

ALABAMA POWER COMPANY

2014 ANNUAL REPORT



A SOUTHERN COMPANY

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
Alabama Power Company 2014 Annual Report

The management of Alabama 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 (2013)* 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, 2014.



Mark A. Crosswhite
Chairman, President, and Chief Executive Officer



Philip C. Raymond
Executive Vice President, Chief Financial Officer, and Treasurer

March 2, 2015

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**To the Board of Directors of
Alabama Power Company**

We have audited the accompanying balance sheets and statements of capitalization of Alabama Power Company (the Company) (a wholly owned subsidiary of The Southern Company) as of December 31, 2014 and 2013, 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, 2014. 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 27 to 72) present fairly, in all material respects, the financial position of Alabama Power Company as of December 31, 2014 and 2013, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Birmingham, Alabama
March 2, 2015

DEFINITIONS

Term	Meaning
AFUDC	Allowance for funds used during construction
ASC	Accounting Standards Codification
CCR.....	Coal combustion residuals
Clean Air Act.....	Clean Air Act Amendments of 1990
CO ₂	Carbon dioxide
DOE	U.S. Department of Energy
EPA.....	U.S. Environmental Protection Agency
FERC.....	Federal Energy Regulatory Commission
GAAP	Generally accepted accounting principles
Georgia Power.....	Georgia Power Company
Gulf Power	Gulf Power Company
IRS	Internal Revenue Service
ITC	Investment tax credit
KWH	Kilowatt-hour
LIBOR.....	London Interbank Offered Rate
Mississippi Power	Mississippi Power Company
mmBtu.....	Million British thermal units
Moody's.....	Moody's Investors Service, Inc.
MW	Megawatt
NDR	Natural Disaster Reserve
NRC	U.S. Nuclear Regulatory Commission
OCI.....	Other comprehensive income
power pool.....	The operating arrangement whereby the integrated generating resources of the traditional operating companies and Southern Power Company are subject to joint commitment and dispatch in order to serve their combined load obligations
PPA.....	Power purchase agreement
PSC.....	Public Service Commission
Rate CNP.....	Rate Certificated New Plant
Rate CNP Environmental.....	Rate Certificated New Plant Environmental
Rate CNP PPA.....	Rate Certificated New Plant Power Purchase Agreement
Rate ECR.....	Rate energy cost recovery
Rate NDR.....	Natural disaster reserve rate
Rate RSE	Rate stabilization and equalization plan
ROE.....	Return on equity
S&P	Standard and Poor's Rating Services, a division of The McGraw Hill Companies, Inc.
SCS.....	Southern Company Services, Inc. (the Southern Company system service company)
SEC	U.S. Securities and Exchange Commission
SEGCO.....	Southern Electric Generating Company
Southern Company system.....	The Southern Company, the traditional operating companies, Southern Power, SEGCO, Southern Nuclear, SCS, SouthernLINC Wireless, and other subsidiaries
SouthernLINC Wireless.....	Southern Communications Services, Inc.
Southern Nuclear.....	Southern Nuclear Operating Company, Inc.
Southern Power	Southern Power Company and its subsidiaries
traditional operating companies..	Alabama Power Company, Georgia Power, Gulf Power, and Mississippi Power

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

Alabama Power Company 2014 Annual Report

OVERVIEW

Business Activities

Alabama Power Company (the Company) operates as a vertically integrated utility providing electricity to retail and wholesale customers within its traditional service territory located in the State of Alabama in addition 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 and grow energy sales, and to effectively manage and secure timely recovery of costs. These costs include those related to projected long-term demand growth, increasingly stringent environmental standards, reliability, fuel, capital expenditures, and restoration following major storms. Appropriately balancing required costs and capital expenditures with customer prices will continue to challenge the Company for the foreseeable future.

Key Performance Indicators

The Company continues to focus on several key performance indicators including customer satisfaction, plant availability, system reliability, and net income after dividends on preferred and preference stock. The Company's financial success is directly tied to customer satisfaction. Key elements of ensuring customer satisfaction include outstanding service, high reliability, and competitive prices. Management uses customer satisfaction surveys to evaluate the Company's results and generally targets the top quartile of these surveys in measuring performance, which the Company achieved during 2014.

Peak season equivalent forced outage rate (Peak Season EFOR) is an indicator of fossil/hydro 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 Company's fossil/hydro 2014 Peak Season EFOR of 2.5% 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. The Company's performance for 2014 was better than the target for these transmission and distribution reliability measures.

The Company uses net income after dividends on preferred and preference stock as the primary measure of the Company's financial performance. In 2014, the Company achieved its targeted net income after dividends on preferred and preference stock.

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

Earnings

The Company's 2014 net income after dividends on preferred and preference stock was \$761 million, representing a \$49 million, or 6.9%, increase over the previous year. The increase was due primarily to an increase in weather-related revenues resulting from colder weather in the first quarter 2014 and warmer weather in the second and third quarters 2014 as compared to the corresponding periods in 2013, an increase in revenues related to net investments under Rate CNP Environmental, and an increase in AFUDC resulting from increased capital expenditures. The factors increasing net income were partially offset by an increase in total operating expenses.

