-	76,539
Other comprehensive income (loss)	-	-	-	-	(1,133)	(1,133)
Cash dividends on common stock	-	-	-	(81,700)	-	(81,700)
Change in benefit plan measurement date	-	-	-	(1,214)	-	(1,214)
Balance at December 31, 2008	**1,793**	**118,060**	**511,547**	**197,417**	**(4,932)**	**822,092**
Net income after dividends on preference stock	**-**	**-**	**-**	**111,233**	**-**	**111,233**
Issuance of common stock	**1,350**	**135,000**	**-**	**-**	**-**	**135,000**
Capital contributions from parent company	**-**	**-**	**23,030**	**-**	**-**	**23,030**
Other comprehensive income (loss)	**-**	**-**	**-**	**-**	**2,470**	**2,470**
Cash dividends on common stock	**-**	**-**	**-**	**(89,300)**	**-**	**(89,300)**
Other	**-**	**-**	**-**	**(233)**	**-**	**(233)**
Balance at December 31, 2009	**3,143**	**$253,060**	**$534,577**	**$219,117**	**$(2,462)**	**$1,004,292**

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

STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2009, 2008, and 2007

Gulf Power Company 2009 Annual Report

	2009	2008	2007
		(in thousands)	
Net income after dividends on preference stock	**$111,233**	$98,345	$84,118
Other comprehensive income (loss):			
Qualifying hedges:			
Changes in fair value, net of tax of $1,132, $(1,077), and $232, respectively	**1,803**	(1,716)	370
Reclassification adjustment for amounts included in net income, net of tax of $419, $366, and $269, respectively	**667**	583	428
Total other comprehensive income (loss)	**2,470**	(1,133)	798
Comprehensive Income	**$113,703**	$97,212	$84,916

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 Company (Alabama Power), Georgia Power Company (Georgia Power), the Company, and Mississippi Power Company (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, owns, and manages generation assets and sells electricity at market-based rates in the wholesale market. SCS, the system service company, provides, at cost, specialized services to Southern Company and its subsidiary companies. SouthernLINC Wireless provides digital wireless communications for use by Southern Company and its subsidiary 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 leveraged leases. Southern Nuclear operates and provides services to Southern Company's nuclear power plants.

The equity method is used for entities in which the Company has significant influence but does not control. Certain prior years' data presented in the financial statements have been reclassified to conform to the current year presentation.

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.

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, digital wireless communications, and other services with respect to business and operations and power pool operations. Costs for these services amounted to $87 million, $86 million, and $73 million during 2009, 2008, and 2007, respectively. Cost allocation methodologies used by SCS were approved by the Securities and Exchange Commission (SEC) 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 $3.9 million, $8.1 million, and $5.1 million, and Mississippi Power $20.9 million, $22.8 million, and $23.1 million in 2009, 2008, and 2007, respectively, for its proportionate share of related expenses. See Note 4 and Note 7 under "Operating Leases" for additional information.

The Company entered into a power purchase agreement (PPA), with Southern Power for a total of approximately 292 megawatts (MWs) annually from June 2009 through May 2014. The PPA was the result of a competitive request for proposal process initiated by the Company in January 2006 to address the anticipated need for additional capacity beginning in 2009. In May 2007, the Florida PSC issued an order approving the PPA for the purpose of cost recovery through the Company's purchased power capacity clause. The PPA with Southern Power was approved by the FERC in July 2007.

The Company provides incidental services to and receives such services from other Southern Company subsidiaries which are generally minor in duration and amount. There were no significant services provided or received in 2009, 2008, or 2007.

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 and Purchased Power Commitments" for additional information.

Regulatory Assets and Liabilities

The Company is subject to the provisions of the Financial Accounting Standards Board in accounting for the effects of rate regulation. 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:

	2009	2008	Note
	(in thousands)		
Deferred income tax charges	**$ 39,018**	$ 24,220	(a)
Asset retirement obligations	**(4,371)**	(4,531)	(a,i)
Other cost of removal obligations	**(191,248)**	(180,325)	(a)
Deferred income tax credits	**(11,412)**	(12,983)	(a)
Loss on reacquired debt	**14,599**	16,248	(b)
Vacation pay	**8,120**	7,991	(c,i)
Under recovered regulatory clause revenues	**2,384**	96,731	(d)
Over recovered regulatory clause revenues	**(14,510)**	(3,295)	(d)
Property damage reserve	**(24,046)**	(9,801)	(e)
Fuel-hedging (realized and unrealized) losses	**15,367**	35,333	(f,i)
Fuel-hedging (realized and unrealized) gains	**(190)**	(1,071)	(f,i)
PPA charges	**8,141**	-	(i,j)
Generation site selection/evaluation costs	**8,373**	2,370	(k)
Other assets	**131**	990	(d,i)
Environmental remediation	**65,223**	66,812	(g,i)
PPA credits	**(7,536)**	-	(i,j)
Other liabilities	**(715)**	(1,518)	(d)
Underfunded retiree benefit plans	**91,055**	81,912	(h,i)
Total assets (liabilities), net	**$ (1,617)**	$ 119,083	

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

(a) Asset retirement and removal assets and 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.
(b) Recovered over either the remaining life of the original issue or, if refinanced, over the life of the new issue, which may range up to 40 years.
(c) Recorded as earned by employees and recovered as paid, generally within one year.
(d) Recorded and recovered or amortized as approved by the Florida PSC, generally within one year.
(e) Recorded and recovered or amortized as approved by the Florida PSC. The storm cost recovery surcharge ended in June 2009.
(f) Fuel-hedging assets and liabilities are recognized over the life of the underlying hedged purchase contracts, which generally do not exceed four years. Upon final settlement, costs are recovered through the fuel cost recovery clause.
(g) Recovered through the environmental cost recovery clause when the remediation is performed.
(h) Recovered and amortized over the average remaining service period which may range up to 14 years. See Note 2 for additional information.
(i) Not earning a return as offset in rate base by a corresponding asset or liability.
(j) Recovered over the life of the PPA for periods up to 14 years.
(k) Deferred pursuant to Florida Statute while the Company continues to evaluate certain potential new generation projects.

In the event that a portion of the Company's operations is no longer subject to applicable accounting rules for rate regulation, the Company would be required to write off or reclassify to accumulated other comprehensive income 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, exists and write down the assets, if impaired, to their fair values. All regulatory assets and liabilities are to be 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 over or 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 cost over or under recovery is expected to exceed 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 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 amounts from prior periods, and approved rates are implemented each January. See Note 3 under "Retail Regulatory Matters" for additional information.

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.

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 accounting standards related to the uncertainty in income taxes, 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.

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:

	2009	2008
	(in thousands)	
Generation	**$ 2,034,826**	$ 1,445,095
Transmission	**317,298**	305,097
Distribution	**938,393**	900,793
General	**136,934**	131,269
Plant acquisition adjustment	**3,052**	3,307
Total plant in service	**$ 3,430,503**	$ 2,785,561

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.

Depreciation and Amortization

Depreciation of the original cost of utility plant in service is provided primarily by using composite straight-line rates, which approximated 3.1% in 2009, 3.4% in 2008, and 3.4% in 2007. 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 are 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, a barge unloading dock, 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 U.S. Army Corps of Engineers. However, liabilities for the removal of these assets have not been recorded because the range of time over which the Company may settle these obligations is unknown and cannot be reasonably estimated. The Company will continue to recognize in the statements of income allowed removal costs in accordance with its regulatory treatment. Any differences between costs recognized in accordance with accounting standards related to asset retirement and environmental obligations 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:

	2009	2008
	(in thousands)	
Balance beginning of year	**$12,042**	$11,942
Liabilities incurred	**224**	-
Liabilities settled	**(300)**	(354)
Accretion	**642**	631
Cash flow revisions	**-**	(177)
Balance end of year	**$12,608**	$12,042

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. The equity component of AFUDC is not included in calculating taxable income. The average annual AFUDC rate was 7.65%, 7.65%, and 7.48%, respectively, for the years 2009, 2008, and 2007. AFUDC, net of taxes, as a percentage of net income after dividends on preference stock was 26.64%, 12.62%, and 3.59%, respectively, for 2009, 2008, and 2007.

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 costs of such damage are 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 2009, $3.5 million in 2008, and $3.5 million in 2007. As of December 31, 2009 and 2008, the balance in the Company's property damage reserve totaled approximately $24.0 million and $9.8 million, respectively, which is included in deferred liabilities in the balance sheets.

When the property damage reserve is inadequate to cover the cost of major storms, the Florida PSC can authorize a storm cost recovery surcharge to be applied to customer bills. Such a surcharge was authorized in 2005 after Hurricane Ivan in 2004 and was extended by a 2006 Florida PSC order approving a stipulation to address costs incurred as a result of Hurricanes Dennis and Katrina in 2005. According to the 2006 Florida PSC 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.

