

MANAGEMENT'S REPORT

Southern Power Company 2002 Annual Report

The management of Southern Power Company has prepared this annual report and is responsible for the financial statements and related information. These statements were prepared in accordance with accounting principles generally accepted in the United States and necessarily include amounts that are based on the best estimates and judgments of management. Financial information throughout this annual report is consistent with the financial statements.

The Company maintains a system of internal accounting controls to provide reasonable assurance that assets are safeguarded and that the accounting records reflect only authorized transactions of the Company. Limitations exist in any system of internal controls based upon the recognition that the cost of the system should not exceed its benefits. The Company believes that its system of internal accounting controls maintains an appropriate cost/benefit relationship.

The Company's system of internal accounting controls is evaluated on an ongoing basis by the Company's internal audit staff. The Company's independent public accountants also consider certain elements of the internal control system in order to determine their auditing procedures for the purpose of expressing an opinion on the financial statements.

William P. Bowers
President and Chief Executive Officer

The Southern Company audit committee of its board of directors, composed of five independent directors, provides a broad overview of management's financial reporting and control functions. This committee meets periodically with management, the internal auditors and the independent public accountants to ensure that these groups are fulfilling their obligations and to discuss auditing, internal controls, and financial reporting matters. The internal auditors and independent public accountants have access to the members of the audit committee at any time.

Management believes that its policies and procedures provide reasonable assurance that the Company's operations are conducted with a high standard of business ethics.

In management's opinion, the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of Southern Power Company in conformity with accounting principles generally accepted in the United States.

Cliff S. Thrasher
Senior Vice President, Comptroller
and Chief Financial Officer
February 17, 2003

INDEPENDENT AUDITORS' REPORT

Southern Power Company:

We have audited the accompanying balance sheets of Southern Power Company (a wholly owned subsidiary of Southern Company) as of December 31, 2002 and 2001, and the related statements of income, comprehensive income, common stockholder's equity, and cash flows for the year ended December 31, 2002 and for the period from January 8, 2001 (inception) to December 31, 2001. These financial statements are the responsibility of Southern Power 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 auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 II-261 through II-275) present fairly, in all material respects, the financial position of Southern Power Company at December 31, 2002 and 2001, and the results of its operations and its cash flows for the year ended December 31, 2002 and for the period from January 8, 2001 (inception) to December 31, 2001 in conformity with accounting principles generally accepted in the United States of America.

Atlanta, Georgia
February 17, 2003

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

Southern Power Company 2002 Annual Report

RESULTS OF OPERATIONS

In January 2001, Southern Power Company was formed as a wholly-owned subsidiary of Southern Company. Southern Power constructs, owns, and manages wholesale generating assets in the Southeast and is the primary growth engine for Southern Company's competitive wholesale energy business.

Earnings

The Company's 2002 earnings totaled \$54.3 million, representing a \$46.1 million increase over 2001. The 2002 increase was the result of increased sales of wholesale capacity and energy to affiliated and non-affiliated companies. The increased sales resulted primarily from the initiation of Power Purchase Agreements (PPAs) with Georgia Power, Savannah Electric and 11 electric municipal cooperatives (EMCs) that went into effect in June 2002. Earnings for 2002 also reflect commercial operation of Wansley Units 6 and 7 and Franklin Unit 1 (the New Units) beginning in June 2002 and a full year of Plant Dahlberg operations. As of December 31, 2002, the Company had approximately 2,400 megawatts in commercial operation.

The Company began significant operations in July 2001 when Plant Dahlberg was transferred from Georgia Power, another wholly-owned subsidiary of Southern Company. The Company's 2001 earnings totaled \$8.2 million and were derived primarily from the sales of wholesale capacity and energy to affiliated and non-affiliated companies.

	Amount	Increase (Decrease) From Prior Year
	2002	2002
<i>(in thousands)</i>		
Operating revenues	\$298,768	\$269,467
Fuel	97,965	94,186
Purchased power	53,663	48,937
Other operation and maintenance	28,351	21,726
Depreciation and amortization	18,319	15,028
Taxes other than Income taxes	4,275	3,882
Total operating expenses	202,573	183,759
Operating income	96,195	85,708
Other income, net	35,599	32,630
Less --		
Interest expense and other, net	49,067	46,329
Income taxes	28,457	25,946
Net Income	\$54,270	\$46,063

Revenues

Operating revenues in 2002 were \$298.8 million, reflecting a \$269.5 million increase from 2001. In 2002, operating revenues were positively impacted by commercial operation of the New Units and the initiation of PPAs with Georgia Power, Savannah Electric and 11 electric municipal cooperatives in June 2002. A majority of the revenues resulted from wholesale energy sales to affiliated companies under PPAs. The remaining operating revenues are attributed to wholesale energy sales to non-affiliated companies under PPAs and sales through the Southern Company system power pool (Southern Pool).

Capacity revenues for 2002 were \$123.9 million, or 41.5% of total revenues. These revenues are an integral component of the PPAs with both associated and non-associated customers.

In 2001, operating revenues of \$29.3 million were solely attributed to operations at Plant Dahlberg. The majority of the revenues, \$26.4 million, were from capacity and energy sales to non-affiliated companies under PPAs. The remainder, \$2.9 million, was from sales to affiliated companies through the Southern Pool.

Revenues from sales to affiliated companies through the Southern Pool that are not covered by PPAs will vary depending on demand and the availability and cost of generating resources at each company within the Southern Pool. These transactions do not have a significant impact on earnings since the energy is generally sold at variable cost.

Expenses

Natural gas fuel costs constitute the single largest expense for the Company. The increase in fuel expense in 2002 is primarily due to the commercial operation of the New Units in 2002 and a full year of operation for Plant Dahlberg. In addition, the average price of natural gas increased 33.4% from 2002 to 2001. The Company's PPAs provide that the purchasers are responsible for substantially all of the cost of fuel relating to energy delivered under such PPAs; therefore, these expense increases do not have a significant impact on net income.

In 2002, purchased power from non-affiliates and affiliates increased by \$33.3 million and \$15.6 million, respectively, to meet the demands of the Company's contractual sales commitments.

Expenses from purchased power transactions will vary depending on demand and the availability and cost of generating resources accessible throughout the Southern Pool. Load requirements are submitted to the Southern Pool on an hourly basis and are fulfilled with the lowest cost alternative, whether that is Southern Power-owned, or affiliate-owned generation or external purchases.

In 2001, purchased power from non-affiliates and affiliates totaled \$4.7 million. These expenses reflected the demand and the availability and cost of generating resources accessible through the Southern Pool.

In 2002, other operation expense increased by \$17.6 million mainly due to increased administrative and general expenses of \$12.3 million and other production expenses of \$5.2 million. These increases are primarily attributed to the June 2002 commercial operation of the New Units.

Other operation expense in 2001 included administrative and general expenses of \$5.6 million and other production expenses of \$0.6 million related to the startup of the Company and the transfer of Plant Dahlberg in July 2001.

In 2002, depreciation and amortization increased as a direct result of the New Units. Depreciation and amortization in 2001 all related to Plant Dahlberg which was placed into service in July 2001.

In 2002, the increase in taxes other than income taxes is related to property taxes for the New Units.

Interest expense in 2002 increased by \$40.9 million from the amount recorded in 2001. This increase in 2002 is primarily attributed to increased debt associated with the Company's ongoing construction program. The majority of the additional debt is comprised of \$575 million in senior notes issued in June 2002 which accounted for \$20.0 million of the increased expense. Increased borrowing against the revolving line of credit increased expense by \$15.7 million and an increase in the note payable to Southern Company of \$209.5 million contributed \$5.2 million of the increase. In 2001, interest expense represented interest on long-term debt and interest on borrowings from Southern Company to support the Company's on-going construction program.

These expenses were offset by interest capitalized related to borrowings used to finance the Company's on-going construction program.

Other, net in 2002 decreased primarily due to unrealized losses on derivative energy contracts.

Effects of Inflation

The Company is subject to long-term contracts and income tax laws that are based on the recovery of historical costs. While the inflation rate has been relatively low in recent years, it continues to have an adverse effect on the Company because of the large investment in generating facilities with long economic lives. Conventional accounting for historical cost does not recognize this economic loss nor the partially offsetting gain that arises through financing facilities with fixed-money obligations such as long-term debt.