The Company's 2013 net income after dividends on preferred and preference stock of \$712 million increased \$8 million, or 1.1%, from the prior year. The increase in net income was due primarily to more favorable weather-related revenues in 2013 compared to 2012, an increase in AFUDC resulting from increased capital expenditures, and a decrease in interest expense resulting from lower interest rates. The factors increasing net income were partially offset by a decrease in revenues related to net investment under Rate CNP Environmental and a decrease in wholesale revenues to municipalities.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

RESULTS OF OPERATIONS

A condensed income statement for the Company follows:

	Amount		Increase (Decrease) from Prior Year	
	2014	2014	2014	2013
		<i>(in millions)</i>		
Operating revenues	\$ 5,942	\$ 324	\$	98
Fuel	1,605	(26)		128
Purchased power	385	156		(26)
Other operations and maintenance	1,468	179		2
Depreciation and amortization	603	(42)		6
Taxes other than income taxes	356	8		8
Total operating expenses	4,417	275		118
Operating income	1,525	49		(20)
Allowance for equity funds used during construction	49	17		13
Interest income	15	(1)		—
Interest expense, net of amounts capitalized	(255)	(4)		(28)
Other income (expense), net	(22)	14		(12)
Income taxes	512	34		1
Net income	800	49		8
Dividends on preferred and preference stock	39	—		—
Net income after dividends on preferred and preference stock	\$ 761	\$ 49	\$	8

Operating Revenues

Operating revenues for 2014 were \$5.9 billion, reflecting a \$324 million increase from 2013. Details of operating revenues were as follows:

	Amount	
	2014	2013
	<i>(in millions)</i>	
Retail — prior year	\$ 4,952	\$ 4,933
Estimated change resulting from —		
Rates and pricing	81	(18)
Sales growth	7	4
Weather	85	21
Fuel and other cost recovery	124	12
Retail — current year	5,249	4,952
Wholesale revenues —		
Non-affiliates	281	248
Affiliates	189	212
Total wholesale revenues	470	460
Other operating revenues	223	206
Total operating revenues	\$ 5,942	\$ 5,618
Percent change	5.8%	1.8%

Retail revenues in 2014 were \$5.2 billion. These revenues increased \$297 million, or 6.0%, in 2014 and increased \$19 million, or 0.4%, in 2013, each as compared to the prior year. The increase in 2014 was due to increased fuel revenues, colder weather in the

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

first quarter 2014 and warmer weather in the second and third quarters 2014 as compared to the corresponding periods in 2013, and increased revenues related to net investments under Rate CNP Environmental primarily resulting from the inclusion of pre-2005 environmental assets. The increase in 2013 was due to more favorable weather, increased fuel revenues and increased revenues associated with Rate CNP PPA. The increase in 2013 was partially offset by a reduction in revenues related to net investments under Rate CNP Environmental. See Note 3 to the financial statements under "Retail Regulatory Matters" for additional information. See "Energy Sales" for a discussion of changes in the volume of energy sold, including changes related to sales growth and weather.

Fuel rates billed to customers are designed to fully recover fluctuating fuel and purchased power costs over a period of time. Fuel revenues generally have no effect on net income because they represent the recording of revenues to offset fuel and purchased power expenses. See Note 3 to the financial statements under "Retail Regulatory Matters – Rate ECR" for additional information.

Wholesale revenues from power sales to non-affiliated utilities were as follows:

	2014	2013	2012
		<i>(in millions)</i>	
Capacity and other	\$ 154	\$ 143	\$ 160
Energy	127	105	117
Total non-affiliated	\$ 281	\$ 248	\$ 277

Wholesale revenues from sales to non-affiliates will vary depending on the market prices of available wholesale energy compared to the cost of the Company's and the Southern Company system's generation, demand for energy within the Southern Company system's service territory, and availability of the Southern Company system's generation. Increases and decreases in energy revenues that are driven by fuel prices are accompanied by an increase or decrease in fuel costs and do not have a significant impact on net income. Short-term opportunity energy sales are also included in wholesale energy sales to non-affiliates. These opportunity sales are made at market-based rates that generally provide a margin above the Company's variable cost to produce the energy.

In 2014, wholesale revenues from sales to non-affiliates increased \$33 million, or 13.3%, as compared to the prior year primarily due to the availability of the Company's lower cost generation. This increase reflects a \$22 million increase in revenues from energy sales and an \$11 million increase in capacity revenues. In 2014, KWH sales increased 12.3% primarily due to the availability of the Company's lower cost generation and a 1.1% increase in the price of energy primarily due to higher natural gas prices. In 2013, wholesale revenues from sales to non-affiliates decreased \$29 million, or 10.5%, as compared to the prior year due to a \$17 million decrease in capacity revenues and a \$12 million decrease in revenues from energy sales. In 2013, KWH sales decreased 11.3% primarily from decreased sales to municipalities, partially offset by a 0.8% increase in the price of energy.

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

In 2014, wholesale revenues from sales to affiliates decreased \$23 million, or 10.8%, as compared to the prior year primarily related to a decrease in revenue from energy sales. In 2014, KWH sales decreased 21.7% primarily due to decreased hydro generation as the result of less rainfall as well as the addition of new generation in the Southern Company system, partially offset by a 13.7% increase in the price of energy primarily due to higher natural gas prices. In 2013, wholesale revenues from sales to affiliates increased \$101 million, or 91.0%, as compared to the prior year primarily due to a \$103 million increase in energy sales, partially offset by a \$2 million decrease in capacity revenues. In 2013, KWH sales increased 88.9% and there was a 1.3% increase in the price of energy.