Injuries and Damages Reserve

The Company is subject to claims and lawsuits 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 $2.9 million and $2.5 million at December 31, 2009 and 2008, respectively. For 2009, $1.6 million and $1.3 million are included in current liabilities and deferred credits and other liabilities in the balance sheets, respectively. For 2008, $2.5 million is included in current liabilities in the balance sheets. Liabilities in excess of the reserve balance of $0.1 million and $0.8 million at December 31, 2009 and 2008, respectively, are included in deferred credits and other liabilities in the balance sheets. Corresponding regulatory assets of $0.1 million and $0.8 million at December 31, 2009 and 2008, respectively, are included in current 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, at weighted average cost when installed.

Fuel Inventory

Fuel inventory includes the average costs of oil, coal, natural gas, and emissions allowances. Fuel is charged to inventory when purchased and then expensed as used and recovered through fuel cost recovery rates approved by the Florida PSC. Emissions allowances granted by the Environmental Protection Agency (EPA) are included in inventory at zero cost.

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 (included in "Other" or shown separately as "Risk Management Activities") and are measured at fair value. See Note 9 for additional information. 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 (OCI) 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. See Note 10 for additional information.

The Company does not offset fair value amounts recognized for multiple derivative instruments executed with the same counterparty under a master netting arrangement. Additionally, the Company has no outstanding collateral repayment obligations or rights to reclaim collateral arising from derivative instruments recognized at December 31, 2009.

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.

Comprehensive Income

The objective of comprehensive income is to report a measure of all changes in common stock equity of an enterprise that result from transactions and other economic events of the period other than transactions with owners. Comprehensive income consists of net income, changes in the fair value of qualifying cash flow hedges, and reclassifications for amounts included in net income.

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 defined benefit plan are expected for the year ending December 31, 2010. The Company also provides a defined benefit pension plan for a selected group of management and highly compensated employees. Benefits under these non-qualified pension plans 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 trusts to the extent required by the FERC. For the year ending December 31, 2010, postretirement trust contributions are expected to total approximately $54,000.

The measurement date for plan assets and obligations for 2009 and 2008 was December 31 while the measurement date for prior years was September 30. Pursuant to accounting standards related to defined postretirement benefit plans, the Company was required to change the measurement date for its defined postretirement benefit plans from September 30 to December 31 beginning with the year ended December 31, 2008. As permitted, the Company adopted the measurement date provisions effective January 1, 2008 resulting in an increase in long-term liabilities of $1.4 million and an increase in prepaid pension costs of approximately $0.6 million.

Pension Plans

The total accumulated benefit obligation for the pension plans was $275 million in 2009 and $243 million in 2008. Changes during the plan year ended December 31, 2009 and the 15-month period ended December 31, 2008 in the projected benefit obligations and the fair value of plan assets were as follows:

	2009	2008
	(in thousands)	
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 260,765**	$ 251,781
Service cost	**6,478**	8,437
Interest cost	**17,139**	19,344
Benefits paid	**(12,884)**	(15,880)
Plan amendments	**-**	-
Actuarial loss (gain)	**27,388**	(2,917)
Balance at end of year	**298,886**	260,765
Change in plan assets		
Fair value of plan assets at beginning of year	**229,407**	345,398
Actual return (loss) on plan assets	**36,840**	(101,036)
Employer contributions	**696**	925
Benefits paid	**(12,884)**	(15,880)
Fair value of plan assets at end of year	**254,059**	229,407
Accrued liability	**$ (44,827)**	$ (31,358)

At December 31, 2009, the projected benefit obligations for the qualified and non-qualified pension plans were $284 million and $15 million, respectively. All pension 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). In 2009, in determining the optimal asset allocation for the pension fund, the Company performed an extensive study based on projections of both assets and liabilities over a 10-year forward horizon. The primary goal of the study was to maximize plan funded status. 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 to gain efficient exposure to the various asset classes and as hedging tools. The Company minimizes the risk of large losses primarily through diversification but also monitors and manages other aspects of risk.

The actual composition of the Company's pension plan assets as of December 31, 2009 and 2008, along with the targeted mix of assets, is presented below:

	Target	2009	2008
Domestic equity	29%	**33%**	34%
International equity	28	**29**	23
Fixed income	15	**15**	14
Special situations	3	**-**	-
Real estate investments	15	**13**	19
Private equity	10	**10**	10
Total	100%	**100%**	100%

The investment strategy for plan assets related to the Company's defined benefit plan is to be broadly diversified across major asset classes. The asset allocation is established after consideration of various factors that affect the assets and liabilities of the pension plan including, but not limited to, historical and expected returns, volatility, correlations of asset classes, the current level of assets and liabilities, and the assumed growth in assets and liabilities. Because a significant portion of the liability of the pension plan is long-term in nature, the assets are invested consistent with long-term investment expectations for return and risk. To manage the actual asset class exposures relative to the target asset allocation, the Company employs a formal rebalancing program. As additional risk management, external investment managers and service providers are subject to written guidelines to ensure appropriate and prudent investment practices.

Detailed below is a description of the investment strategies for each major asset category disclosed above:

- ***Domestic equity.*** This portion of the portfolio comprises a mix of large and small capitalization stocks with generally an equal distribution of value and growth attributes managed both actively and through passive index approaches.
- ***International equity.*** This portion of the portfolio is actively managed with a blend of growth stocks and value stocks with both developed and emerging market exposure.
- ***Fixed income.*** This portion of the portfolio is actively managed through an allocation to long-dated, investment grade corporate and government bonds.
- ***Special situations.*** Though currently unfunded, this portion of the portfolio was established both to execute opportunistic investment strategies with the objectives of diversifying and enhancing returns and exploiting short-term inefficiencies, as well as to invest in promising new strategies of a longer-term nature.
- ***Real estate investments.*** Assets in this portion of the portfolio are invested in traditional private market, equity-oriented investments in real properties (indirectly through pooled funds or partnerships) and in publicly traded real estate securities.
- ***Private equity.*** This portion of the portfolio generally consists of investments in private partnerships that invest in private or public securities typically through privately negotiated and/or structured transactions. Leveraged buyouts, venture capital, and distressed debt are examples of investment strategies within this category.

The fair values of pension plan assets as of December 31, 2009 and 2008 are presented below. These fair value measurements exclude cash, receivables related to investment income, pending investments sales, and payables related to pending investment purchases.

	Fair Value Measurements Using			
As of December 31, 2009:	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
		(in thousands)		
Assets:				
Domestic equity*	$ 50,434	$ 20,856	$ -	$ 71,290
International equity*	65,197	6,497	-	71,694
Fixed income:				
U.S. Treasury, government, and agency bonds	-	18,783	-	18,783
Mortgage- and asset-backed securities	-	5,107	-	5,107
Corporate bonds	-	12,589	-	12,589
Pooled funds	-	455	-	455
Cash equivalents and other	126	15,396	-	15,522
Special situations	-	-	-	-
Real estate investments	7,862	-	24,699	32,561
Private equity	-	-	25,053	25,053
Total	$ 123,619	$ 79,683	$ 49,752	$ 253,054
Liabilities:				
Derivatives	(202)	(51)	-	(253)
Total	$ 123,417	$ 79,632	$ 49,752	$ 252,801

*Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds. Management believes that the portfolio is well-diversified with no significant concentrations of risk.

	Fair Value Measurements Using			
As of December 31, 2008:	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
		(in thousands)		
Assets:				
Domestic equity*	$ 47,250	$ 19,242	$ -	$ 66,492
International equity*	42,508	3,909	-	46,417
Fixed income:				
U.S. Treasury, government, and agency bonds	-	19,866	-	19,866
Mortgage- and asset-backed securities	-	9,413	-	9,413
Corporate bonds	-	12,882	-	12,882
Pooled funds	-	139	-	139
Cash equivalents and other	994	9,089	-	10,083
Special situations	-	-	-	-
Real estate investments	6,476	-	37,790	44,266
Private equity	-	-	22,063	22,063
Total	$ 97,228	$ 74,540	$ 59,853	$ 231,621
Liabilities:				
Derivatives	(348)	-	-	(348)
Total	$ 96,880	$ 74,540	$ 59,853	$ 231,273

*Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds. Management believes that the portfolio is well-diversified with no significant concentrations of risk.

Changes in the fair value measurement of the Level 3 items in the pension plan assets valued using significant unobservable inputs for the years ended December 31, 2009 and 2008 are as follows:

	2009		**2008**	
	Real Estate Investments	**Private Equity**	**Real Estate Investments**	**Private Equity**
	(in thousands)		*(in thousands)*	
Beginning balance	**$37,790**	**$22,063**	$47,025	$23,400
Actual return on investments:				
Related to investments held at year end	**(10,741)**	**1,724**	(7,615)	(6,332)
Related to investments sold during the year	**(2,938)**	**452**	180	1,125
Total return on investments	**(13,679)**	**2,176**	(7,435)	(5,207)
Purchases, sales, and settlements	**588**	**814**	(1,800)	3,870
Transfers into/out of Level 3	**-**	**-**	-	-
Ending balance	**$24,699**	**$25,053**	$37,790	$22,063

The fair values presented above are prepared in accordance with applicable accounting standards regarding fair value. For purposes of determining the fair value of the pension plan assets and the appropriate level designation, management relies on information provided by the plan's trustee. This information is reviewed and evaluated by management with changes made to the trustee information as appropriate.