FUTURE EARNINGS POTENTIAL

General

The results of operations for 2002 and 2001 are not necessarily indicative of future earnings. The level of future earnings depends on numerous factors including completion of construction on new generating facilities,

regulatory matters, energy sales, creditworthiness of customers, total generating capacity available in the Super Southeast, and the remarketing of capacity.

The Company is working to maintain and expand its share of wholesale energy sales in the Southeastern power markets. By the end of 2005, the Company plans to have approximately 6,600 megawatts of available generating capacity in commercial operation. At December 31, 2002, 2,400 megawatts were in commercial operation.

The Company currently has general authorization from the Federal Energy Regulatory Commission (FERC) to sell power to non-affiliates at market-based prices. Specific FERC approval must be obtained with respect to a market-based contract with an affiliate. As with any seller that has been authorized to sell at market-based rates, the FERC retains the authority to modify or withdraw the Company's market-based rate authority if it determines that the underlying requirements for having such authority are no longer applicable. In that event, the Company would be required to obtain FERC approval of rates based on cost of service, which may be lower than those in negotiated market-based rates.

In June 2002, PPAs with Georgia Power, Savannah Electric and 11 electric municipal cooperatives went into effect. Additionally, in June 2002 commercial operation of the New Units began.

In 2003, the Company expects Plant Franklin Unit 2, Plant Harris Units 1 and 2 and Plant Stanton A to be completed and placed into commercial operation. In 2004, the Company's PPA with Georgia Power will begin for Plant Harris Unit 2. The Company also expects Plant Franklin Unit 3 and Plant McIntosh Units 10 and 11 to begin commercial operation in 2005. Substantially all of the Company's generating capacity in operation, under construction or planned has been sold under PPAs. (See Note 5 to the financial statements herein for additional details.)

Also, effective in January 2003, the Company entered into contracts with North Carolina Municipal Power Authority 1 (North Carolina) and the City of Dalton (Dalton). Under the North Carolina contract, the Company will be responsible for supplying North Carolina's capacity and energy needs in excess of its existing resources and disposing of its surplus energy. The contract term is January 1, 2003 through December

31, 2004. Under the Dalton contract, the Company is responsible for supplying Dalton's requirements for capacity and energy in excess of Dalton's existing resources. The contract term is for 15 years, beginning January 1, 2003, with a customer option to convert to a fixed capacity purchase at the end of year 10.

Although under some of the Company's PPAs energy will be sold to Southern Company's five regulated operating companies, the Company's generating facilities will not be in the operating companies' regulated rate bases, and the Company will not be able to seek recovery from the affiliated companies' ratepayers for construction, repair or maintenance costs. It is expected that the capacity payments in the PPAs will produce sufficient cash flow to meet these costs, pay debt service and provide an equity return. However, the Company's overall profit will depend on numerous factors, including efficient operation of its generating facilities.

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

The Company's PPAs with non-affiliated counterparties have provisions that require the posting of collateral or an acceptable substitute guarantee in the event that Standard & Poor's or Moody's downgrades the credit ratings of such counterparty to below-investment grade, or, if the counterparty is not rated or fails to maintain a minimum coverage ratio. The PPAs are expected to provide the Company with a stable source of revenue during their respective terms.

The Company has PPAs with subsidiaries of Dynegy Inc. (Dynegy) which are now rated below investment grade. Minimum capacity revenues under one of these contracts average approximately \$13 million annually through May 2005. Dynegy has provided a letter of credit expiring in April 2003 totaling \$20 million (approximately 18 months of capacity payments) to the Company. In addition, two one-year letters of credit totaling \$50 million (approximately 14 months of capacity payments) were provided in April 2002 as security for obligations of

Dynegy affiliates under the Plant Franklin Unit 3 PPAs beginning in 2005. These letters of credit can be drawn in the event of a default under the PPA or failure to renew the letters of credit prior to expiration. In the event of such a default, and if the Company was unable to resell that capacity in the market, future earnings could be affected. The outcome of this matter cannot now be determined.

In 2002, the Company executed additional PPAs whereby the Company will sell capacity and energy from planned generating facilities at Plant McIntosh to Georgia Power and Savannah Electric beginning in 2005. These PPAs are subject to regulatory approval. Under these contracts and all other existing PPAs, the Company has the right, at its sole discretion, to supply capacity and energy under these arrangements from any resource available to it as part of the Southern Pool. Reference is made to Note 3 to the financial statements herein for additional information.

Fixed and variable operation and maintenance (O&M) costs will be covered either through capacity charges or other charges based on dollars per kilowatt year or dollars per megawatt hour. The Company has also entered into long-term service contracts with General Electric International, Inc. (GE) to reduce its exposure to certain O&M costs relating to GE equipment. See Note 5 to the financial statements herein for additional information.

Industry Restructuring

The electric utility industry in the United States is continuing to evolve as a result of regulatory and competitive factors. Among the early primary agents of change was the Energy Policy Act of 1992 (Energy Act). The Energy Act allows independent power producers (IPPs) to access a utility's transmission network in order to sell electricity to other utilities. This enhanced the incentive for IPPs to build power plants for a utility's large industrial and commercial customers where retail access is allowed and sell energy to other utilities. Also, electricity sales for resale rates were affected by numerous new energy suppliers, including power marketers and brokers.

This past year, merchant energy companies and traditional electric utilities with significant energy marketing and trading activities came under severe financial pressures. Many of these companies have completely exited or drastically reduced all energy

marketing and trading activities and sold foreign and domestic electric infrastructure assets. The Company has not experienced any material financial impact regarding its limited energy trading operations and recent generating capacity additions. In general, the Company only constructs new generating capacity after entering into long-term capacity contracts for the new facilities.

FERC Matters

In December 1999, the FERC issued its final rule on Regional Transmission Organizations (RTOs). The order encouraged utilities owning transmission systems to form RTOs on a voluntary basis. Southern Company has submitted a series of status reports informing the FERC of progress toward the development of a Southeastern RTO. In these status reports, Southern Company explained that it is developing a for-profit RTO known as SeTrans with a number of non-jurisdictional cooperative and public power entities. In 2001, Entergy Corporation and Cleco Power joined the SeTrans development process. In 2002, the sponsors of SeTrans established a Stakeholder Advisory Committee, which will participate in the development of the RTO, and held public meetings to discuss the SeTrans proposal. On October 10, 2002, the FERC granted Southern Company's and other SeTrans' sponsors petition for a declaratory order regarding the governance structure and the selection process for the Independent System Administrator (ISA) of the SeTrans RTO. The FERC also provided guidance on other issues identified in the petition. The SeTrans sponsors announced the selection of ESB International, Ltd. (ESBI) to be the preferred ISA candidate. Should negotiations with this candidate successfully conclude with final agreement among the parties, the SeTrans sponsors intend to seek any state and federal regulatory or other approvals necessary for formation of the SeTrans RTO and the approval of ESBI to serve in the capacity of the SeTrans ISA. The creation of SeTrans is not expected to have a material impact on the Company's financial statements; however, the outcome of this matter cannot now be determined.

In July 2002, the FERC issued a notice of proposed rulemaking regarding open access transmission service and standard electricity market design. The proposal, if adopted, would among other things: (1) require transmission assets of jurisdictional utilities to be operated by an independent entity; (2) establish a standard market design; (3) establish a single

type of transmission service that applies to all customers; (4) assert jurisdiction over the transmission component of bundled retail service; (5) establish a generation reserve margin; (6) establish bid caps for a day ahead and spot energy markets; and (7) revise the FERC policy on the pricing of transmission expansions. Comments on certain aspects of the proposal have been submitted by Southern Company. Any impact of this proposal on Southern Company and its subsidiaries will depend on the form in which final rules may be ultimately adopted; however, the Company's revenues, expenses, assets, and liabilities could be adversely affected by changes in the transmission regulatory structure in its regional power market.

Environmental Matters

The Company's business activities are subject to extensive governmental regulation related to public health and the environment. Litigation over environmental issues and claims of various types, including property damage, personal injury and citizen enforcement of environmental requirements, has increased generally throughout the United States; in particular, personal injury claims for damages caused by alleged exposure to hazardous materials have become more frequent.

Several major bills to amend the Clean Air Act to impose more stringent emissions limitations have been proposed. Three of these, the Bush Administration's Clear Skies Act, the Clean Power Act of 2002, and the Clean Air Planning Act of 2002, proposed to further limit power plant emissions of sulfur dioxide, nitrogen oxides, and mercury. The latter two bills also proposed to limit emissions of carbon dioxide. None of these bills were enacted into law in the last Congress. Similar bills have been, and are anticipated to be, introduced this year. The Bush Administration's Clear Skies Act was recently reintroduced, and President Bush has stated that it will be a high priority for the administration. Other bills already introduced include the Climate Stewardship Act of 2003, which proposes capping greenhouse gas emissions.