In 2014, other operating revenues increased \$17 million, or 8.3%, as compared to the prior year primarily due to increases in open access transmission tariff revenues, transmission service agreement revenues, and co-generation steam revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

Energy Sales

Changes in revenues are influenced heavily by the change in the volume of energy sold from year to year. KWH sales for 2014 and the percent change from the prior year were as follows:

	Total KWHs	Total KWH Percent Change		Weather-Adjusted Percent Change	
	2014	2014	2013	2014	2013
	<i>(in billions)</i>				
Residential	18.7	4.5%	1.7%	(0.8)%	(1.1)%
Commercial	14.1	1.6	(0.5)	(1.3)	0.5
Industrial	23.8	3.9	3.4	3.9	3.4
Other	0.2	—	(1.4)	—	(1.4)
Total retail	56.8	3.5	1.8	1.0 %	1.1 %
Wholesale —					
Non-affiliates	4.6	12.3	(10.8)		
Affiliates	5.7	(21.7)	88.9		
Total wholesale	10.3	(9.4)	34.5		
Total energy sales	67.1	1.3%	6.3%		

Changes in retail energy sales are generally the result of changes in electricity usage by customers, changes in weather, and changes in the number of customers. Retail energy sales in 2014 were 3.5% higher than in 2013. Residential and commercial sales increased 4.5% and 1.6%, respectively, due primarily to colder weather in the first quarter 2014 and warmer weather in the second and third quarters 2014 as compared to the corresponding periods in 2013. Weather-adjusted residential and commercial sales decreased 0.8% and 1.3%, respectively, due primarily to a decrease in customer demand in 2014 compared to 2013. Industrial sales increased 3.9% in 2014 compared to 2013 as a result of an increase in demand resulting from changes in production levels primarily in the primary metals, chemicals, automotive and plastics, and stone, clay, and glass sectors. Household income, one of the primary drivers of residential customer usage, was flat in 2014.

Retail energy sales in 2013 were 1.8% higher than in 2012. Residential sales increased 1.7%, due primarily to more favorable weather in 2013. Weather-adjusted residential sales decreased 1.1% in 2013, primarily due to a decrease in customer demand. Commercial sales and weather-adjusted commercial sales remained relatively flat in 2013 compared to 2012. Industrial sales increased 3.4% in 2013 compared to 2012 as a result of an increase in demand resulting from changes in production levels primarily in the chemicals, primary metals, and stone, clay, and glass sectors.

Weather adjusted wholesale non-affiliate KWH sales decreased 8.0% in 2014 and 11.0% in 2013 due primarily to a decrease in demand from municipalities. See "Operating Revenues" above for a discussion of significant changes in wholesale revenues from sales to non-affiliates and wholesale revenues from sales to affiliated companies as related to changes in price and KWH sales.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

Details of the Company's generation and purchased power were as follows:

	2014	2013	2012
Total generation (<i>billions of KWHs</i>)	63.6	65.3	59.9
Total purchased power (<i>billions of KWHs</i>)	6.6	4.0	5.4
Sources of generation (<i>percent</i>) —			
Coal	54	53	53
Nuclear	23	21	25
Gas	17	17	18
Hydro	6	9	4
Cost of fuel, generated (<i>cents per net KWH</i>) —			
Coal	3.14	3.29	3.30
Nuclear	0.84	0.84	0.80
Gas	3.69	3.38	3.06
Average cost of fuel, generated (<i>cents per net KWH</i>)*	2.68	2.73	2.61
Average cost of purchased power (<i>cents per net KWH</i>)**	5.92	5.76	4.86

* KWHs generated by hydro are excluded from the average cost of fuel, generated.

** Average cost of purchased power includes fuel purchased by the Company for tolling agreements where power is generated by the provider.

Fuel and purchased power expenses were \$2.0 billion in 2014, an increase of \$130 million, or 7.0%, compared to 2013. The increase was primarily due to a \$147 million increase related to the volume of KWHs purchased and a \$10 million increase in the average cost of purchased power. These increases were partially offset by a \$19 million decrease in the average cost of fuel and an \$8 million decrease in the volume of KWHs generated.

Fuel and purchased power expenses were \$1.9 billion in 2013, an increase of \$102 million, or 5.8%, compared to 2012. The increase was primarily due to a \$95 million increase in the volume of KWHs generated, a \$38 million increase in the average cost of fuel, and a \$37 million increase in the average cost of purchased power. These increases were partially offset by a \$68 million decrease related to the volume of KWHs purchased.

Fuel and purchased power energy transactions do not have a significant impact on earnings, since energy expenses are generally offset by energy revenues through the Company's energy cost recovery clause. The Company, along with the Alabama PSC, continuously monitors the under/over recovered balance to determine whether adjustments to billing rates are required. See Note 3 to the financial statements under "Retail Regulatory Matters – Rate ECR" for additional information.

Fuel

Fuel expenses were \$1.6 billion in 2014, a decrease of \$26 million, or 1.6%, compared to 2013. The decrease was primarily due to a 4.5% decrease in the average cost of KWHs generated by coal, partially offset by a 30.8% decrease in the volume of KWHs generated by hydro facilities as a result of less rainfall, and a 9.2% increase in the average cost of KWHs generated by natural gas, which excludes tolling agreements. Fuel expenses were \$1.6 billion in 2013, an increase of \$128 million, or 8.5%, compared to 2012. This increase was primarily due to a 10.5% increase in the average cost of KWHs generated by natural gas, which excludes tolling agreements, and a 9.9% increase in KWHs generated by coal. This was partially offset by a 110.9% increase in the volume of KWHs generated by hydro facilities resulting from greater rainfall.