Securities for which the activity is observable in an active market or traded exchange are categorized as Level 1. Fixed income securities classified as Level 2 are valued utilizing matrix pricing, a common model utilizing observable inputs. Domestic and international equity securities classified as Level 2 consist of pooled funds where the value is not quoted on an exchange but where the value is determined using observable inputs from the market. Securities that are valued using unobservable inputs are classified as Level 3 and include investments in real estate and investments in limited partnerships. The Company invests (through the pension plan trustee) directly in the limited partnerships which then invest in various types of funds or various private entities within a fund. The fair value of the limited partnerships' investments is based on audited annual capital accounts statements which are generally prepared on a fair value basis. The Company also relies on the fact that, in most instances, the underlying assets held by the limited partnerships are reported at fair value. External investment managers typically send valuations to both the custodian and to the Company within 90 days of quarter end. The custodian reports the most recent value available and adjusts the value for cash flows since the statement date for each respective fund.

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

	2009	2008
	(in thousands)	
Other regulatory assets, deferred	**$ 85,194**	$ 71,990
Other, current liabilities	**(910)**	(863)
Employee benefit obligations	**(43,917)**	(30,495)

Presented below are the amounts included in regulatory assets at December 31, 2009 and 2008 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 2010.

	Prior Service Cost	**Net (Gain) Loss**
	(in thousands)	
Balance at December 31, 2009:		
Regulatory assets	**$ 8,506**	**$ 76,688**
Balance at December 31, 2008:		
Regulatory assets	$ 9,984	$ 62,006
Estimated amortization in net periodic pension cost in 2010:		
Regulatory assets	$ 1,302	$ 398

The changes in the balances of regulatory assets and regulatory liabilities related to the defined benefit pension plans for the year ended December 31, 2009 and the 15 months ended December 31, 2008 are presented in the following table:

	Regulatory Assets	**Regulatory Liabilities**
	(in thousands)	
Balance at December 31, 2007	$ 6,561	$ (60,464)
Net loss (gain)	66,170	61,989
Change in prior service costs	-	-
Reclassification adjustments:		
Amortization of prior service costs	(323)	(1,525)
Amortization of net gain	(418)	-
Total reclassification adjustments	(741)	(1,525)
Total change	65,429	60,464
Balance at December 31, 2008	$ 71,990	$ -
Net loss (gain)	**14,906**	**-**
Change in prior service costs	**-**	**-**
Reclassification adjustments:		
Amortization of prior service costs	**(1,478)**	**-**
Amortization of net gain	**(224)**	**-**
Total reclassification adjustments	**(1,702)**	**-**
Total change	**13,204**	**-**
Balance at December 31, 2009	**$ 85,194**	**$ -**

Components of net periodic pension cost were as follows:

	2009	2008	2007
		(in thousands)	
Service cost	**$ 6,478**	$ 6,750	$ 6,835
Interest cost	**17,139**	15,475	14,519
Expected return on plan assets	**(24,357)**	(23,757)	(21,934)
Recognized net (gain) loss	**224**	334	342
Net amortization	**1,478**	1,478	1,419
Net periodic pension cost	**$ 962**	$ 280	$ 1,181

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, 2009, estimated benefit payments were as follows:

	Benefit Payments
	(in thousands)
2010	$ 14,388
2011	15,105
2012	15,825
2013	16,696
2014	18,102
2015 to 2019	106,458

Other Postretirement Benefits

Changes during the plan year ended December 31, 2009 and the 15-month period ended December 31, 2008 in the accumulated postretirement benefit obligations (APBO) and in the fair value of plan assets were as follows:

	2009	2008
	(in thousands)	
Change in benefit obligation		
Benefit obligation at beginning of year	**$ 72,391**	$ 73,909
Service cost	**1,328**	1,766
Interest cost	**4,705**	5,671
Benefits paid	**(4,115)**	(4,864)
Actuarial (gain) loss	**497**	(4,522)
Plan amendments	**(2,416)**	-
Retiree drug subsidy	**250**	431
Balance at end of year	**72,640**	72,391
Change in plan assets		
Fair value of plan assets at beginning of year	**13,180**	19,610
Actual return (loss) on plan assets	**2,735**	(5,556)
Employer contributions	**2,923**	3,559
Benefits paid	**(3,865)**	(4,433)
Fair value of plan assets at end of year	**14,973**	13,180
Accrued liability	**$ (57,667)**	$ (59,211)

Other postretirement benefit 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 other postretirement benefit plan assets as of the end of the year, along with the targeted mix of assets, is presented below:

	Target	**2009**	2008
Domestic equity	28%	**32%**	33%
International equity	27	**28**	22
Fixed income	18	**18**	17
Special situations	3	**-**	-
Real estate investments	14	**12**	19
Private equity	10	**10**	9
Total	100%	**100%**	100%

Detailed below is a description of the investment strategies for each major asset category disclosed above:

- ***Domestic equity.*** This portion of the portfolio comprises a mix of large and small capitalization stocks with generally an equal distribution of value and growth attributes managed both actively and through passive index approaches.
- ***International equity.*** This portion of the portfolio is actively managed with a blend of growth stocks and value stocks with both developed and emerging market exposure.
- ***Fixed income.*** This portion of the portfolio is comprised of domestic bonds.
- ***Special situations.*** Though currently unfunded, this portion of the portfolio was established both to execute opportunistic investment strategies with the objectives of diversifying and enhancing returns and exploiting short-term inefficiencies, as well as to invest in promising new strategies of a longer-term nature.
- ***Trust-owned life insurance.*** Some of the Company's taxable trusts invest in these investments in order to minimize the impact of taxes on the portfolio.
- ***Real estate investments.*** Assets in this portion of the portfolio are invested in traditional private market, equity-oriented investments in real properties (indirectly through pooled funds or partnerships) and in publicly traded real estate securities.
- ***Private equity.*** This portion of the portfolio generally consists of investments in private partnerships that invest in private or public securities typically through privately negotiated and/or structured transactions. Leveraged buyouts, venture capital, and distressed debt are examples of investment strategies within this category.

The fair values of other postretirement benefit plan assets as of December 31, 2009 and 2008 are presented below. These fair value measurements exclude cash, receivables related to investment income, pending investments sales, and payables related to pending investment purchases.

	Fair Value Measurements Using			
As of December 31, 2009:	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
	(in thousands)			
Assets:				
Domestic equity*	$ 2,706	$ 1,119	$ -	$ 3,825
International equity*	3,499	348	-	3,847
Fixed income:				
U.S. Treasury, government, and agency bonds	-	1,008	-	1,008
Mortgage- and asset-backed securities	-	274	-	274
Corporate bonds	-	675	-	675
Pooled funds	-	553	-	553
Cash equivalents and other	8	827	-	835
Trust-owned life insurance	-	-	-	-
Special situations	-	-	-	-
Real estate investments	420	-	1,326	1,746
Private equity	-	-	1,346	1,346
Total	$ 6,633	$ 4,804	$ 2,672	$ 14,109
Liabilities:				
Derivatives	(11)	(3)	-	(14)
Total	$ 6,622	$ 4,801	$ 2,672	$ 14,095

*Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds. Management believes that the portfolio is well-diversified with no significant concentrations of risk.

	Fair Value Measurements Using			
As of December 31, 2008:	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
	(in thousands)			
Assets:				
Domestic equity*	$ 2,591	$ 1,055	$ -	$ 3,646
International equity*	2,332	216	-	2,548
Fixed income:				
U.S. Treasury, government, and agency bonds	-	1,089	-	1,089
Mortgage- and asset-backed securities	-	516	-	516
Corporate bonds	-	706	-	706
Pooled funds	-	551	-	551
Cash equivalents and other	54	499	-	553
Trust-owned life insurance	-	-	-	-
Special situations	-	-	-	-
Real estate investments	355	-	2,073	2,428
Private equity	-	-	1,211	1,211
Total	$ 5,332	$ 4,632	$ 3,284	$ 13,248
Liabilities:				
Derivatives	(20)	-	-	(20)
Total	$ 5,312	$ 4,632	$ 3,284	$ 13,228

*Level 1 securities consist of actively traded stocks while Level 2 securities consist of pooled funds. Management believes that the portfolio is well-diversified with no significant concentrations of risk.

Changes in the fair value measurement of the Level 3 items in the other postretirement benefit plan assets valued using significant unobservable inputs for the years ended December 31, 2009 and 2008 are as follows:

	2009		**2008**	
	Real Estate Investments	**Private Equity**	**Real Estate Investments**	**Private Equity**
	(in thousands)		*(in thousands)*	
Beginning balance	**$ 2,073**	**$1,211**	$2,499	$1,243
Actual return on investments:				
Related to investments held at year end	**(624)**	**68**	(339)	(297)
Related to investments sold during the year	**(154)**	**25**	9	59
Total return on investments	**(778)**	**93**	(330)	(238)
Purchases, sales, and settlements	**31**	**42**	(96)	206
Transfers into/out of Level 3	**-**	**-**	-	-
Ending balance	**$ 1,326**	**$1,346**	$2,073	$1,211

The fair values presented above are prepared in accordance with applicable accounting standards regarding fair value. For purposes of determining the fair value of the pension plan assets and the appropriate level designation, management relies on information provided by the plan's trustee. This information is reviewed and evaluated by management with changes made to the trustee information as appropriate.