Federal and state environmental regulatory agencies are actively considering and developing additional control strategies for emission of air pollution from all major sources of air pollution, particularly electric generating facilities. This includes the overall reduction of emission of nitrogen oxides (NOx) in the eastern United States, the reduction of NOx and particulate matter emissions to reduce regional haze and visibility impairment in sensitive areas, the development of appropriate control standards

and technologies for emissions of mercury and the reduction of so-called "greenhouse gases" (such as carbon dioxide) to address concerns over global climate change.

Development and implementation of final federal and state rules on these issues could require substantial further reductions in all air emissions associated with electricity generation. Additional compliance costs and capital expenditures resulting from the implementation of such rules and standards cannot be determined until the results of legal challenges are known and final rules have been adopted at both the federal and state level.

The EPA and state environmental regulatory agencies are reviewing and evaluating various other matters including: control strategies to reduce regional haze; limits on pollutant discharges to impaired waters; cooling water intake restrictions; and hazardous waste disposal requirements. The impact of any new standards will depend on the development and implementation of applicable regulations.

Several major pieces of environmental legislation are being considered for reauthorization or amendment by Congress. These include: the Clean Air Act; the Clean Water Act; the Comprehensive Environmental Response, Compensation and Recovery Act; the Toxic Substances Control Act; and the Endangered Species Act. Changes to these laws could affect many areas of the Company's operations. The full impact of any such changes cannot be determined at this time.

Compliance with possible additional legislation related to global climate change and other environmental and health concerns could significantly affect the Company. The impact of new legislation, if any, will depend on the subsequent development and implementation of applicable regulations.

All of the Company's PPAs contain provisions that permit charging the purchaser with some of the new costs incurred as a result of change in law, including environmental regulations.

Certain environmental, natural resource and land use concerns could have an effect on site selection for future plants. This includes the potential for designation of target areas as non-attainment for ozone or particulate matter under newly adopted National Ambient Air Quality Standards, the availability of water withdrawal rights, uncertainties regarding aesthetic impacts such as increased

light or noise or regarding any potential for adverse health impacts associated with electric and magnetic fields. Such concerns and uncertainties can increase the cost of siting and operating any type of electric generating facility.

Accounting Policies

Critical Policies

The Company's significant accounting policies are described in Note 1 to the financial statements. The Company has three critical accounting policies that require a significant amount of judgment and are considered to be the most important to the presentation of the Company's financial position and results of operations. The first critical policy is the recognition of capacity revenues from long-term contracts at the lesser of the levelized basis or the cash collected over the contract periods. Second, the Company designates qualifying derivative instruments as cash flow or fair value hedges under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and marks such derivative instruments to market based primarily on quoted market prices. The unrealized changes in fair value of qualifying cash flow hedges are deferred in other comprehensive income. Any ineffectiveness in those hedges and changes in non-qualifying positions are reported as a component of current period income. Finally, the Company uses flow-through accounting for state manufacturer's tax credits. This means that the Company recognizes the credit as a reduction of tax expense when it is more likely than not to be allowed by the Georgia Department of Revenue.

Derivatives

Effective January 2001, the Company adopted FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. In October 2002, the Emerging Issues Task Force (EITF) of the FASB announced accounting changes related to energy trading contracts in Issue No. 02-03. In October 2002, the Company prospectively adopted the EITF's requirements to reflect the impact of certain energy trading contracts on a net basis. This change had no material impact on the company's income statement. Another change also required certain energy trading contracts to be accounted for on an accrual basis effective January 2003. This change had no impact on the Company's current accounting treatment.

Asset Retirement Obligations

In January 2003, the Company adopted FASB Statement No. 143, Accounting for Asset Retirement Obligations. Statement No. 143 establishes new accounting and reporting standards for legal obligations associated with the ultimate cost of retiring long-lived assets. The present value of the ultimate costs for an asset's future retirement must be recorded in the period in which the liability is incurred. The cost must be capitalized as part of the related long-lived asset and depreciated over the asset's useful life. Additionally, Statement No. 143 does not permit non-regulated companies to continue accruing future retirement costs for long-lived assets that they do not have a legal obligation to retire.

The Company has no liability for asset retirement obligations. In January 2003, the Company recorded a reduction to the accumulated reserve for depreciation and a cumulative effect of change in accounting principle of \$0.6 million. This represents removal costs accrued prior to the implementation of Statement No. 143.

FINANCIAL CONDITION

Plant Additions

The major change in the Company's financial condition during 2002 was the addition of approximately \$1.2 billion to utility plant related to on-going construction of combined-cycle units and the transfer of two units at Plant Wansley from Georgia Power. The funds for these additions were provided by the Company's credit facility, the issuance of senior notes in June 2002, and capital contributions and subordinated loans from Southern Company. The Statements of Cash Flows provide additional information.

Credit Rating Risk

The Company does not have any credit agreements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. There are contracts that could require collateral -- but not accelerated payment -- in the event of a credit rating change to below investment grade. These contracts are primarily for physical electricity sales, fixed-price physical gas purchases and agreements covering interest rate swaps and currency swaps. At December

31, 2002, the maximum potential collateral requirements under the electricity sale contracts and financial instruments were approximately \$194 million. Generally, collateral may be provided for by a Southern Company guaranty, a letter of credit or cash. At December 31, 2002, there were no material collateral requirements for the gas purchase contracts.

Exposure to Market Risks

The Company is exposed to market risks, including changes in interest rates, currency exchange rates, and certain commodity prices. To manage the volatility attributable to these exposures, the Company nets the exposures to take advantage of natural offsets and enters into various derivative transactions for the remaining exposures pursuant to the Company's policies in areas such as counterparty exposure and hedging practices. The Company's policy is that derivatives are to be used primarily for hedging purposes. Derivative positions are monitored using techniques that include market valuation and sensitivity analysis.

The weighted average interest rate on variable long-term debt outstanding at December 31, 2002 was 3.65%. If the Company sustained a 100 basis-point change in interest rates for all variable rate long-term debt, the change would affect annualized gross interest cost by approximately \$5.6 million at December 31, 2002. Most or all of that change would be capitalized, given the size of the Company's construction program. To further mitigate the Company's exposure to interest rates, it has entered into interest rate swaps that were designated as cash flow hedges for planned debt issuances. The Company is not aware of any facts or circumstances that would significantly affect such exposures in the near term. See "Financing Activities" herein and Notes 1 and 7 to the financial statements under the heading "Financial Instruments" for additional information.

The Company has firm purchase commitments that require payment in Euros. As a hedge against fluctuations in the exchange rate for Euros, the Company entered into forward contracts to purchase Euros and has designated these contracts as fair value hedges. Since the terms of these Euro contracts mirror the purchase commitment terms, there is no ineffectiveness recognized in income. At December 31, 2002, the Company had outstanding contracts covering a notional amount of \$5.5 million in commitments through May 2003.

Because energy from the Company's facilities is primarily sold under long-term PPAs with tolling agreements and provisions shifting substantially all of the responsibility for fuel cost to the purchasers, the Company's exposure to market volatility in commodity fuel prices and prices of electricity is limited. To mitigate residual risks in those areas, the Company enters into fixed-price contracts for the purchase or sale of fuel and electricity. In connection with the transfers of Plant Franklin in 2001 and Plant Wansley in 2002 to the Company, Georgia Power transferred approximately \$5.6 million and \$1.6 million, respectively, in derivative assets relating to electric and gas forward contracts in effect at the date of the transfers. These contracts were recorded at fair value on the date of the transfer, which was equal to Georgia Power's carrying amount. Following the transfer, these contracts are marked to market through income until realized and settled.

At December 31, 2002 and 2001, the fair value of changes in derivative energy contracts and year-end valuations were as follows:

	Changes in Fair Value	
	2002	2001
	<i>(in thousands)</i>	
Contracts beginning of year	\$5,496	\$ -
Contracts realized or settled	(4,336)	-
New contracts at inception	1,576	5,617
Changes in valuation techniques	-	-
Current period changes	1,128	(121)
Contracts end of year	\$3,864	\$5,496

At December 31, 2002, all of these contracts are actively quoted and mature within one year.