Purchased Power – Non-Affiliates

In 2014, purchased power expense from non-affiliates was \$185 million, an increase of \$85 million, or 85.0%, compared to 2013. The increase was primarily due to a 42.1% increase in the average cost per KWH purchased primarily due to demand during peak periods and a 28.8% increase in the amount of energy purchased to meet the demand created during cold weather in the first quarter 2014 and the addition of a new PPA in 2014. In 2013, purchased power expense from non-affiliates was \$100 million, an increase of \$27 million, or 37.0%, compared to 2012. The increase over the prior year was primarily due to a 52.6% increase in the amount of energy purchased, partially offset by a 17.2% decrease in the average cost per KWH.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

Energy purchases from non-affiliates will vary depending on the market prices of wholesale energy as compared to the cost of the Southern Company system's generation, demand for energy within the Southern Company system's service territory, and the availability of the Southern Company system's generation.

Purchased Power – Affiliates

Purchased power expense from affiliates was \$200 million in 2014, an increase of \$71 million, or 55.0%, compared to 2013. This increase was primarily due to a 96.4% increase in the amount of energy purchased to meet the demand created during cold weather in the first quarter 2014, partially offset by a 20.8% decrease in the average cost per KWH purchased due to the availability of lower cost Southern Company system generation at the time of purchase. Purchased power expense from affiliates was \$129 million in 2013, a decrease of \$53 million, or 29.1%, compared to 2012. This decrease was primarily due to a 50.4% decrease in the amount of energy purchased, partially offset by a 42.5% increase in the average cost per KWH.

Energy purchases from affiliates will vary depending on demand for energy and the availability and cost of generating resources at each company within the Southern Company system. These purchases are made in accordance with the IIC or other contractual agreements, as approved by the FERC.

Other Operations and Maintenance Expenses

In 2014, other operations and maintenance expenses increased \$179 million, or 13.9%, as compared to the prior year. Steam production, other power generation, and hydro generation expenses increased \$110 million primarily due to scheduled outage costs. See Note 3 to the financial statements under "Retail Regulatory Matters – Cost of Removal Accounting Order" for additional information. Distribution and transmission expenses increased \$31 million primarily related to increases in maintenance and labor expenses. Nuclear production expenses increased \$14 million primarily related to labor expenses.

Depreciation and Amortization

Depreciation and amortization decreased \$42 million, or 6.5%, in 2014 as compared to the prior year. The decrease in 2014 was primarily due to the amortization of \$120 million of the regulatory liability for other cost of removal obligations, partially offset by increases due to depreciation rates related to environmental assets and amortization of certain regulatory assets. See Note 3 to the financial statements under "Retail Regulatory Matters – Cost of Removal Accounting Order" for additional information. In 2013, depreciation and amortization increased \$6 million, or 0.9%, as compared to the prior year. The increase in 2013 was primarily due to an increase in depreciation related to environmental assets, additions to property, plant, and equipment related to distribution and transmission projects, as well as the amortization of software. These increases were partially offset by the deferral of certain expenses under an accounting order. See Note 3 to the financial statements under "Retail Regulatory Matters – Compliance and Pension Cost Accounting Order" for additional information. The increase related to environmental assets was offset by revenues under Rate CNP Environmental.

Allowance for Equity Funds Used During Construction

AFUDC equity increased \$17 million, or 53.1%, in 2014 as compared to the prior year primarily due to an increase in capital expenditures related to environmental and steam generation. AFUDC equity increased \$13 million, or 68.4%, in 2013 as compared to the prior year primarily due to increased capital expenditures associated with environmental, steam and nuclear generating facilities, and transmission. See Note 1 to financial statements under "Allowance for Funds Used During Construction" for additional information.

Interest Expense, Net of Amounts Capitalized

Interest expense, net of amounts capitalized decreased \$28 million, or 9.8%, in 2013. The decrease in 2013 was primarily due to a decrease in interest rates and the timing of issuances and redemptions of long-term debt.

Other Income (Expense), Net

Other income (expense), net increased \$14 million, or 38.9%, in 2014 as compared to the prior year primarily due to a decrease in non-operating expenses and an increase in sales of non-utility property. Other income (expense), net decreased \$12 million, or 50.0%, in 2013 as compared to the prior year primarily due to increases in donations, partially offset by increases in non-operating income related to gains on sales of non-utility property.

Income Taxes

Income taxes increased \$34 million, or 7.1%, in 2014 as compared to the prior year primarily due to higher pre-tax earnings.

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 in recent years. See Note 3 to the financial statements under "Retail Regulatory Matters – Rate RSE" for additional information.

FUTURE EARNINGS POTENTIAL

General

The Company operates as a vertically integrated utility providing electricity to retail and wholesale customers within its traditional service area located in the State of Alabama in addition to wholesale customers in the Southeast. Prices for electricity provided by the Company to retail customers are set by the Alabama PSC under cost-based regulatory principles. Prices for 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" and Note 3 to the financial statements under "Retail Regulatory Matters" 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 primary business of selling electricity. These factors include the Company's ability to maintain a constructive regulatory environment that continues to allow for the timely recovery of prudently-incurred costs during a time of increasing costs. Future earnings in the near term will depend, in part, upon maintaining and growing sales which are subject to a number of factors. These factors include weather, competition, new energy contracts with other utilities, energy conservation practiced by customers, the use of alternative energy sources by customers, the price of electricity, the price elasticity of demand, and the rate of economic growth or decline in the Company's service territory. Changes in regional and global economic conditions may impact sales for the Company, as the pace of the economic recovery remains uncertain. The timing and extent of the economic recovery will impact growth and may impact future earnings.