Securities for which the activity is observable in an active market or traded exchange are categorized as Level 1. Fixed income securities classified as Level 2 are valued utilizing matrix pricing, a common model utilizing observable inputs. Domestic and international equity securities classified as Level 2 consist of pooled funds where the value is not quoted on an exchange but where the value is determined using observable inputs from the market. Securities that are valued using unobservable inputs are classified as Level 3 and include investments in real estate and investments in limited partnerships. The Company invests (through the pension plan trustee) directly in the limited partnerships which then invest in various types of funds or various private entities within a fund. The fair value of the limited partnerships' investments is based on audited annual capital accounts statements which are generally prepared on a fair value basis. The Company also relies on the fact that, in most instances, the underlying assets held by the limited partnerships are reported at fair value. External investment managers typically send valuations to both the custodian and to the Company within 90 days of quarter end. The custodian reports the most recent value available and adjusts the value for cash flows since the statement date for each respective fund.

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

	2009	2008
	(in thousands)	
Other regulatory assets, deferred	**$ 5,861**	$ 9,922
Other current liabilities	**-**	(500)
Employee benefit obligations	**(57,667)**	(58,711)

Presented below are the amounts included in regulatory assets at December 31, 2009 and 2008 related to the other postretirement benefit plans that had not yet been recognized in net periodic postretirement benefit cost along with the estimated amortization of such amounts for 2010.

	Prior Service Cost	**Net (Gain)Loss**	**Transition Obligation**
		(in thousands)	
Balance at December 31, 2009:			
Regulatory asset	**$ 881**	**$ 4,273**	**$ 707**
Balance at December 31, 2008:			
Regulatory asset	$ 3,187	$ 5,302	$ 1,433
Estimated amortization as net periodic postretirement cost in 2010:			
Regulatory asset	$ 186	$ (37)	$ 257

The changes in the balance of regulatory assets related to the other postretirement benefit plans for the plan year ended December 31, 2009 and the 15 months ended December 31, 2008 are presented in the following table:

	Regulatory Assets
	(in thousands)
Balance at December 31, 2007	$ 8,040
Net loss	2,759
Change in prior service costs/transition obligation	-
Reclassification adjustments:	
Amortization of transition obligation	(445)
Amortization of prior service costs	(432)
Amortization of net gain	-
Total reclassification adjustments	(877)
Total change	1,882
Balance at December 31, 2008	$ 9,922
Net gain	**(1,097)**
Change in prior service costs/transition obligation	**(2,416)**
Reclassification adjustments:	
Amortization of transition obligation	**(323)**
Amortization of prior service costs	**(293)**
Amortization of net gain	**68**
Total reclassification adjustments	**(548)**
Total change	**(4,061)**
Balance at December 31, 2009	**$ 5,861**

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

	2009	2008	2007
		(in thousands)	
Service cost	**$ 1,328**	$ 1,413	$ 1,351
Interest cost	**4,705**	4,536	4,330
Expected return on plan assets	**(1,436)**	(1,452)	(1,320)
Net amortization	**548**	702	792
Net postretirement cost	**$ 5,145**	$ 5,199	$ 5,153

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, 2009, 2008, and 2007 by approximately $1.3 million, $1.4 million, and $1.5 million, respectively.

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

	Benefit Payments	Subsidy Receipts	Total
		(in thousands)	
2010	$ 4,528	$ (382)	$ 4,146
2011	4,942	(422)	4,520
2012	5,173	(482)	4,691
2013	5,385	(543)	4,842
2014	5,606	(607)	4,999
2015 to 2019	29,912	(4,076)	25,836

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 2006 for the 2007 plan year using a discount rate of 6.00% and an annual salary increase of 3.50%.

	2009	2008	2007
Discount rate:			
Pension plans	**5.93%**	6.75%	6.30%
Other postretirement benefit plans	**5.84**	6.75	6.30
Annual salary increase	**4.18**	3.75	3.75
Long-term return on plan assets			
Pension plans	**8.50**	8.50	8.50
Other postretirement benefit plans	**8.36**	8.38	8.36

The Company estimates the expected rate of return on pension plan and other postretirement benefit plan assets using a financial model to project the expected return on each current investment portfolio. The analysis projects an expected rate of return on each of seven different asset classes in order to arrive at the expected return on the entire portfolio relying on each trust's target asset allocation and reasonable capital market assumptions. The financial model is based on four key inputs: anticipated returns by asset class (based in part on historical returns), each trust's asset allocation, an anticipated inflation rate, and the projected impact of a periodic rebalancing of each trust's portfolio.

An additional assumption used in measuring the APBO was a weighted average medical care cost trend rate of 8.50% for 2010, decreasing gradually to 5.25% through the year 2016 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, 2009 as follows:

	1 Percent Increase	1 Percent Decrease
	(in thousands)	
Benefit obligation	$ 3,571	$ 3,214
Service and interest costs	273	294

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. Total matching contributions made to the plan for 2009, 2008, and 2007 were $3.7 million, $3.5 million, and $3.5 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 such as regulation of air emissions and water discharges. 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 and other claims for damages caused by alleged exposure to hazardous materials, and common law nuisance claims for injunctive relief and property damage allegedly caused by greenhouse gas and other emissions, 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. These actions were filed concurrently with the issuance of notices of violation of the NSR provisions to the Company with respect to the Company's Plant Crist. After Alabama Power was dismissed from the original action, the EPA filed a separate action in January 2001 against Alabama Power in the U.S. District Court for the Northern District of Alabama. In these lawsuits, the EPA alleges that NSR violations occurred at eight coal-fired generating facilities operated by Alabama Power and Georgia Power, including one facility co-owned by the Company. The civil actions request penalties and injunctive relief, including an order requiring installation of the best available control technology at the affected units. The original action, now solely 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 a portion of the Alabama Power lawsuit relating to the alleged NSR violations at Plant Miller. In July 2008, the U.S. District Court for the Northern District of Alabama granted partial summary judgment in favor of Alabama Power with respect to its other affected units regarding the proper legal test for determining whether projects are routine maintenance, repair, and replacement and therefore are excluded from NSR permitting. The decision did not resolve the case, which remains ongoing.

The Company believes that 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 $37,500 per day, per violation at each generating unit, depending on the date of the alleged violation. An adverse outcome 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

New York Case

In July 2004, three environmental groups and attorneys general from eight states, each outside of Southern Company's service territory, and the corporation counsel for New York City filed complaints in the U.S. District Court for the Southern District of New York against Southern Company and four other electric power companies. 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. The 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, on September 21, 2009, the U.S. Court of Appeals for the Second Circuit reversed the district court's ruling, vacating the dismissal of the plaintiffs' claim, and remanding the case to the district court. On November 5, 2009, the defendants, including Southern Company, sought rehearing en banc, and the court's ruling is subject to potential appeal. Therefore, the ultimate outcome of these matters cannot be determined at this time.

Kivalina Case

In February 2008, the Native Village of Kivalina and the City of Kivalina filed a suit in the U.S. District Court for the Northern District of California against several electric utilities (including Southern Company), several oil companies, and a coal company. The plaintiffs are the governing bodies of an Inupiat village in Alaska. The plaintiffs contend that the village is being destroyed by erosion allegedly caused by global warming that the plaintiffs attribute to emissions of greenhouse gases by the defendants. The plaintiffs assert claims for public and private nuisance and contend that some of the defendants have acted in concert and are therefore jointly and severally liable for the plaintiffs' damages. The suit seeks damages for lost property values and for the cost of relocating the village, which is alleged to be $95 million to $400 million. Southern Company believes that these claims are without merit and notes that the complaint cites no statutory or regulatory basis for the claims. On September 30, 2009, the U.S. District Court for the Northern District of California granted the defendants' motions to dismiss the case based on lack of jurisdiction and ruled the claims were barred by the political question doctrine and by the plaintiffs' failure to establish the standard for determining that the defendants' conduct caused the injury alleged. On November 5, 2009, the plaintiffs filed an appeal with the U.S. Court of Appeals for the Ninth Circuit challenging the district court's order dismissing the case. The ultimate outcome of this matter cannot be determined at this time.

Other Litigation

Common law nuisance claims for injunctive relief and property damage allegedly caused by greenhouse gas emissions have become more frequent, and courts have recently determined that private parties and states have standing to bring such claims. For example, on October 16, 2009, the U.S. Court of Appeals for the Fifth Circuit reversed the U.S. District Court for the Southern District of Mississippi's dismissal of private party claims against certain oil, coal, chemical, and utility companies alleging damages as a result of Hurricane Katrina. In reversing the dismissal, the U.S. Court of Appeals for the Fifth Circuit held that plaintiffs have standing to assert their nuisance, trespass, and negligence claims and none of these claims are barred by the political question doctrine. The Company is not currently a party to this litigation but was named as a defendant in an amended complaint which was rendered moot in August 2007 by the U.S. District Court for the Southern District of Mississippi when such court dismissed the original matter. The ultimate outcome of this matter cannot be determined at this time.