Unrealized gains and losses on electric and gas contracts used to hedge anticipated purchases and sales are deferred in other comprehensive income. Gains and losses on contracts that do not represent hedges are recognized in the income statement as incurred. At December 31, 2002, the fair value of derivative energy contracts was as follows:

	Amounts
	<i>(in thousands)</i>
Other comprehensive income	\$2,706
Net income	1,158
Total fair value	\$3,864

Approximately \$(4.9) million and \$0.6 million of gains (losses) were recognized in income in 2002 and 2001, respectively. The Company is exposed to market-price risk in the event of nonperformance by parties to the derivative energy contracts. The Company's policy is to enter into agreements with counterparties that have investment grade credit ratings by Moody's and Standard & Poor's, or with counterparties who have posted collateral to cover potential credit exposure. Therefore, the Company does not anticipate market risk exposure from nonperformance by the counterparties. For additional information, see Note 1 to the financial statements under "Financial Instruments."

Financing Activities

During 2002, Southern Company made to the Company equity contributions of approximately \$279.1 million, plus subordinated loans of approximately \$209.5 million. Equity contributions and subordinated loans from Southern Company total \$941.7 million to the Company at the end of 2002. No dividends were paid in 2002.

In June 2002, the Company issued \$575 million of 6.25% Senior Notes, Series A due July 15, 2012. The net proceeds were used to reduce outstanding indebtedness under a revolving credit agreement and to reduce loans from Southern Company. The Company also settled several interest rate swap agreements entered into in anticipation of this issuance at a \$16.9 million loss. This amount has been deferred in other comprehensive income and will be amortized to interest expense over the life of the senior notes.

Also in June 2002, the Company issued a long-term note payable to Chilton County, Alabama for \$2.1 million. The proceeds of the note were used for the purchase of land for a potential future generation site. The note is payable over the next 5 years at an imputed interest rate of 6.25%.

Capital Requirements for Construction

The Company estimates that construction expenditures for the years 2003 through 2005 will total \$377 million, \$381 million and \$278 million, respectively. Actual construction costs may vary from this estimate because of changes in such factors as: business conditions; environmental regulations; FERC rules and transmission regulations; the cost and efficiency of

construction labor, equipment, and materials; and the cost of capital.

The Company has approximately 4,100 megawatts of new generating capacity scheduled to be placed in service by 2005.

Other Capital Requirements

In addition to the funds needed for the construction program, approximately \$380.6 million will be required by the end of 2005 for maturities of long-term debt.

These capital requirements and purchase commitments -- discussed in Notes 3 and 5 to the financial statements -- are as follows:

	2003	2004	2005
	(in millions)		
Notes payable to Chilton County	\$ 0.2	\$ 0.2	\$ 0.2
Purchase commitments			
Fuel	\$22.7	\$22.9	\$18.6
Long-term service agreements	\$17.1	\$22.7	\$21.4

Sources of Capital

The Company will use both external funds and equity capital from Southern Company to finance its construction program. External funds will be from the issuance of unsecured senior debt and utilization of existing credit arrangements from banks.

At December 31, 2002, the Company had approximately \$19.5 million of cash and cash equivalents to meet short-term cash needs and contingencies. To meet liquidity and capital resource requirements, the Company had at December 31, 2002 approximately \$470 million of unused committed credit arrangements with banks as shown in the following table.

At the beginning of 2003, bank arrangements are as follows:

Total	Unused	Unused Expiring In	
		2003	2004 & beyond
(in millions)			
\$850	\$470	\$--	\$470

Amounts drawn under the arrangements are used to finance acquisition and construction costs related to gas-fired electric generating facilities and for general

corporate purposes, subject to borrowing limitations for each generating facility. The arrangements permit the Company to fund construction of future generating facilities upon meeting certain requirements. At December 31, 2002, the Company had \$380 million in outstanding bank borrowings. See Note 7 to the financial statements under "Long-Term Debt" for additional information.

Cautionary Statement Regarding Forward-Looking Information

The Company's 2002 Annual Report includes forward-looking statements in addition to historical information. Forward-looking information includes, among other things, statements concerning scheduled completion of new generation, capacity projections and the strategic goals for the Company's wholesale business. 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 comparable terminology. The Company cautions that there are various important factors that could cause actual results to differ materially from those indicated in 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, and also changes in environmental 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; the effects, extent, and timing of the entry of additional competition in the markets in which the Company operates; the impact of fluctuations in commodity prices, interest rates, and customer demand; state and federal rate regulations; political, legal, and economic conditions and developments in the United States; the performance of projects undertaken by the Company and the success of efforts to invest in and develop new opportunities; internal restructuring or other restructuring options that may be pursued; potential business strategies, including acquisitions or dispositions of assets or businesses, which cannot be assured to be completed or beneficial to the Company; the ability of counterparties of the Company to make payments as and when due; the effects of, and changes in, economic conditions in the areas in which the Company operates, including the current soft economy; the direct or indirect effects on the Company's business resulting from the terrorist incidents on September 11, 2001, or any similar such

incidents or responses to such incidents; financial market conditions and the results of financing efforts; the ability of the Company to obtain additional generating capacity at competitive prices; weather and other natural phenomena; and other factors discussed elsewhere herein and in other reports (including the Form 10-K) filed from time to time by the Company with the Securities and Exchange Commission.

STATEMENTS OF INCOME

For the Year Ended December 31, 2002 and For the Period from January 8, 2001 (Inception) to December 31, 2001
Southern Power Company 2002 Annual Report

	2002	2001
	<i>(in thousands)</i>	
Operating Revenues:		
Sales for resale --		
Non-affiliates	\$114,919	\$26,390
Affiliates	183,111	2,906
Other revenues	738	5
Total operating revenues	298,768	29,301
Operating Expenses:		
Operation --		
Fuel	97,965	3,779
Purchased power --		
Non-affiliates	34,499	1,209
Affiliates	19,164	3,517
Other	23,800	6,243
Maintenance	4,551	382
Depreciation and amortization	18,319	3,291
Taxes other than income taxes	4,275	393
Total operating expenses	202,573	18,814
Operating Income	96,195	10,487
Other Income and (Expense):		
Interest income	288	78
Interest expense, net of amounts capitalized	(8,886)	(427)
Other income (expense), net	(4,870)	580
Total other income and (expense)	(13,468)	231
Earnings Before Income Taxes	82,727	10,718
Income taxes	28,457	2,511
Net Income	\$ 54,270	\$ 8,207

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

STATEMENTS OF CASH FLOWS

For the Year Ended December 31, 2002 and For the Period from January 8, 2001 (Inception) to December 31, 2001

Southern Power Company 2002 Annual Report

	2002	2001
	(in thousands)	
Operating Activities:		
Net income	\$ 54,270	\$ 8,207
Adjustments to reconcile net income to net cash provided from operating activities --		
Depreciation and amortization	18,319	3,291
Deferred income taxes and investment tax credits, net	2,739	3,534
Other, net	17,955	5,406
Changes in certain current assets and liabilities --		
Receivables, net	(12,433)	(5,381)
Fossil fuel stock	(7,606)	(3,425)
Materials and supplies	(822)	(5,731)
Other current assets	(10,198)	(183)
Accounts payable	8,628	2,242
Taxes accrued	7,834	394
Interest accrued	20,713	-
Other current liabilities	-	250
Net cash provided from (used for) operating activities	99,399	8,604
Investing Activities:		
Gross property additions	(1,214,677)	(765,511)
Increase in construction related payables	3,229	28,171
Other	(885)	(10,126)
Net cash used for investing activities	(1,212,333)	(747,466)
Financing Activities:		
Increase (decrease) in notes payable to parent, net	209,538	950
Proceeds --		
Senior notes	575,000	-
Other long-term debt	87,873	293,205
Capital contributions from parent company	279,133	452,097
Settlement of interest rate swaps on senior note	(16,884)	-
Other	(5,963)	(3,679)
Net cash provided from (used for) financing activities	1,128,697	742,573
Net Change in Cash and Cash Equivalents	15,763	3,711
Cash and Cash Equivalents at Beginning of Period	3,711	-
Cash and Cash Equivalents at End of Period	\$ 19,474	\$ 3,711
Supplemental Cash Flow Information:		
Cash paid during the period for --		
Interest (net of \$35,311 and \$2,891 capitalized for 2002 and 2001, respectively)	\$ -	\$ 427
Income taxes (net of refunds)	23,937	(423)