Environmental Matters

Compliance costs related to federal and state 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 differ materially from the amounts estimated. The timing, specific requirements, and estimated costs could change as environmental statutes and regulations are adopted or modified. Further, higher costs that are recovered through regulated rates could contribute to reduced demand for electricity, which could negatively affect results of operations, cash flows, and financial condition. See Note 3 to the financial statements under "Environmental Matters" for additional information.

New Source Review Actions

As part of a nationwide enforcement initiative against the electric utility industry which began in 1999, the EPA brought civil enforcement actions in federal district court against the Company alleging violations of the New Source Review provisions of the Clean Air Act at certain coal-fired electric generating units, including a unit co-owned by Mississippi Power. An adverse outcome could require substantial capital expenditures that cannot be determined at this time and could possibly require payment of substantial penalties. See Note 3 to the financial statements under "Environmental Matters – New Source Review Actions" for additional information. The ultimate outcome of these matters cannot be determined at this time.

Environmental Statutes and Regulations

General

The Company's operations are subject to extensive regulation by state and federal environmental agencies under a variety of statutes and regulations governing environmental media, including air, water, and land resources. Applicable statutes include the Clean Air Act; the Clean Water Act; the Comprehensive Environmental Response, Compensation, and Liability Act; the Resource Conservation and Recovery Act; the Toxic Substances Control Act; the Emergency Planning & Community Right-to-Know Act; 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 2014, the Company had invested approximately \$3.6 billion in environmental capital retrofit projects to comply with these requirements, with annual totals of approximately \$355 million, \$184 million, and \$62 million for 2014, 2013, and 2012, respectively. The Company expects that capital expenditures to comply with existing environmental statutes and

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

regulations will total approximately \$641 million from 2015 through 2017, with annual totals of approximately \$417 million, \$171 million, and \$53 million for 2015, 2016, and 2017, respectively. Costs related to the proposed water and final CCR rules are not included in the estimated environmental capital expenditures. See "Capital Requirements and Contractual Obligations" for additional information regarding estimated incremental environmental compliance expenditures. In addition, these estimated expenditures do not include any potential compliance costs that may arise from the EPA's proposed rules that would limit CO₂ emissions from new, existing, and modified or reconstructed fossil-fuel-fired electric generating units. See "Global Climate Issues" for additional information.

The Company's ultimate environmental compliance strategy, including potential unit retirement and replacement decisions, and future environmental capital expenditures will be affected by the final requirements of new or revised environmental regulations and regulations relating to global climate change that are promulgated, including the proposed environmental regulations described below; the outcome of any legal challenges to the environmental rules; the cost, availability, and existing inventory of emissions allowances; and the Company's fuel mix. Compliance costs may arise from existing unit retirements, installation of additional environmental controls, upgrades to the transmission system, closure and monitoring of CCR facilities, and adding or changing fuel sources for certain existing units. The ultimate outcome of these matters cannot be determined at this time. See "Retail Regulatory Matters –Environmental Accounting Order" herein for additional information on planned unit retirements and fuel conversions at the Company.

Southern Electric Generating Company (SEGCO) is jointly owned with Georgia Power. As part of its environmental compliance strategy, SEGCO expects to complete the addition of natural gas as the primary fuel source for its generating units in 2015. The capacity of SEGCO's units is sold equally to the Company and Georgia Power through a PPA. If such compliance costs cannot continue to be recovered through retail rates, they could have a material financial impact on the Company's financial condition and results of operations. See Note 4 to the financial statements for additional information.

Compliance with any new federal or state legislation or regulations relating to air quality, water, CCR, global climate change, or other environmental and health concerns could 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. Additionally, many of the Company's commercial and industrial customers may also be affected by existing and future environmental requirements, which for some may have the potential to ultimately affect their demand for electricity.

Air Quality

Compliance with the Clean Air Act and resulting regulations has been and will continue to be a significant focus for the Company. Since 1990, the Company has spent approximately \$3.4 billion in reducing and monitoring emissions pursuant to the Clean Air Act. Additional controls are currently planned or under consideration to further reduce air emissions, maintain compliance with existing regulations, and meet new requirements.

In 2012, the EPA finalized the Mercury and Air Toxics Standards (MATS) rule, which imposes stringent emissions limits for acid gases, mercury, and particulate matter on coal- and oil-fired electric utility steam generating units. Compliance for existing sources is required by April 16, 2015 up to April 16, 2016 for affected units for which extensions have been granted. On November 25, 2014, the U.S. Supreme Court granted a petition for review of the final MATS rule.

The EPA regulates ground level ozone concentrations through implementation of an eight-hour ozone National Ambient Air Quality Standard (NAAQS). In 2008, the EPA adopted a more stringent eight-hour ozone NAAQS, which it began to implement in 2011. In 2012, the EPA published its final determination of nonattainment areas based on the 2008 eight-hour ozone NAAQS. All areas within the Company's service territory have achieved attainment of this standard. On December 17, 2014, the EPA published a proposed rule to further reduce the current eight-hour ozone standard. The EPA is required by federal court order to complete this rulemaking by October 1, 2015. Finalization of a lower eight-hour ozone standard could result in the designation of new ozone nonattainment areas within the Company's service territory.

The EPA regulates fine particulate matter concentrations on an annual and 24-hour average basis. All areas within the Company's service territory have achieved attainment with the 1997 and 2006 particulate matter NAAQS, and the EPA has officially redesignated former nonattainment areas within the service territory as attainment for these standards. In 2012, the EPA issued a final rule that increases the stringency of the annual fine particulate matter standard. The EPA promulgated final designations for the 2012 annual standard on December 18, 2014, and no new nonattainment areas were designated within the Company's service territory. The EPA has, however, deferred its designation decision for one area in Alabama, so future nonattainment designation of this area is possible.