Environmental Remediation

The Company must comply with 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.

The Company's environmental remediation liability includes estimated costs of environmental remediation projects of approximately $65.2 million as of December 31, 2009. These estimated costs relate to site closure criteria by the Florida Department of Environmental Protection (FDEP) for potential impacts to soil and groundwater from herbicide applications at the Company's substations. The schedule for completion of the remediation projects will be subject to FDEP approval. The projects have been approved by the Florida PSC for recovery through the Company's environmental cost recovery clause; therefore, there is no impact to net income as a result of these liabilities.

The final outcome of these matters cannot now be determined. However, based on the currently known conditions at these sites and the nature and extent of activities relating to these sites, the Company does not believe that additional liabilities, if any, at these sites would be material to the Company's financial statements.

FERC Matters

Market-Based Rate Authority

The Company has authorization from the FERC to sell power to non-affiliates, including short-term opportunity sales, at market-based prices. Specific FERC approval must be obtained with respect to a market-based contract with an affiliate.

In December 2004, the FERC initiated a proceeding to assess Southern Company's generation market power within its retail service territory. The ability to charge market-based rates in other markets was 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 have been subject to refund to a cost-based rate level.

On December 23, 2009, Southern Company and the FERC trial staff reached an agreement in principle that would resolve the proceeding in its entirety. The agreement does not reflect any finding or suggestion that the Company possesses or has exercised any market power. The agreement likewise does not require the Company to make any refunds related to sales during the 15-month refund period. Under the agreement, the Company will donate $0.1 million to nonprofit organizations in the State of Florida for the purpose of offsetting the electricity bills of low-income retail customers. The agreement is subject to review and approval by the FERC.

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. 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. In November 2006, Southern Company filed with the FERC a compliance plan in connection with the order. In April 2007, the FERC approved, with certain modifications, the plan submitted by Southern Company. Implementation of the plan did not have a material impact on the Company's financial statements. In November 2007, Southern Company notified the FERC that the plan had been implemented. In December 2008, the FERC division of audits issued for public comment its final audit report pertaining to compliance implementation and related matters. No comments were submitted challenging the audit report's findings of Southern Company's compliance. The proceeding remains open pending a decision from the FERC regarding the audit report.

Retail Regulatory Matters

General

The Company's rates and charges for service to retail customers are subject to the regulatory oversight of the Florida PSC. The Company's rates are a combination of base rates and several separate cost recovery clauses for specific categories of costs. These separate cost recovery clauses address such items as fuel and purchased energy costs, purchased power capacity costs, energy conservation, and demand side management programs, and the costs of compliance with environmental laws and regulations. Costs not addressed through one of the specific cost recovery clauses are recovered through the Company's base rates.

On November 2, 2009, the Florida PSC approved the Company's annual rate requests for its purchased power capacity, energy conservation, and environmental compliance cost recovery factors for 2010. On December 1, 2009, the Florida PSC approved the Company's annual rate request for its 2010 fuel cost recovery factor, which includes both fuel and purchased energy costs. The net effect of the approved changes to the Company's cost recovery factors for 2010 is a 3.9% rate increase for residential customers using 1,000 kilowatt-hours per month. The billing factors for 2010 are intended to allow the Company to recover projected 2010 costs as well as refund or collect the 2009 over or under recovered amounts in 2010. 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 factors has no significant effect on the Company's revenues or net income, but does impact annual cash flow.

Fuel Cost Recovery

The Company petitions for fuel cost recovery rates to be approved by the Florida PSC on an annual basis. The fuel cost recovery rates include the costs of fuel and purchased energy. The Company continuously monitors the over or under recovered fuel cost balance in light of the inherent variability in fuel costs. If the projected fuel cost 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 is being requested. As of December 31, 2009 and 2008, the Company had an under recovered fuel balance of approximately $2.4 million and $96.7 million, respectively, which is included in current assets in the balance sheets.

Purchased Power Capacity Recovery

The Florida PSC allows the Company to recover its costs for capacity purchased from other power producers under PPAs through a separate cost recovery component or factor in the Company's retail energy rates. Like the other specific cost recovery factors included in the Company's retail energy rates, the rates for purchased capacity are set annually on a calendar year basis. When the Company enters into a new PPA, it is reviewed and approved by the Florida PSC for cost recovery purposes. As of December 31, 2009 and 2008, the Company had an over recovered purchased power capacity balance of approximately $1.5 million and $0.3 million, respectively, which is included in other regulatory liabilities, current in the balance sheets.

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. In August 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 in March 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. On April 1, 2009, the Company filed an update to the plan which was approved by the Florida PSC on November 2, 2009. The Florida PSC acknowledged that the costs associated with the Company's Clean Air Interstate Rule and Clean Air Visibility Rule compliance plan are eligible for recovery through the environmental cost recovery clause. At December 31, 2009 and 2008, the over recovered environmental balance was approximately $11.7 million and $71 thousand, respectively, which is included in other regulatory liabilities, current in the balance sheets.

4. JOINT OWNERSHIP AGREEMENTS

The Company and Mississippi Power jointly own Plant Daniel Units 1 and 2, which together represent capacity of 1,000 MWs. 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 MWs 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 and the Company is responsible for providing its own financing.

At December 31, 2009, 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	$ 242,078[(a)]	$ 262,315
Accumulated depreciation	100,242	150,190
Construction work in progress	70,657	1,542
Ownership	25%	50%

(a) Includes net plant acquisition adjustment of $3.1 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 and no subsidiary is allocated more expense than would be paid if it filed a separate income tax return. In accordance with Internal Revenue Service (IRS) regulations, each company is jointly and severally liable for the tax liability.

Current and Deferred Income Taxes

Details of income tax provisions are as follows:

	2009	2008	2007
		(in thousands)	
Federal –			
Current	**$ 62,980**	$ 26,592	$ 51,321
Deferred	**(14,453)**	21,481	(9,431)
	48,527	48,073	41,890
State –			
Current	**6,590**	3,563	6,581
Deferred	**(2,092)**	2,467	(1,388)
	4,498	6,030	5,193
Total	**$ 53,025**	$ 54,103	$ 47,083

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:

	2009	2008
	(in thousands)	
Deferred tax liabilities–		
Accelerated depreciation	**$ 332,971**	$ 284,653
Fuel recovery clause	**965**	39,176
Pension and other employee benefits	**15,539**	15,356
Regulatory assets associated with employee benefit obligations	**37,768**	34,787
Regulatory assets associated with asset retirement obligations	**5,106**	4,877
Other	**9,084**	3,747
Total	**401,433**	382,596
Deferred tax assets–		
Federal effect of state deferred taxes	**13,076**	14,039
Postretirement benefits	**18,465**	17,428
Pension and other employee benefits	**41,124**	38,156
Property reserve	**10,642**	4,872
Other comprehensive loss	**1,546**	3,097
Asset retirement obligations	**5,106**	4,877
Other	**16,995**	7,003
Total	**106,954**	89,472
Net deferred tax liabilities	**294,479**	293,124
Less current portion, net	**2,926**	(38,770)
Accumulated deferred income taxes in the balance sheets	**$ 297,405**	$ 254,354

At December 31, 2009, the tax-related regulatory assets to be recovered from customers was $39.0 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, 2009, the tax-related regulatory liabilities to be credited to customers was $11.4 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 $1.6 million in 2009, $1.7 million in 2008, and $1.7 million in 2007. At December 31, 2009, 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:

	2009	2008	2007
Federal statutory rate	**35.0%**	35.0%	35.0%
State income tax, net of federal deduction	**1.7**	2.5	2.5
Non-deductible book depreciation	**0.3**	0.0	0.4
Difference in prior years' deferred and current tax rate	**(0.4)**	(0.5)	(0.6)
Production activities deduction	**(0.9)**	0.1	(1.4)
Allowance for funds used during construction	**(4.9)**	(2.2)	(0.6)
Other, net	**0.3**	(0.8)	(0.4)
Effective income tax rate	**31.1%**	34.1%	34.9%

The decrease in the 2009 effective tax rate is primarily the result of an increase in nontaxable allowance for equity funds used during construction.

The American Jobs Creation Act of 2004 created a tax deduction for a portion of income attributable to U.S. production activities as defined in the Internal Revenue Code Section 199 (production activities deduction). The deduction is equal to a stated percentage of qualified production activities net income. The percentage is phased in over the years 2005 through 2010 with a 3% rate applicable to the years 2005 and 2006, a 6% rate applicable for the years 2007 through 2009, and a 9% rate thereafter. The IRS has not clearly defined a methodology for calculating this deduction. However, Southern Company reached an agreement with the IRS on a calculation methodology and signed a closing agreement in December 2008. Therefore, in 2008, the Company reversed the unrecognized tax benefit related to the calculation methodology and adjusted the deduction for all previous years to conform to the agreement which resulted in a decrease in the 2008 deduction when compared to the 2007 deduction. Certain aspects of the production activities deduction remain unresolved. The net impact of the reversal of the unrecognized tax benefits combined with the application of the new methodology had no material effect on the Company's financial statements.