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

BALANCE SHEETS

At December 31, 2002 and 2001

Southern Power Company 2002 Annual Report

Assets	2002	2001
	<i>(in thousands)</i>	
Current Assets:		
Cash and cash equivalents	\$ 19,474	\$ 3,711
Receivables --		
Customer accounts receivable	6,609	3,766
Affiliated companies	11,555	1,965
Accumulated provision for uncollectible accounts	(350)	(350)
Fossil fuel stock, at average cost	11,031	3,425
Materials and supplies, at average cost	6,553	5,731
Prepayments	8,796	183
Other	9,954	9,208
Total current assets	73,622	27,639
Property, Plant, and Equipment:		
In service	896,163	265,153
Less accumulated provision for depreciation	21,590	3,291
	874,573	261,862
Construction work in progress	1,082,987	500,358
Total property, plant, and equipment	1,957,560	762,220
Assets from risk management activities	-	9,059
Deferred Charges and Other Assets:		
Accumulated deferred income taxes	38,591	11,915
Other	16,203	12,024
Total deferred charges and other assets	54,794	23,939
Total Assets	\$2,085,976	\$822,857

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

BALANCE SHEETS

At December 31, 2002 and 2001

Southern Power Company 2002 Annual Report

Liabilities and Stockholder's Equity	2002	2001
	<i>(in thousands)</i>	
Current Liabilities:		
Securities due within one year	\$ 200	\$ -
Notes payable to parent	210,488	950
Accounts payable --		
Affiliated	37,748	26,135
Other	4,522	4,278
Taxes accrued --		
Income taxes	3,915	394
Other	4,313	-
Interest accrued	20,713	-
Other	3,484	886
Total current liabilities	285,383	32,643
Long-Term Debt:		
Senior notes	575,000	-
Other long-term debt	382,089	293,205
Unamortized debt (discount) premium, net	(1,210)	-
Long-term debt	955,879	293,205
Deferred Credits and Other Liabilities:		
Obligations under risk management activities	63,191	365
Deferred capacity revenues --		
Affiliated	13,075	-
Other	3,147	1,717
Other --		
Affiliated	15,644	23,415
Other	3,053	4,519
Total deferred credits and other liabilities	98,110	30,016
Common stockholder's equity		
Common stock, par value \$0.01 per share --		
Authorized - 1,000,000 shares		
Outstanding - 1,000 shares	-	-
Paid-in capital	731,230	452,097
Retained earnings	62,477	8,207
Accumulated other comprehensive (loss) income	(47,103)	6,689
Total common stockholder's equity	746,604	466,993
Total Liabilities and Stockholder's Equity	\$2,085,976	\$822,857
Commitments and Contingent Matters (See notes)		

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

STATEMENTS OF COMMON STOCKHOLDER'S EQUITY

For the Year Ended December 31, 2002 and For the Period from January 8, 2001 (Inception) to December 31, 2001
Southern Power Company 2002 Annual Report

	Common Stock	Paid-In Capital	Retained Earnings	Other Comprehensive Income (loss)	Total
	<i>(in thousands)</i>				
Balance at December 31, 2000	\$ -	\$ -	\$ -	\$ -	\$ -
Net income	-	-	8,207	-	8,207
Capital contributions from parent company	-	452,097	-	-	452,097
Other comprehensive income	-	-	-	6,689	6,689
Balance at December 31, 2001	-	452,097	8,207	6,689	466,993
Net income	-	-	54,270	-	54,270
Capital contributions from parent company	-	279,133	-	-	279,133
Other comprehensive (loss)	-	-	-	(53,792)	(53,792)
Balance at December 31, 2002	\$ -	\$731,230	\$62,477	\$ (47,103)	\$746,604

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

STATEMENTS OF COMPREHENSIVE INCOME

For the Year Ended December 31, 2002 and For the Period from January 8, 2001 (Inception) to December 31, 2001
Southern Power Company 2002 Annual Report

	2002	2001
	<i>(in thousands)</i>	
Net income	\$54,270	\$ 8,207
Other comprehensive (loss) income:		
Changes in fair value of qualifying hedges, net of tax of \$(34,030) and \$4,219 for the years 2002 and 2001, respectively	(54,360)	6,689
Less: Reclassification adjustment for amounts included in net income, net of tax of \$355 and \$0 for the years 2002 and 2001, respectively	568	-
Total other comprehensive (loss) income	(53,792)	6,689
Comprehensive Income	\$ 478	\$14,896

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

NOTES TO FINANCIAL STATEMENTS

Southern Power Company 2002 Annual Report

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Southern Power is a wholly owned subsidiary of Southern Company, which is also the parent company of five operating companies, a system service company (SCS), Southern Company Gas (Southern GAS), and other direct and indirect subsidiaries. The operating companies -- Alabama Power Company, Georgia Power Company, Gulf Power Company, Mississippi Power Company, and Savannah Electric and Power Company -- provide electric service in four southeastern states. Southern Power constructs, owns and manages Southern Company's competitive generation assets and sells electricity at market-based rates in the wholesale market. Contracts among the operating companies and Southern Power -- related to jointly owned generating facilities, interconnecting transmission lines or the exchange of electric power -- are regulated by the Federal Energy Regulatory Commission (FERC) and/or the Securities and Exchange Commission (SEC). SCS provides, at cost, specialized services to Southern Company and subsidiary companies. Southern GAS, which began operation in August 2002, is a competitive retail natural gas marketer serving communities in Georgia.

Southern Company is registered as a holding company under the Public Utility Holding Company Act of 1935 (PUHCA). Both Southern Company and its subsidiaries are subject to the regulatory provisions of the PUHCA. The Company follows accounting principles generally accepted in the United States. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates, and the actual results may differ from these estimates.

Southern Power was formed on January 8, 2001. Southern Power began commercial operations in August 2001 after Georgia Power transferred its interest in Plant Dahlberg Units 1 through 10. See Note 2, Asset Transfers, for further information regarding asset transfers from affiliates. The consolidated financial statements include the accounts of Southern Power and its wholly-owned subsidiary, Southern Company - Florida LLC (SCF) which was established to own, operate and maintain Plant Stanton Unit A. See Note 4 for further information. All intercompany accounts and transactions have been eliminated in consolidation.

Certain prior years' data presented in the financial statements have been reclassified to conform with current year presentation.

Affiliate Transactions

Southern Power has an agreement with SCS under which the following services are rendered to the Company at direct or allocated cost: general and design engineering, purchasing, accounting and statistical analysis, finance and treasury, tax, information resources, marketing, auditing, insurance and pension administration, human resources, systems and procedures and other services with respect to business and operations and power pool transactions. SCS also enters into fuel purchase and transportation arrangements and contracts, financial instruments for purposes of hedging and wholesale energy purchase and sale transactions for the benefit of Southern Power. As Southern Power has no employees, all employee related charges are rendered at cost under agreements with SCS or the operating companies. Costs for these services from SCS amounted to approximately \$29.5 million and \$12 million during 2002 and 2001, respectively, of which approximately \$16.2 million in 2002 and \$4.7 million in 2001 was general, administrative, operation and maintenance expenses; the remainder was capitalized to construction work in progress. Cost allocation methodologies used by SCS are approved by the SEC and management believes they are reasonable.

Southern Power has an agreement with Georgia Power to provide operation and maintenance services for Plants Dahlberg, Wansley and Franklin. These services are billed at cost on a monthly basis and are recorded as operations and maintenance expense in the accompanying statements of income. For the periods ended December 31, 2002 and 2001, these services totaled approximately \$5.3 million and \$1.0 million, respectively.

Additionally, Southern Power has agreements with Alabama Power and Georgia Power to provide procurement, payables and other functions related to the construction at Plants Harris and Franklin in Alabama and Plant Wansley in Georgia. Costs for these services are billed monthly and are capitalized.

Effective June 2002, Southern Power entered into Power Purchase Agreements (PPAs) with Georgia Power and Savannah Electric for the sale of capacity and energy. Billings under these agreements totaled \$165 million,

including \$13.5 million of deferred capacity revenues included in deferred capacity revenues on the Balance Sheet at December 31, 2002. See Note 5 herein for additional information.

The operating companies, Southern Power, and Southern GAS may jointly enter into various types of wholesale energy, natural gas and certain other contracts, either directly or through SCS as agent. Each participating company may be jointly and severally liable for the obligations incurred under these agreements.

See Note 5 for information regarding PPAs between Southern Power and Alabama Power, Georgia Power and Savannah Electric.