Final revisions to the NAAQS for sulfur dioxide (SO₂), which established a new one-hour standard, became effective in 2010. No areas within the Company's service territory have been designated as nonattainment under this rule. However, the EPA has

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

announced plans to make additional designation decisions for SO₂ in the future, which could result in nonattainment designations for areas within the Company's service territory. Implementation of the revised SO₂ standard could require additional reductions in SO₂ emissions and increased compliance and operational costs.

On February 13, 2014, the EPA proposed to delete from the Alabama State Implementation Plan (SIP) the Alabama opacity rule that the EPA approved in 2008, which provides operational flexibility to affected units. In March 2013, the U.S. Court of Appeals for the Eleventh Circuit ruled in favor of the Company and vacated an earlier attempt by the EPA to rescind its 2008 approval. The EPA's latest proposal characterizes the proposed deletion as an error correction within the meaning of the Clean Air Act. The Company believes this interpretation of the Clean Air Act to be incorrect. If finalized, this proposed action could affect unit availability and result in increased operations and maintenance costs for affected units, including units co-owned with Mississippi Power and units owned by SEGCO, which is jointly owned with Georgia Power.

The Company's service territory is subject to the requirements of the Cross State Air Pollution Rule (CSAPR). CSAPR is an emissions trading program that limits SO₂ and nitrogen oxide emissions from power plants in 28 states in two phases, with Phase I beginning in 2015 and Phase II beginning in 2017. In 2012, the U.S. Court of Appeals for the District of Columbia Circuit vacated CSAPR in its entirety, but on April 29, 2014, the U.S. Supreme Court overturned that decision and remanded the case back to the U.S. Court of Appeals for the District of Columbia Circuit for further proceedings. The U.S. Court of Appeals for the District of Columbia Circuit granted the EPA's motion to lift the stay of the rule, and the first phase of CSAPR took effect on January 1, 2015.

The EPA finalized the Clean Air Visibility Rule (CAVR) in 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 to certain sources, including fossil fuel-fired generating facilities, built between 1962 and 1977 and any additional emissions reductions necessary for each designated area to achieve reasonable progress toward the natural visibility conditions goal by 2018 and for each 10-year period thereafter.

In 2012, the EPA published proposed revisions to the New Source Performance Standard (NSPS) for Stationary Combustion Turbines (CTs). If finalized as proposed, the revisions would apply the NSPS to all new, reconstructed, and modified CTs (including CTs at combined cycle units), during all periods of operation, including startup and shutdown, and alter the criteria for determining when an existing CT has been reconstructed.

In February 2013, the EPA proposed a rule that would require certain states to revise the provisions of their SIPs relating to the regulation of excess emissions at industrial facilities, including fossil fuel-fired generating facilities, during periods of startup, shut-down, or malfunction (SSM). The EPA proposed to supplement the 2013 proposed rule on September 17, 2014, making it more stringent. The EPA has entered into a settlement agreement requiring it to finalize the proposed rule by May 22, 2015. The proposed rule would require states subject to the rule (including Alabama) to revise their SSM provisions within 18 months after issuance of the final rule.

The Company has developed and continually updates a comprehensive environmental compliance strategy to assess compliance obligations associated with the current and proposed environmental requirements discussed above. As part of this strategy, the Company has developed a compliance plan for the MATS rule which includes reliance on existing emission control technologies, the construction of baghouses to provide an additional level of control on the emissions of mercury and particulates from certain generating units, the use of additives or other injection technology, the use of existing or additional natural gas capability, and unit retirements. Additionally, certain transmission system upgrades are required. The impacts of the eight-hour ozone, fine particulate matter and SO₂ NAAQS, the Alabama opacity rule, CSAPR, CAVR, the MATS rule, the NSPS for CTs, and the SSM rule on the Company cannot be determined at this time and will depend on the specific provisions of the proposed and final rules, the resolution of pending and future legal challenges, and/or the development and implementation of rules at the state level. These 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.

Water Quality

The EPA's final rule establishing standards for reducing effects on fish and other aquatic life caused by new and existing cooling water intake structures at existing power plants and manufacturing facilities became effective on October 14, 2014. The effect of this final rule will depend on the results of additional studies and implementation of the rule by regulators based on site-specific factors. The ultimate impact of this rule will also depend on the outcome of ongoing legal challenges and cannot be determined at this time.

In June 2013, the EPA published a proposed rule which requested comments on a range of potential regulatory options for addressing revised technology-based limits for certain wastestreams from steam electric power plants and best management practices for CCR surface impoundments. The EPA has entered into a consent decree requiring it to finalize revisions to the steam

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Alabama Power Company 2014 Annual Report

electric effluent guidelines by September 30, 2015. The ultimate impact of the rule will also depend on the specific technology requirements of the final rule and the outcome of any legal challenges and cannot be determined at this time.

On April 21, 2014, the EPA and the U.S. Army Corps of Engineers jointly published a proposed rule to revise the regulatory definition of waters of the U.S. for all Clean Water Act (CWA) programs, which would significantly expand the scope of federal jurisdiction under the CWA. In addition, the rule as proposed could have significant impacts on economic development projects which could affect customer demand growth. The ultimate impact of the proposed rule will depend on the specific requirements of the final rule and the outcome of any legal challenges and cannot be determined at this time. If finalized as proposed, this rule could significantly increase permitting and regulatory requirements and costs associated with the siting of new facilities and the installation, expansion, and maintenance of transmission and distribution lines.