Unrecognized Tax Benefits

For 2009, the total amount of unrecognized tax benefits increased by $1.3 million, resulting in a balance of $1.6 million as of December 31, 2009.

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

	2009	2008	2007
		(thousands)	
Unrecognized tax benefits at beginning of year	**$ 294**	$ 887	$ 211
Tax positions from current periods	**455**	93	469
Tax positions from prior periods	**890**	11	207
Reductions due to settlements	**-**	(697)	-
Reductions due to expired statute of limitations	**-**	-	-
Balance at end of year	**$ 1,639**	$ 294	$ 887

The tax positions from current periods increase for 2009 relate primarily to the production activities deduction tax position and other miscellaneous uncertain tax positions. The tax positions increase from prior periods for 2009 relates primarily to the production activities deduction tax position. See "Effective Tax Rate" above for additional information.

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

	2009	2008	2007
		(thousands)	
Tax positions impacting the effective tax rate	**$ 1,639**	$ 294	$ 887
Tax positions not impacting the effective tax rate	**-**	-	-
Balance of unrecognized tax benefits	**$ 1,639**	$ 294	$ 887

Accrued interest for unrecognized tax benefits was as follows:

	2009	2008	2007
		(thousands)	
Interest accrued at beginning of year	**$ 17**	$ 58	$ 5
Interest reclassified due to settlements	**-**	(54)	-
Interest accrued during the year	**73**	13	53
Balance at end of year	**$ 90**	$ 17	$ 58

The Company classifies interest on tax uncertainties as interest expense. The Company did not accrue any penalties on uncertain tax positions.

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

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 2006.

6. FINANCING

Securities Due Within One Year

At December 31, 2009, the Company had $140 million of senior notes due to mature within one year. The date of maturity for these notes is June 2010.

Bank Term Loans

At December 31, 2009, the Company had a $110 million bank loan outstanding, which matures in April 2011.

Senior Notes

At December 31, 2009 and 2008, the Company had a total of $727.5 million and $588.7 million of senior notes outstanding, respectively. These senior notes are effectively subordinate to all secured debt of the Company which totaled approximately $41 million at December 31, 2009.

Pollution Control Revenue 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 has $288.0 million of outstanding pollution control revenue bonds and is required to make payments sufficient for the authorities to meet principal and interest requirements of such bonds. Proceeds from certain issuances are restricted until qualifying expenditures are incurred.

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, 2009. 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 five 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.

In January 2009, the Company issued to Southern Company 1,350,000 shares of the Company's common stock, without par value, and realized proceeds of $135 million. On January 25, 2010, the Company issued to Southern Company 500,000 shares of the Company's common stock, without par value, and realized proceeds of $50 million. The proceeds were used to repay a portion of the Company's short-term debt and for other general corporate purposes, including the Company's continuous construction program.

Dividend Restrictions

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

Assets Subject to Lien

The Company has granted a lien on its property at Plant Daniel in connection with the issuance of two series of pollution control revenue 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 December 31, 2009, the Company had $220 million of lines of credit with banks, all of which remained unused. These bank credit arrangements will expire in 2010 and $70 million contain provisions allowing one-year term loans executable at expiration. Of the $220 million, $69 million provides support for variable rate pollution control bonds, and $151 million provides liquidity support for the Company's commercial paper program and other general corporate purposes, including the Company's continuous construction program. Commitment fees average less than ¾ of 1% for the Company.

Certain credit arrangements contain covenants that limit the level of indebtedness to capitalization to 65%, as defined in the arrangements. At December 31, 2009, 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. At December 31, 2009, the Company had $88.9 million of commercial paper outstanding. At December 31, 2008, the Company had $89.9 million of commercial paper and $50 million of short-term bank notes outstanding. During 2009, the peak amount outstanding for short-term debt was $152.1 million and the average amount outstanding was $51.7 million. The peak amount outstanding for short-term debt in 2008 was $141.2 million and the average amount outstanding was $36.9 million. The average annual interest rate on short-term debt was 1.0% and 2.2% for 2009 and 2008, respectively.

7. COMMITMENTS

Construction Program

The Company is engaged in a continuous construction program, the cost of which is currently estimated to total $271.4 million in 2010, $350.2 million in 2011, and $418.5 million in 2012. The construction programs are subject to periodic review and revision, and actual construction costs may vary from these estimates because of numerous factors. These factors include: changes in business conditions; revised load growth estimates; storm impacts; changes in environmental statutes and regulations; changes in FERC rules and regulations; Florida PSC approvals; changes in legislation; the cost and efficiency of construction labor, equipment, and materials; project scope and design changes; and the cost of capital. In addition, there can be no assurance that costs related to capital expenditures will be fully recovered. At December 31, 2009, significant purchase commitments were outstanding in connection with the ongoing construction program.

Included in the amounts above are $113.4 million in 2010, $194.8 million in 2011, and $194.2 million in 2012 for environmental expenditures. The Company does not have any significant 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 a 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 $59.2 million over the remaining life of the LTSA, which is currently estimated to be up to 8 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 for 2009 and 2008, respectively. 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 has entered into various long-term commitments for the procurement of limestone to be used in flue gas desulfurization equipment. Limestone contracts are structured with tonnage minimums and maximums in order to account for fluctuations in coal burn and sulfur content. The Company has a minimum contractual obligation of 0.8 million tons equating to approximately $67.7 million, through 2019. Estimated expenditures (based on minimum contracted obligated dollars) over the next five years are $6.0 million in 2010, $6.2 million in 2011, $6.3 million in 2012, $6.5 million in 2013, and $6.7 million in 2014. Limestone costs are 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 and nitrogen oxide emissions 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, 2009. Also, the Company has entered into various long-term commitments for the purchase of capacity, electricity, and transmission. The energy-related costs associated with PPAs are recovered through the fuel cost recovery clause. The capacity-related costs associated with PPAs are recovered through the purchased power capacity cost recovery clause.

Total estimated minimum long-term obligations at December 31, 2009 were as follows:

	Commitments		
	Purchased Power*	Natural Gas	Coal
		(in thousands)	
2010	$ 39,432	$ 112,080	$ 515,241
2011	41,185	79,724	75,561
2012	41,289	57,842	-
2013	41,380	47,664	-
2014	55,937	53,512	-
2015 and thereafter	659,261	130,889	-
Total	$ 878,484	$ 481,711	$ 590,802

*Included above is $69.9 million in obligations with affiliated companies. Certain PPAs are accounted for as operating leases.

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 $10.1 million, $5.0 million, and $4.7 million for 2009, 2008, and 2007, respectively. Included in these lease expenses are rail car 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 $7.9 million in 2009, $4.0 million in 2008, and $4.4 million in 2007. 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, 2009, estimated minimum rental commitments for noncancelable operating leases were as follows:

	Minimum Lease Payments		
	Barges & Rail Cars	Other	Total
		(in thousands)	
2010	$ 12,380	$ 2,145	$ 14,525
2011	9,768	2,053	11,821
2012	8,266	452	8,718
2013	6,925	233	7,158
2014	5,504	131	5,635
2015 and thereafter	1,613	-	1,613
Total	$ 44,456	$ 5,014	$ 49,470

The Company and Mississippi Power jointly entered into operating lease agreements for aluminum rail cars for the transportation of coal to Plant Daniel. The Company has the option to purchase the rail cars 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 rail cars that do not include purchase options.

The Company entered into operating lease agreements for barges and tow boats for the transport of coal at Plant Crist. The Company has the option to renew the leases at the end of each lease term. No barge lease costs were incurred for 2009, 2008, or 2007.

In addition to rail car 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 2009. The Company's annual lease payments for 2010 to 2014 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, 2009, there were 308 current and former employees of the Company participating in the stock option plan, and there were 21 million shares of Southern Company common stock remaining available for awards under this plan. 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 estimated fair values of stock options granted in 2009, 2008, and 2007 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	**2009**	2008	2007
Expected volatility	**15.6%**	13.1%	14.8%
Expected term *(in years)*	**5.0**	5.0	5.0
Interest rate	**1.9%**	2.8%	4.6%
Dividend yield	**5.4%**	4.5%	4.3%
Weighted average grant-date fair value	**$1.80**	$2.37	$4.12

The Company's activity in the stock option plan for 2009 is summarized below:

	Shares Subject to Option	Weighted Average Exercise Price
Outstanding at December 31, 2008	1,279,765	$ 32.25
Granted	435,820	31.38
Exercised	(56,735)	24.68
Cancelled	(729)	35.30
Outstanding at December 31, 2009	**1,658,121**	**$ 32.28**
Exercisable at December 31, 2009	**994,073**	**$ 31.81**

The number of stock options vested, and expected to vest in the future, as of December 31, 2009 was not significantly different from the number of stock options outstanding at December 31, 2009 as stated above. As of December 31, 2009, the weighted average remaining contractual term for the options outstanding and options exercisable was 6.4 years and 4.9 years, respectively, and the aggregate intrinsic value for the options outstanding and options exercisable was $3.2 million and $2.4 million, respectively.

As of December 31, 2009, there was $0.2 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.