Southern Power and its affiliates generally settle amounts related to the above transactions on a monthly basis in the month following the performance of such services or the purchase or sale of electricity.

Also see Notes 2, 3, 4 and 7 for information related to various types of financing support provided by Southern Company.

Revenues and Fuel Costs

Revenues are recognized as services are rendered. Capacity is sold at rates specified under contractual terms and is recognized at the lesser of the levelized basis or the cash collected over the respective contract periods. Energy is generally sold at market-based rates and the associated revenue is recognized as the energy is delivered.

Significant portions of Southern Power's revenues have been derived from certain customers. For the year ended December 31, 2002, Georgia Power, Savannah Electric, LG&E Energy Marketing, Inc. and Dynegy Power Marketing Inc. accounted for approximately 33.5%, 17.2%, 15.8% and 4.4% of revenues, respectively. For the period ended December 31, 2001, LG&E Energy Marketing, Inc. and Dynegy Power Marketing Inc. accounted for approximately 66% and 21% of revenues, respectively.

Fuel costs are expensed as the fuel is consumed. The Company relies mainly on natural gas to fuel its generating units. See Note 3 herein for further details on future commitments.

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

Property, Plant and Equipment

Property, plant and equipment are stated at original cost. Original cost includes materials, direct labor incurred by affiliated companies, minor items of property and appropriate administrative costs. Interest is capitalized on qualifying projects during the development and construction period. In 2002 and 2001, interest of approximately \$35.3 million and \$2.9 million, respectively, was capitalized in connection with the development and construction of power plants. The cost of maintenance, repairs and replacement of minor items of property is charged to maintenance expense as incurred. The cost of replacements of property that extend the useful life of the plant, exclusive of minor items of property, is capitalized.

Depreciation

Depreciation of the original cost of assets is computed under the straight-line method based on the assets' estimated useful lives determined by the Company. The primary assets in property, plant and equipment are power plants all of which have an estimated useful life of 35 years, except Plant Dahlberg which has an estimated useful life of 40 years.

In January 2003, Southern Power adopted FASB Statement No. 143, Accounting for Asset Retirement Obligations. Statement No. 143 establishes new accounting and reporting standards for legal obligations associated with the ultimate cost of retiring long-lived assets. The present value of the ultimate costs for an asset's future retirement must be recorded in the period in which the liability is incurred. The cost must be

capitalized as part of the related long-lived asset and depreciated over the asset's useful life. Additionally, Statement No. 143 does not permit the continued accrual of future retirement costs for long-lived assets that the company does not have a legal obligation to retire.

The Company has no liability for asset retirement obligations. In January 2003, the Company recorded a reduction to the accumulated reserve for depreciation and a cumulative effect of change in accounting principle of \$0.6 million. This represents removal costs accrued prior to the implementation of Statement No. 143.

Impairment of Long-Lived Assets

The Company evaluates long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The determination of whether an impairment has occurred is based on an estimate of undiscounted future cash flows attributable to the assets, as compared to the carrying value of the assets. If an impairment has occurred, the amount of the impairment recognized is determined by estimating the fair value of the assets and recording a provision for 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 provision is required. Until the assets are disposed of, their estimated fair value is reevaluated when circumstances or events change.

Deferred Project Development Costs

The Company capitalizes project development costs once it is determined that it is probable that a specific site will be acquired and a power plant constructed. These costs include professional services, permits and other costs directly related to the construction of a new project. These costs are generally transferred to construction work in progress upon commencement of construction. The total deferred project development costs at December 31, 2002 and December 31, 2001 were \$3.6 million and \$4.5 million, respectively.

Financial Instruments

The Company uses derivative financial instruments to hedge exposures to fluctuations in interest rates, foreign

currency exchange rates, the prices of certain fuel purchases and electricity purchases and sales. All derivative financial instruments are recognized as either assets or liabilities and are measured at fair value.

The Company and its affiliates, through SCS acting as their agent, enter into commodity related forward and option contracts to limit exposure to changing prices on certain fuel purchases and electricity purchases and sales. Substantially all of the Company's bulk energy purchases and sales contracts are derivatives. However, in many cases, these contracts qualify as normal purchases and sales and are accounted for under the accrual method. Other contracts qualify as cash flow hedges of anticipated transactions, resulting in the deferral of related gains and losses, and are recorded in other comprehensive income until the hedged transactions occur. Any ineffectiveness is recognized currently in net income. Contracts that do not qualify for the normal purchase and sale exception and that do not meet the hedge requirements are marked to market through current period income and are recorded on a net basis in the consolidated Statements of Income.

The Company is exposed to losses related to financial instruments in the event of counterparties' nonperformance. The Company has established controls to determine and monitor the creditworthiness of counterparties in order to mitigate the Company's exposure to counterparty credit risk.

The Company has firm purchase commitments for equipment that require payment in Euros. As a hedge against fluctuations in the exchange rate for Euros, the Company entered into forward contracts to purchase Euros. The Company has designated these contracts as fair value hedges. At December 31, 2002, Southern Power had outstanding contracts covering a notional amount of \$5.5 million in commitments through May 2003. The forward contracts to purchase Euros are on the same dates and in the same amounts as the Euro payments that the Company owes for the equipment. As all of the critical terms of the forward Euro purchases (dates and amounts) match those of the Euro payment obligations, the changes in fair value attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. Therefore, there is no ineffectiveness related to this hedge.

Other Southern Power financial instruments for which the carrying amounts did not equal fair value at December 31, 2002 were as follows:

	Carrying Amount	Fair Value
	(in millions)	
Long-term debt:		
At December 31, 2002	\$956	\$990

The fair values for securities were based on either closing market prices or closing prices of comparable instruments.

Income 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.

Comprehensive Income

Comprehensive income -- consisting of net income and changes in the fair value of qualifying cash flow hedges, net of income taxes less reclassifications of amounts included in net income-- is presented in the financial statements. 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.

2. ASSET TRANSFERS

On July 31, 2001, Georgia Power transferred its interests in Plant Dahlberg Units 1 through 10 and related working capital to Southern Power. In accordance with the affiliate transaction rules of PUHCA, these assets were transferred at Georgia Power's net carrying costs of \$260.1 million. The transferred assets consist primarily of 10 combustion turbine units (810 MW) in operation, all located in Jackson County, Georgia. In connection with the asset transfer, Georgia Power also assigned to the Company its interest in three PPAs related to Plant Dahlberg. The results of operations of Plant Dahlberg were included in the financial statements from August 1, 2001.

The following projects, which were under construction, were transferred from Alabama Power and Georgia Power to Southern Power and recorded in construction work in progress at the respective affiliate's book value:

Plant	Transferred from	Date	Amount (in millions)
Harris Units 1 & 2	Alabama Power	06/2001	\$ 91.4
Franklin Units 1 & 2	Alabama Power and Georgia Power	11/2001	267.9
Wansley Units 6 & 7	Georgia Power	01/2002	389.9

In conjunction with these transfers, Alabama Power and Georgia Power have assigned PPAs related to these plants and certain vendor contracts related to the on-going construction of these facilities to Southern Power. Southern Company has entered into limited keep-well arrangements with Alabama Power and Georgia Power whereby Southern Company will contribute funds to the Company via loans or capital contributions to fund the performance of Southern Power as equipment purchaser under certain arrangements. As of December 31, 2002, Southern Power's remaining purchase obligations to equipment vendors under these contracts totaled \$12.2 million.

In addition, Southern Company has entered into keep-well agreements with Alstom Power for the transfer of an equipment contract at the Company's Plant Franklin Unit 3. At December 31, 2002, the amount outstanding under this contract was \$0.1 million.

3. CONTINGENCIES AND COMMITMENTS

General Litigation Matters

Southern Power is subject to certain claims and legal actions arising in the ordinary course of business. The Company's business activities are subject to extensive governmental regulation related to public health and the environment. Litigation over environmental issues and claims of various types, including property damage, personal injury and citizen enforcement of environmental requirements, has increased generally throughout the United States. In particular, personal injury claims for damages caused by alleged exposure to hazardous materials have become more frequent.

The ultimate outcome of such litigation currently filed against the Company cannot be predicted at this time;

however, after consultation with legal counsel, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the Company's financial statements.

Fuel

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

<u>Year</u>	<u>Fuel Purchases (in thousands)</u>
2003	\$ 22,692
2004	22,890
2005	18,577
2006	18,577
2007	18,577
2008 and beyond	449,588
<u>Total</u>	<u>\$550,901</u>

Natural gas purchases (in dollars) are based on various indices at the actual time of delivery; therefore, only the volume commitments are firm and disclosed in the following chart.