These proposed and final water quality regulations could result in significant additional capital expenditures and compliance costs that could affect future unit retirement and replacement decisions. Also, results of operations, cash flows, and financial condition could be significantly impacted if such costs are not recovered through regulated rates.

Coal Combustion Residuals

The Company currently manages CCR at onsite storage units consisting of landfills and surface impoundments (CCR Units) at six generating plants. In addition to on-site storage, the Company also sells a portion of its CCR to third parties for beneficial reuse. Individual states regulate CCR and the State of Alabama has its own regulatory requirements. The Company has an inspection program in place to assist in maintaining the integrity of its coal ash surface impoundments.

On December 19, 2014, the EPA issued the Disposal of Coal Combustion Residuals from Electric Utilities final rule (CCR Rule), but has not yet published it in the Federal Register. The CCR Rule will regulate the disposal of CCR, including coal ash and gypsum, as non-hazardous solid waste in CCR Units at active generating power plants. The CCR Rule does not mandate closure of CCR Units, but includes minimum criteria for active and inactive surface impoundments containing CCR and liquids, lateral expansions of existing units, and active landfills. Failure to meet the minimum criteria can result in the mandated closure of a CCR Unit. Although the EPA does not require individual states to adopt the final criteria, states have the option to incorporate the federal criteria into their state solid waste management plans in order to regulate CCR in a manner consistent with federal standards. The EPA's final rule continues to exclude the beneficial use of CCR from regulation.

The ultimate impact of the CCR Rule cannot be determined at this time and will depend on the Company's ongoing review of the CCR Rule, the results of initial and ongoing minimum criteria assessments, and the outcome of legal challenges. The cost and timing of potential ash pond closure and ongoing monitoring activities that may be required in connection with the CCR Rule is also uncertain; however, the Company has developed a preliminary nominal dollar estimate of costs associated with closure and groundwater monitoring of ash ponds in place of approximately \$311 million and ongoing post-closure care of approximately \$49 million. The Company will record asset retirement obligations (ARO) for the estimated closure costs required under the CCR Rule during 2015. SEGCO, which is jointly owned with Georgia Power, will also record an ARO for ash ponds commonly used at Plant E.C. Gaston. The Company's results of operations, cash flows, and financial condition could be significantly impacted if such costs are not recovered through regulated rates.

Global Climate Issues

In 2014, the EPA published three sets of proposed standards that would limit CO₂ emissions from new, existing, and modified or reconstructed fossil-fuel-fired electric generating units. On January 8, 2014, the EPA published proposed standards for new units, and, on June 18, 2014, the EPA published proposed standards governing existing units, known as the Clean Power Plan, and separate standards governing CO₂ emissions from modified and reconstructed units. The EPA's proposed Clean Power Plan establishes guidelines for states to develop plans to address CO₂ emissions from existing fossil fuel-fired electric generating units. The EPA's proposed guidelines establish state-specific interim and final CO₂ emission rate goals to be achieved between 2020 and 2029 and in 2030 and thereafter. The proposed guidelines and standards could result in operational restrictions and material compliance costs, including capital expenditures, which could affect future unit retirement and replacement decisions. The Company's results of operations, cash flows, and financial condition could be significantly impacted if such costs are not recovered through regulated rates or through market based contracts.

The Southern Company system filed comments on the EPA's proposed Clean Power Plan on December 1, 2014. These comments addressed legal and technical issues in addition to providing a preliminary estimated cost of complying with the proposed guidelines utilizing one of the EPA's compliance scenarios. Costs associated with this proposal could be significant to the utility industry and the Southern Company system. However, the ultimate financial and operational impact of the proposed Clean Power Plan on the Southern Company system cannot be determined at this time and will depend upon numerous known and unknown factors. Some of the unknown factors include: the structure, timing, and content of the EPA's final guidelines; individual state

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

implementation of these guidelines, including the potential that state plans impose different standards; additional rulemaking activities in response to legal challenges and related court decisions; the impact of future changes in generation and emissions-related technology and costs; the impact of future decisions regarding unit retirement and replacement, including the type and amount of any such replacement capacity; and the time periods over which compliance will be required.

Over the past several years, the U.S. Congress has also considered many proposals to reduce greenhouse gas emissions, mandate renewable or clean energy, and impose energy efficiency standards. Such proposals are expected to continue to be considered by the U.S. Congress. International climate change negotiations under the United Nations Framework Convention on Climate Change are also continuing.

The EPA's greenhouse gas reporting rule requires annual reporting of CO₂ equivalent emissions in metric tons for a company's operational control of facilities. Based on ownership or financial control of facilities, the Company's 2013 greenhouse gas emissions were approximately 40.8 million metric tons of CO₂ equivalent. The preliminary estimate of the Company's 2014 greenhouse gas emissions on the same basis is approximately 40 million metric tons of CO₂ equivalent. The level of greenhouse gas emissions from year to year will depend on the level of generation, the mix of fuel sources, and other factors.

Retail Regulatory Matters

The Company's revenues from regulated retail operations are collected through various rate mechanisms subject to the oversight of the Alabama PSC. The Company currently recovers its costs from the regulated retail business primarily through Rate RSE, Rate CNP, Rate ECR, and Rate NDR. In addition, the Alabama PSC issues accounting orders to address current events impacting the Company. See Note 1 to the financial statements under "Nuclear Outage Accounting Order" and Note 3 to the financial statements under "Retail Regulatory Matters" for additional information regarding the Company's rate mechanisms and accounting orders.