For the years ended December 31, 2009, 2008, and 2007, total compensation cost for stock option awards recognized in income was $0.9 million, $0.8 million, and $1.1 million, respectively, with the related tax benefit also recognized in income of $0.4 million, $0.3 million, and $0.4 million, respectively.

The compensation cost and tax benefits 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.

The total intrinsic value of options exercised during the years ended December 31, 2009, 2008, and 2007 was $0.2 million, $1.3 million, and $3.0 million, respectively. The actual tax benefit realized by the Company for the tax deductions from stock option exercises for the years ended December 31, 2009, 2008, and 2007 totaled $0.1 million, $0.5 million, and $1.1 million, respectively.

9. FAIR VALUE MEASUREMENTS

The fair value measurement is based on inputs of observable and unobservable market data that a market participant would use in pricing the asset or liability. The use of observable inputs is maximized where available and the use of unobservable inputs is minimized for fair value measurement and reflects a three-tier fair value hierarchy that prioritizes inputs to valuation techniques used for fair value measurement.

- Level 1 consists of observable market data in an active market for identical assets or liabilities.
- Level 2 consists of observable market data, other than that included in Level 1, that is either directly or indirectly observable.
- Level 3 consists of unobservable market data. The input may reflect the assumptions of the Company of what a market participant would use in pricing an asset or liability. If there is little available market data, then the Company's own assumptions are the best available information.

In the case of multiple inputs being used in a fair value measurement, the lowest level input that is significant to the fair value measurement represents the level in the fair value hierarchy in which the fair value measurement is reported.

The fair value measurements performed on a recurring basis and the level of the fair value hierarchy in which they fall at December 31, 2009 are as follows:

	Fair Value Measurements Using			
At December 31, 2009:	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
		(in thousands)		
Assets:				
Energy-related derivatives	$ -	$ 202	$ -	$ 202
Interest rate derivatives	-	2,934	-	2,934
Cash equivalents and restricted cash	9,366	-	-	9,366
Total	$ 9,366	$ 3,136	$ -	$12,502
Liabilities:				
Energy-related derivatives	$ -	$13,889	$ -	$13,889

Energy-related derivatives and interest rate derivatives primarily consist of over-the-counter contracts. See Note 10 for additional information. The cash equivalents and restricted cash consist of securities with original maturities of 90 days or less. These financial instruments and investments are valued primarily using the market approach.

As of December 31, 2009, the fair value measurements of investments calculated at net asset value per share (or its equivalent), as well as the nature and risks of those investments, are as follows:

As of December 31, 2009:	**Fair Value**	**Unfunded Commitments**	**Redemption Frequency**	**Redemption Notice Period**
	(in thousands)			
Cash equivalents and restricted cash:				
Money market funds	$ 9,366	None	Daily	Not applicable

The money market funds are short-term investments of excess funds in various money market mutual funds, which are portfolios of short-term debt securities. The money market funds are regulated by the SEC and typically receive the highest rating from credit rating agencies. Regulatory and rating agency requirements for money market funds include minimum credit ratings and maximum maturities for individual securities and a maximum weighted average portfolio maturity. Redemptions are available on a same day basis, up to the full amount of the Company investment in the money market funds.

As of December 31, 2009, other financial instruments for which the carrying amount did not equal fair value were as follows:

	Carrying Amount	**Fair Value**
	(in thousands)	
Long-term debt:		
2009	**$ 1,118,914**	**$ 1,137,761**
2008	$ 849,265	$ 831,763

The fair values were based on either closing market prices (Level 1) or closing prices of comparable instruments (Level 2).

10. DERIVATIVES

The Company is exposed to market risks, primarily commodity price risk and interest rate risk. To manage the volatility attributable to these exposures, the Company nets its exposures, where possible, 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. The Company's 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. Derivative instruments are recognized at fair value in the balance sheets as either assets or liabilities.

Energy-Related Derivatives

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 manages fuel-hedging programs, implemented per the guidelines of the Florida PSC, through the use of financial derivative contracts.

To mitigate residual risks relative to movements in electricity prices, the Company enters into physical fixed-price contracts for the purchase and sale of electricity through the wholesale electricity market. To mitigate residual risks relative to movements in gas prices, the Company may enter into fixed-price contracts for natural gas purchases; however, a significant portion of contracts are priced at market.

Energy-related derivative contracts are accounted for in one of two methods:

- *Regulatory Hedges* – Energy-related derivative contracts which are designated as regulatory hedges relate primarily to the Company's fuel hedging programs, where gains and losses are initially recorded as regulatory liabilities and assets, respectively, and then are included in fuel expense as the underlying fuel is used in operations and ultimately recovered through the fuel cost recovery clause.
- *Not Designated* – Gains and losses on energy-related derivative contracts that are not designated or fail to qualify as hedges are recognized in the statements of income as incurred.

Some energy-related derivative contracts require physical delivery as opposed to financial settlement, and this type of derivative is both common and prevalent within the electric industry. When an energy-related derivative contract is settled physically, any cumulative unrealized gain or loss is reversed and the contract price is recognized in the respective line item representing the actual price of the underlying goods being delivered.

At December 31, 2009, the net volume of energy-related derivative contracts for natural gas positions for the Company, together with the longest hedge date over which it is hedging its exposure to the variability in future cash flows for forecasted transactions and the longest date for derivatives not designated as hedges, were as follows:

Net Purchased mmBtu*	Longest Hedge Date	Longest Non-Hedge Date
(in thousands)		
11,000	2014	-

*mmBtu - million British thermal units

Interest Rate Derivatives

The Company also enters into interest rate derivatives, which include forward-starting interest rate swaps, to hedge exposure to changes in interest rates. Derivatives related to existing variable rate securities or forecasted transactions are accounted for as cash flow hedges. The derivatives employed as hedging instruments are structured to minimize ineffectiveness.

For cash flow hedges, the fair value gains or losses are recorded in OCI and are reclassified into earnings at the same time the hedged transactions affect earnings.

At December 31, 2009, the Company had outstanding interest rate derivatives designated as cash flow hedges on forecasted debt as follows:

Notional Amount	Variable Rate Received	Weighted Average Fixed Rate Paid	Hedge Maturity Date	Fair Value Gain (Loss) December 31, 2009
(in thousands)				*(in thousands)*
$100,000	3-month LIBOR	3.79%	April 2020	$2,934

The estimated pre-tax losses that will be reclassified from OCI to interest expense for the next 12-month period ending December 31, 2010 are $0.9 million. The Company has deferred gains and losses that are expected to be amortized into earnings through 2018.

Derivative Financial Statement Presentation and Amounts

At December 31, 2009 and 2008, the fair value of energy-related derivatives and interest rate derivatives was reflected in the balance sheets as follows:

	Asset Derivatives			Liability Derivatives		
Derivative Category	**Balance Sheet Location**	**2009**	2008	**Balance Sheet Location**	**2009**	2008
		(in thousands)			*(in thousands)*	
Derivatives designated as hedging instruments for regulatory purposes						
Energy-related derivatives:	Other current assets	**$ 142**	$ 1,017	Liabilities from risk management activities	**$ 9,442**	$ 26,928
	Other deferred charges and assets	**48**	54	Other deferred credits and liabilities	**4,447**	5,305
Total derivatives designated as hedging instruments for regulatory purposes		**$ 190**	$ 1,071		**$ 13,889**	$ 32,233
Derivatives designated as hedging instruments in cash flow hedges						
Interest rate derivatives:	Other current assets	**$ 2,934**	$ -	Liabilities from risk management activities	**$ -**	$ -
Derivatives not designated as hedging instruments						
Energy-related derivatives:	Other current assets	**$ 12**	$ -	Liabilities from risk management activities	**$ -**	$ -
Total		**$ 3,136**	$ 1,071		**$ 13,889**	$ 32,233

All derivative instruments are measured at fair value. See Note 9 for additional information.

At December 31, 2009 and 2008, the pre-tax effect of unrealized derivative gains (losses) arising from energy-related derivative instruments designated as regulatory hedging instruments and deferred on the balance sheets were as follows:

	Unrealized Losses			Unrealized Gains		
Derivative Category	**Balance Sheet Location**	**2009**	2008	**Balance Sheet Location**	**2009**	2008
		(in thousands)			*(in thousands)*	
Energy-related derivatives:	Other regulatory assets, current	**$ (9,442)**	$ (26,928)	Other regulatory liabilities, current	**$ 142**	$ 1,017
	Other regulatory assets, deferred	**(4,447)**	(5,305)	Other regulatory liabilities, deferred	**48**	54
Total energy-related derivative gains (losses)		**$ (13,889)**	$ (32,233)		**$ 190**	$ 1,071

For the years ended December 31, 2009, 2008, and 2007, the pre-tax effect of interest rate derivatives designated as cash flow hedging instruments on the statements of income were as follows:

Derivatives in Cash Flow Hedging Relationships	Gain (Loss) Recognized in OCI on Derivative (Effective Portion)			Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)			
					Amount		
Derivative Category	**2009**	2008	2007	**Statements of Income Location**	**2009**	2008	2007
		(in thousands)				*(in thousands)*	
Interest rate derivatives	**$ 2,934**	$ (2,792)	$ 602	Interest expense	**$(1,085)**	$ (949)	$ (696)

There was no material ineffectiveness recorded in earnings for any period presented.