Total estimated long-term obligations at December 31, 2002 were as follows:

<u>Year</u>	<u>Natural Gas MMBtu</u>
2003	20,180,312
2004	7,125,668
2005	4,046,104
2006	2,250,859
2007	830,151
2008 and beyond	-
<u>Total</u>	<u>34,433,094</u>

Purchases of natural gas were approximately \$133.5 million and \$4.4 million for the periods ended December 31, 2002 and 2001, respectively. Additional commitments

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

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

Construction Program

The Company currently estimates property additions to be \$377 million, \$381 million and \$278 million in 2003, 2004 and 2005, respectively. Southern Power has approximately 4,100 megawatts of additional generating capacity scheduled to be placed in service by 2005.

Significant purchase commitments are outstanding in connection with the construction program.

Southern Power's obligations for construction of transmission interconnection facilities to these plants by Alabama Power and Georgia Power totaled \$13.5 million and \$13 million at December 31, 2002 and 2001, respectively, and are guaranteed by Southern Company.

Southern Company has also granted performance guarantees on behalf of Southern Power and its subsidiary for construction payment obligations associated with Plant Stanton. See Note 4 herein for additional information.

Long-Term Service Agreements

Southern Power has entered into several Long-Term Service Agreements (LTSAs) with General Electric International, Inc. (GE) for the purpose of securing maintenance support for its combined cycle and combustion turbine generating facilities. The LTSAs stipulate that for a fee, GE will perform all planned inspections on the covered equipment, which 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 a limit specified in each contract.

In general, except for Plant Dahlberg, these LTSAs are in effect through two major inspection cycles per unit. The Dahlberg agreement is in effect through the first major inspection of each unit. Scheduled payments to GE are made at various intervals based on actual operation hours of the respective units. Total payments to GE under these agreements are \$852 million over the life of the agreements, which are approximately 28 to 30 years per unit. However, the LTSAs contain various cancellation provisions at the Company's option.

Payments made to GE prior to the performance of any planned inspections are recorded as a prepayment in the Balance Sheets. Costs are capitalized or charged to expense based on the nature of the work performed.

4. JOINT-OWNERSHIP AGREEMENTS

Southern Power, through its wholly owned subsidiary SCF, is a 65% owner of Plant Stanton Unit A (Stanton A), a combined-cycle project that will total 633 MW upon completion. The unit is co-owned by Orlando Utilities Commission (OUA) (28%), Florida Municipal Power Agency (FMPA) (3.5%), and Kissimmee Utility Authority (KUA) (3.5%). Southern Power has a services agreement with SCS where SCS will be responsible for the operation and maintenance of Stanton A and the overall project management of the construction process. Construction on Stanton A began in October 2001 with an expected completion date of October 1, 2003. At December 31, 2002 and 2001, Southern Power's share of the construction costs for Stanton A was \$128.3 million and \$31.4 million, respectively, and is recorded in construction work in progress in the consolidated Balance Sheets.

Southern Company has agreed to grant performance guarantees on behalf of Southern Power and its subsidiary, SCF, for SCF's payment obligations under ownership and PPAs associated with the Stanton A project. Southern Power's maximum exposure is \$53 million under the construction and ownership agreement and \$20 million under the PPAs. See Note 5 herein for additional information.

5. LONG-TERM POWER SALES AGREEMENTS

The Company has entered into long-term power sales agreements for portions of its generating unit capacity, as follows:

Project	Capacity (megawatts)	Contract Term
<u>Affiliated</u>		
Franklin Unit 1	571 *	6/02-5/10
Franklin Unit 2	615 **	6/03-5/11
Wansley Units 6 & 7	1,134	6/02-12/09
Harris Unit 1	618	6/03-5/10
Harris Unit 2	618 ***	6/04-5/19
McIntosh	1,240	6/04-5/20
Total Affiliated	4,796	

<u>Non-Affiliated</u>		
Dahlberg Units		
1-7	578	6/00-12/04
Dahlberg Units		
8-10	225	6/00-5/05
Stanton A	396	11/03-11/13
Franklin Unit 3	625	6/05-5/30
Total Non-affiliated	1,824	

* 370 megawatts during the first year

** 400 megawatts during the first year

*** Contract does not begin until second year of operation of Harris Unit 2.

Capacity revenues from these long-term power sales agreements amounted to \$120.1 million and \$18.6 million for the periods ended December 31, 2002 and 2001, respectively. Future capacity payments to be received under these power sales agreements as of December 31, 2002 are as follows:

Year	Payments	
	Affiliated	Non-Affiliated
	(in millions)	
2003	\$ 172.5	\$ 53.6
2004	241.1	76.2
2005	325.1	127.8
2006	338.2	156.8
2007	336.2	155.4
2008 and beyond	2,040.3	1,319.9
Total	\$3,453.4	\$1,889.7

Included in the amounts above are capacity payments to be received related to a five-year contract (beginning in 2000) with Dynegy of approximately \$13 million annually through May 2005. As a result of Dynegy's liquidity problems, it has provided a letter of credit totaling \$20 million which can be drawn in the event of a default under the PPA or the failure to renew the letter of credit prior to expiration in April 2003.

Georgia Power required that certain counterparties to the Dahlberg PPAs make prepayments for operational rights to the units. These prepayments were recorded as liabilities by Georgia Power and were transferred to Southern Power in connection with the Plant Dahlberg transfer. At December 31, 2002 and 2001, the unamortized balance of these amounts totaled \$2.8 million and \$4.2 million, respectively, and is being amortized into income over the life of the agreements.

In June 2002, Southern Power began providing services under PPAs with 11 Georgia electric municipal cooperatives (EMCs). Under the agreements, Southern Power will coordinate the generating resources and meet the additional capacity requirements of the EMCs. The contracts are in effect through 2009 with options to renew.

Effective in January 2003, the Company entered into contracts with North Carolina Municipal Power Authority 1 (North Carolina) and the City of Dalton (Dalton). Under the North Carolina contract, the Company will be responsible for supplying North Carolina's capacity and energy needs in excess of its existing resources and disposing of its surplus energy. The contract term is for January 1, 2003 through December 31, 2004. Under the Dalton contract, the Company is responsible for supplying Dalton's requirements for capacity and energy in excess of Dalton's existing resources. The contract term is for 15 years, beginning January 1, 2003, with a customer option to convert to a fixed capacity purchase at the end of year 10.

6. INCOME TAXES

Details of the federal and state income tax provisions are as follows:

	2002	2001
	(in thousands)	
Total provision for income taxes:		
Federal:		
Current	\$ 26,990	\$1,402
Deferred	2,338	3,017
	29,238	4,419
State:		
Current	4,622	240
Deferred	401	517
State manufacturer's tax credits	(5,804)	(2,665)
	(781)	(1,908)
Total	\$28,457	\$2,511

Southern Power recorded a reduction in 2002 and 2001 tax expense of approximately \$5.8 million and \$2.7 million, respectively, under the flow-through method of accounting for the State of Georgia manufacturer's tax credits. The State of Georgia provides a tax credit for qualified investment property to manufacturing companies that construct new facilities. The credit ranges from 1% to 5% of construction expenditures depending upon the county in which the new facility is located. Southern Power's policy is to recognize these credits when management believes they are more likely than not to be allowed by the Georgia Department of Revenue.

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:

	2002	2001
	(in millions)	
Deferred tax liabilities:		
Accelerated depreciation	\$(17,401)	\$(4,444)
Other	(729)	(3,451)
Total	(18,130)	(7,895)
Deferred tax assets:		
Book/tax basis difference on asset transfer	15,644	19,810
Levelized capacity revenues	8,003	-
Other comprehensive on interest rate swaps	30,745	-
Other	2,329	-
Total	56,721	19,810
Accumulated deferred income taxes in the consolidated Balance Sheets	\$38,591	\$11,915

Deferred tax liabilities were primarily the result of property related timing differences and derivative hedging instruments. Deferred tax assets were primarily the result of a deferred tax gain related to the transfer of Plant Dahlberg from Georgia Power. Southern Power has recognized a payable to Georgia Power for Georgia Power's deferred tax liability resulting from this gain of approximately \$15.6 million and \$19.8 million at December 31, 2002 and 2001, respectively, which is recorded in other deferred credits on the accompanying consolidated balance sheet.

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

	2002	2001
Federal statutory rate	35.0	35.0
State income tax, net of federal deduction	3.9	4.6
State manufacturer's tax Credits, net of federal effect	(4.5)	(16.2)
Effective income tax rate	34.4	23.4

Southern Company and its subsidiaries file a consolidated federal income tax return. Under a joint consolidated income tax agreement, each subsidiary's current and deferred tax expense is computed on a stand-alone basis. In accordance with Internal Revenue Service regulations, each company is jointly and severally liable for the tax liability.

7. FINANCING

Southern Company is currently authorized by the SEC under the PUHCA to fund the development of Southern Power up to an aggregate amount not to exceed \$1.7 billion, which may take the form of purchases or contributions of equity interests, loans and guarantees issued in support of Southern Power's securities or obligations. Southern Power has SEC approval under the PUHCA to issue up to an aggregate amount of \$2.5 billion of preferred securities, long and short-term debt and other equity issuances.

Common Stock

Southern Power has authorized common stock of 1 million shares at \$.01 par value per share. One thousand shares have been issued to Southern Company and were outstanding at December 31, 2002.

Note Payable to Parent

In 2001, Southern Power entered into an intercompany note payable to Southern Company. The note is payable on demand and bears interest at a variable rate. At December 31, 2002 and 2001, \$210.5 million and \$1 million, respectively, were outstanding with an interest rate of 5.04% and 2.49%, respectively. As part of the Company's ongoing financing plan, in March 2003, \$190 million of the note was converted to a capital contribution from Southern Company, leaving a balance of \$51 million.

Long-Term Debt

In November 2001, the Company entered into an \$850 million unsecured syndicated revolving credit facility (Facility). The purpose of the Facility is to finance the acquisition and construction costs related to gas-fired electric generating facilities and general corporate purposes (subject to a \$25 million limit), and to pay or support commercial paper used to fund construction of facilities. At December 31, 2002, Southern Power had borrowed approximately \$380 million under the Facility leaving an unused borrowing authority of approximately \$470 million. Borrowings under the Facility bear interest at Southern Power's option equal to either the Eurodollar rate plus a specified margin ranging from 1.125% to 2.875%, depending on Southern Power's credit rating and the amount drawn down under the facility, or a base rate plus a specified margin. The interest rate and average

interest rate on the Facility were 2.73% and 3.15% and 3.44% and 3.61%, respectively, at December 31, 2002 and 2001 and during the periods then ended. Southern Power is required to pay a commitment fee on the unused balance of the Facility. The commitment fee ranges from 0.3% to 0.45%, depending on Southern Power's credit rating. For the periods ended December 31, 2002 and 2001, Southern Power paid approximately \$1.1 million and \$0.1 million in commitment fees, respectively. All borrowings outstanding under the Facility are due in November 2004.

The Facility contains certain financial covenants relating to Southern Power's debt capitalization which require that additional debt incurred by Southern Power must generally be unsecured and Southern Power must have its ratings reaffirmed at investment grade including the new debt. The Facility also contains restrictions related to the assumption of additional debt, which require a maximum 60% debt ratio, excluding intercompany loans. Southern Power was in compliance with such covenants at December 31, 2002. Initial borrowings under the Facility for new projects would be prohibited if Southern Power or Southern Company experiences a material adverse change (as defined in the Facility). For Southern Power's bank credit arrangements, there is a cross default to Southern Company's indebtedness, which if triggered would require prepayment of debt related to projects financed under the credit arrangement that are not complete.

In June 2002, Southern Power issued \$575 million of 6.25% Senior Notes, Series A due July 15, 2012. The net proceeds were used to reduce outstanding indebtedness under the Facility and to reduce the intercompany note payable to Southern Company. Southern Power also settled several interest rate swap agreements entered into in anticipation of this issuance at a \$16.9 million loss. This amount has been deferred in other comprehensive income and will be amortized to interest expense over the life of the senior notes. Also in June 2002, the Company issued a long-term note payable to Chilton County, Alabama for \$2.1 million. The proceeds of the note were used for the purchase of land for a potential future generation site. The note is payable over the next 5 years at an imputed interest rate of 6.25%.

Southern Company has committed to fund at least 40% of Southern Power's construction project financing and to pay for construction cost overruns to the extent that Southern Power's own cash flow is insufficient. Also, Southern Company will prepay any portion of revolving

credit arrangements used for Southern Power's construction projects not completed within two years of the proposed completion date.

Financial Instruments

At December 31, 2002, Southern Power had \$500 million notional amount of interest rate swaps outstanding with deferred losses of \$63 million as follows:

Cash Flow Hedges

	Maturity	Weighted Variable Rate Received	Average Fixed Rate Paid	Notional Amount	Fair Value Gain (Loss)
(in millions)					
Southern Power	2013	*	6.23%	\$350	\$(50)
Southern Power	2008	*	5.48	150	(13)

*Rate has not been set.

For the year 2002, approximately \$0.9 million was reclassified from other comprehensive income to interest expense. These reclassifications related to losses incurred upon settlement of interest rate swaps associated with the issuance of senior notes in June 2002. (See "Long-Term Debt" herein). For the year 2003, approximately \$1.7 million is expected to be reclassified.

In February 2003, the Company initiated a commercial paper program to fund a portion of the construction costs of new plants. The Company's strategy is to refinance such short-term borrowings with long-term securities following plant completion. The amount of commercial paper will initially represent about 45% of total debt, but is forecasted to decline to about 7% at year-end 2005 as increasingly more construction costs are refinanced with long-term securities.

The Company's commercial paper program is supported by the Facility. The Facility was structured to accommodate commercial paper, and the conditions that Southern Power must meet to reserve against the Facility for a project-specific commercial paper issue are the same as those for a regular draw on the Facility. The Company is not likely to be restricted from making draws on the Facility to repay any commercial paper coming due, as those conditions include representations and warranties that do not contain any material adverse effect clauses or creditworthiness measures.

8. QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized quarterly financial information for 2002 and 2001 is as follows:

Quarter Ended	Operating Revenues	Operating Income	Net Income
	(in millions)		
March 2002	\$ 19,299	\$ 7,862	\$ 4,455
June 2002	57,777	16,271	8,858
September 2002	136,195	45,298	27,329
December 2002	85,497	26,764	13,628
March 2001	\$ -	\$(107)	\$ (65)
June 2001	-	(1,569)	(949)
September 2001	14,604	7,056	5,957
December 2001	14,697	5,107	3,264

The Company's business is influenced by seasonal weather conditions. The Company's revenues initiated in July 2001 with the transfer of Plant Dahlberg and three related PPAs from Georgia Power.

SELECTED FINANCIAL AND OPERATING DATA 2001-2002

Southern Power Company 2002 Annual Report

	2002	2001
Operating Revenues (in thousands):		
Sales for resale - non-affiliates	114,919	26,390
Sales for resale - affiliates	183,111	2,906
Total revenues from sales of electricity	298,030	29,296
Other revenues	738	5
Total	\$298,768	\$29,301
Net Income (in thousands)	\$54,270	\$8,207
Return on Average Common Equity (percent)	8.94	3.51
Total Assets (in thousands)	\$2,085,976	\$822,857
Gross Property Additions (in thousands)	\$1,214,677	\$765,511
Capitalization (in thousands):		
Common stock equity	\$746,604	\$466,993
Long-term debt	955,879	293,205
Total (excluding amounts due within one year)	\$1,702,483	\$760,198
Capitalization Ratios (percent):		
Common stock equity	43.9	61.4
Long-term debt	56.1	38.6
Total (excluding amounts due within one year)	100.0	100.0
Security Ratings:		
Unsecured Long-Term Debt -		
Moody's	Baa1	-
Standard and Poor's	BBB+	-
Fitch	BBB+	-
Kilowatt-Hour Sales (in thousands):		
Sales for resale - non-affiliates	1,240,290	164,926
Sales for resale - affiliates	3,607,107	69,307
Total	4,847,397	234,233
Average Revenue Per Kilowatt-Hour (cents):	6.15	12.51
Plant Available Capacity		
Ratings (year-end) (megawatts)	2,408	800
Maximum Peak-Hour Demand (megawatts):		
Winter	949	-
Summer	1,426	-
Annual Load Factor (percent)	51.1	-
Plant Availability (percent):	95.1	83.7
Source of Energy Supply (percent):		
Gas	77.4	100.0
Purchased power -		
From non-affiliates	5.9	-
From affiliates	16.7	-
Total	100.0	100.0