For the years ended December 31, 2009, 2008, and 2007, the pre-tax effect of energy-related derivatives not designated as hedging instruments on the statements of income were immaterial.

Contingent Features

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 derivatives that could require collateral, but not accelerated payment, in the event of various credit rating changes of certain affiliated companies. At December 31, 2009, the fair value of derivative liabilities with contingent features was $3.1 million.

At December 31, 2009, the Company had no collateral posted with its derivative counterparties; however, because of the joint and several liability features underlying these derivatives, the maximum potential collateral requirements arising from the credit-risk-related contingent features, at a rating below BBB- and/or Baa3, is $33.3 million.

Currently, the Company has investment grade credit ratings from the major rating agencies with respect to debt and preference stock.

Generally, collateral may be provided by a Southern Company guaranty, letter of credit, or cash. The Company participated in certain agreements that could require collateral in the event that one or more Southern Company system power pool participants has a credit rating change to below investment grade.

11. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial data for 2009 and 2008 are as follows:

Quarter Ended	Operating Revenues	Operating Income	Net Income After Dividends on Preference Stock
		(in thousands)	
March 2009	**$ 284,284**	**$ 30,914**	**$ 16,542**
June 2009	**341,095**	**54,320**	**32,269**
September 2009	**377,641**	**67,392**	**41,208**
December 2009	**299,209**	**36,036**	**21,214**
March 2008	$ 311,535	$ 40,708	$ 19,530
June 2008	349,867	52,314	26,992
September 2008	421,841	69,039	37,343
December 2008	303,960	30,628	14,480

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

SELECTED FINANCIAL AND OPERATING DATA 2005-2009
Gulf Power Company 2009 Annual Report

	2009	2008	2007	2006	2005
Operating Revenues (in thousands)	**$1,302,229**	$1,387,203	$1,259,808	$1,203,914	$1,083,622
Net Income after Dividends					
on Preference Stock (in thousands)	**$111,233**	$98,345	$84,118	$75,989	$75,209
Cash Dividends					
on Common Stock (in thousands)	**$89,300**	$81,700	$74,100	$70,300	$68,400
Return on Average Common Equity (percent)	**12.18**	12.66	12.32	12.29	12.59
Total Assets (in thousands)	**$3,293,607**	$2,879,025	$2,498,987	$2,340,489	$2,175,797
Gross Property Additions (in thousands)	**$450,421**	$390,744	$239,337	$147,086	$142,583
Capitalization (in thousands)**:**					
Common stock equity	**$1,004,292**	$822,092	$731,255	$634,023	$602,344
Preference stock	**97,998**	97,998	97,998	53,887	53,891
Long-term debt	**978,914**	849,265	740,050	696,098	616,554
Total (excluding amounts due within one year)	**$2,081,204**	$1,769,355	$1,569,303	$1,384,008	$1,272,789
Capitalization Ratios (percent)**:**					
Common stock equity	**48.3**	46.5	46.6	45.8	47.3
Preference stock	**4.7**	5.5	6.2	3.9	4.2
Long-term debt	**47.0**	48.0	47.2	50.3	48.5
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
Standard and Poor's	**-**	-	-	-	A+
Fitch	**-**	-	-	-	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	**374,091**	373,595	373,036	364,647	354,466
Commercial	**53,272**	53,548	53,838	53,466	53,398
Industrial	**279**	287	298	295	298
Other	**512**	499	491	484	479
Total	**428,154**	427,929	427,663	418,892	408,641
Employees (year-end)	**1,365**	1,342	1,324	1,321	1,335

SELECTED FINANCIAL AND OPERATING DATA 2005-2009 (continued)
Gulf Power Company 2009 Annual Report

	2009	2008	2007	2006	2005
Operating Revenues (in thousands):					
Residential	**$588,073**	$581,723	$537,668	$510,995	$465,346
Commercial	**376,125**	369,625	329,651	305,049	273,114
Industrial	**138,164**	165,564	135,179	132,339	123,044
Other	**4,206**	3,854	3,831	3,655	3,355
Total retail	**1,106,568**	1,120,766	1,006,329	952,038	864,859
Wholesale - non-affiliates	**94,105**	97,065	83,514	87,142	84,346
Wholesale - affiliates	**32,095**	106,989	113,178	118,097	91,352
Total revenues from sales of electricity	**1,232,768**	1,324,820	1,203,021	1,157,277	1,040,557
Other revenues	**69,461**	62,383	56,787	46,637	43,065
Total	**$1,302,229**	$1,387,203	$1,259,808	$1,203,914	$1,083,622
Kilowatt-Hour Sales (in thousands):					
Residential	**5,254,491**	5,348,642	5,477,111	5,425,491	5,319,630
Commercial	**3,896,105**	3,960,923	3,970,892	3,843,064	3,735,776
Industrial	**1,727,106**	2,210,597	2,048,389	2,136,439	2,160,760
Other	**25,121**	23,237	24,496	23,886	22,730
Total retail	**10,902,823**	11,543,399	11,520,888	11,428,880	11,238,896
Wholesale - non-affiliates	**1,813,592**	1,816,839	2,227,026	2,079,165	2,295,850
Wholesale - affiliates	**870,470**	1,871,158	2,884,440	2,937,735	1,976,368
Total	**13,586,885**	15,231,396	16,632,354	16,445,780	15,511,114
Average Revenue Per Kilowatt-Hour (cents):					
Residential	**11.19**	10.88	9.82	9.42	8.75
Commercial	**9.65**	9.33	8.30	7.94	7.31
Industrial	**8.00**	7.49	6.60	6.19	5.69
Total retail	**10.15**	9.71	8.73	8.33	7.70
Wholesale	**4.70**	5.53	3.85	4.09	4.11
Total sales	**9.07**	8.70	7.23	7.04	6.71
Residential Average Annual Kilowatt-Hour Use Per Customer	**14,049**	14,274	14,755	15,032	15,181
Residential Average Annual Revenue Per Customer	**$1,572**	$1,552	$1,448	$1,416	$1,328
Plant Nameplate Capacity Ratings (year-end) (megawatts)	**2,659**	2,659	2,659	2,659	2,712
Maximum Peak-Hour Demand (megawatts):					
Winter	**2,310**	2,360	2,215	2,195	2,124
Summer	**2,538**	2,533	2,626	2,479	2,433
Annual Load Factor (percent)	**53.8**	56.7	55.0	57.9	57.7
Plant Availability Fossil-Steam (percent)	**89.7**	88.6	93.4	91.3	89.7
Source of Energy Supply (percent):					
Coal	**61.7**	77.3	81.8	82.5	79.7
Gas	**28.0**	15.3	13.6	12.4	13.1
Purchased power -					
From non-affiliates	**2.2**	2.6	1.6	1.9	2.8
From affiliates	**8.1**	4.8	3.0	3.2	4.4
Total	**100.0**	100.0	100.0	100.0	100.0

DIRECTORS AND OFFICERS
Gulf Power Company 2009 Annual Report

DIRECTORS

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

C. LeDon Anchors (1)
Attorney at Law
Anchors Smith Grimsley
A Professional Limited Company
Fort Walton Beach, Florida. Elected 2001

William C. Cramer, Jr.
President
Bill Cramer Chevrolet Cadillac Buick GMC, 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
Dean, College of Aeronautics
Florida Institute of Technology
Melbourne, Florida. Elected 2003

OFFICERS

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

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

Theodore J. McCullough
Vice President – Senior Production Officer
23 Years of Service

Philip C. Raymond
Vice President and Chief Financial Officer
18 Years of Service

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

Connie J. Erickson
Comptroller
7 Years of Service

Susan D. Ritenour
Secretary and Treasurer
28 Years of Service

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

Marsha S. Johnson
Vice President
24 Years of Service

E. Wayne Boston (2)
Assistant Secretary and Assistant Treasurer
39 Years of Service

Melissa K. Caen (3)
Assistant Secretary and Assistant Treasurer
3 Years of Service

(1) Retired effective March 22, 2010.
(2) Retired effective July 23, 2009.
(3) Elected effective July 23, 2009.

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 over 425,000 customers within its service area of approximately 7,500 square miles in the Florida panhandle. In 2009, retail energy sales accounted for 80 percent of the Company's total sales of 13.6 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 Mellon
Global Corporate Trust
900 Ashwood Parkway, Suite 425
Atlanta, Georgia 30338

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:

Corporate Office
Principal Address & Deliveries:
Gulf Power Company
500 Bayfront Parkway
Pensacola, FL 32520
(850) 444-6111

Mailing Address:
Gulf Power Company
One Energy Place
Pensacola, FL 32520

Auditors
Deloitte & Touche LLP
Suite 1500
191 Peachtree Street, N.E.
Atlanta, GA 30303-1924

Legal Counsel
Beggs & Lane
A Registered Limited Liability Partnership
P.O. Box 12950
Pensacola, FL 32591-2950

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