Rate RSE

Rate RSE adjustments are based on forward-looking information for the applicable upcoming calendar year. Rate adjustments for any two-year period, when averaged together, cannot exceed 4.0% and any annual adjustment is limited to 5.0%. If the Company's actual retail return is above the allowed weighted cost of equity (WCE) range, customer refunds will be required; however, there is no provision for additional customer billings should the actual retail return fall below the WCE range.

On December 1, 2014, the Company submitted the required annual filing under Rate RSE to the Alabama PSC. The Rate RSE increase was 3.49%, or \$181 million annually, effective January 1, 2015. The revenue adjustment includes the performance based adder of 0.07%. Under the terms of Rate RSE, the maximum increase for 2016 cannot exceed 4.51%.

Rate CNP

The Company's retail rates, approved by the Alabama PSC, provide for adjustments to recognize the placing of new generating facilities into retail service under Rate CNP. The Company may also recover retail costs associated with certificated PPAs under Rate CNP PPA. On March 4, 2014, the Alabama PSC issued a consent order that the Company leave in effect the current Rate CNP PPA factor for billings for the period April 1, 2014 through March 31, 2015. It is anticipated that no adjustment will be made to Rate CNP PPA in 2015.

The Company has elected the normal purchase normal sale (NPNS) scope exception under the derivative accounting rules for its two wind PPAs, which total approximately 400 MWs. The NPNS exception allows the PPAs to be recorded at a cost, rather than fair value, basis. The industry's application of the NPNS exception to certain physical forward transactions in nodal markets was previously under review by the SEC at the request of the electric utility industry. In June 2014, the SEC requested the Financial Accounting Standards Board to address the issue through the Emerging Issues Task Force (EITF). Any accounting decisions will now be subject to EITF deliberations. The outcome of the EITF's deliberations cannot be determined at this time. If the Company is ultimately required to record these PPAs at fair value, an offsetting regulatory asset or regulatory liability will be recorded.

Rate CNP Environmental allows for the recovery of the Company's retail costs associated with environmental laws, regulations, or other such mandates. Rate CNP Environmental is based on forward-looking information and provides for the recovery of these costs pursuant to a factor that is calculated annually. Environmental costs to be recovered include operations and maintenance expenses, depreciation, and a return on certain invested capital. The Rate CNP Environmental increase effective January 1, 2015 was 1.5%, or \$75 million annually, based upon projected billings.

Rate ECR

The Company has established energy cost recovery rates under the Company's Rate ECR as approved by the Alabama PSC. Rates are based on an estimate of future energy costs and the current over or under recovered balance. Revenues recognized under Rate

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

ECR and recorded on the financial statements are adjusted for the difference in actual recoverable fuel costs and amounts billed in current regulated rates. The difference in the recoverable fuel costs and amounts billed give rise to the over or under recovered amounts recorded as regulatory assets or liabilities. The Company, along with the Alabama PSC, continually monitors the over or under recovered cost balance to determine whether an adjustment to billing rates is required. Changes in the Rate ECR factor have no significant effect on the Company's net income, but will impact operating cash flows. Currently, the Alabama PSC may approve billing rates under Rate ECR of up to 5.910 cents per KWH. In December 2014, the Alabama PSC issued a consent order that the Company leave in effect for 2015 the energy cost recovery rates which began in 2011. Therefore, the Rate ECR factor as of January 1, 2015 remained at 2.681 cents per KWH. Effective with billings beginning in January 2016, the Rate ECR factor will be 5.910 cents per KWH, absent a further order from the Alabama PSC.

Environmental Accounting Order

Based on an order from the Alabama PSC, the Company is allowed to establish a regulatory asset to record the unrecovered investment costs, including the unrecovered plant asset balance and the unrecovered costs associated with site removal and closure associated with future unit retirements caused by environmental regulations. These costs would be amortized over the affected unit's remaining useful life, as established prior to the decision regarding early retirement. See "Environmental Matters – Environmental Statutes and Regulations" herein for additional information regarding environmental regulations.

As part of its environmental compliance strategy, the Company plans to retire Plant Gorgas Units 6 and 7. These units represent 200 MWs of the Company's approximately 12,200 MWs of generating capacity. The Company also plans to cease using coal at Plant Barry Units 1 and 2 (250 MWs), but such units will remain available on a limited basis with natural gas as the fuel source. Additionally, the Company expects to cease using coal at Plant Barry Unit 3 (225 MWs) and Plant Greene County Units 1 and 2 (300 MWs) and begin operating those units solely on natural gas. These plans are expected to be effective no later than April 2016.

In accordance with an accounting order from the Alabama PSC, the Company will transfer the unrecovered plant asset balances to a regulatory asset at their respective retirement dates. The regulatory asset will be amortized through Rate CNP Environmental over the remaining useful lives, as established prior to the decision for retirement. As a result, these decisions will not have a significant impact on the Company's financial statements.

Cost of Removal Accounting Order

In accordance with an accounting order issued on November 3, 2014 by the Alabama PSC, at December 31, 2014, the Company fully amortized the balance of \$123 million in certain regulatory asset accounts, and offset this amortization expense with the amortization of \$120 million of the regulatory liability for other cost of removal obligations. The regulatory asset account balances amortized as of December 31, 2014 represented costs previously deferred under a compliance and pension cost accounting order as well as a non-nuclear outage accounting order, which were approved by the Alabama PSC in 2012 and August 2013, respectively. Approximately \$95 million of non-nuclear outage costs and \$28 million of compliance and pension costs were fully amortized at December 31, 2014.

The cost of removal accounting order also required the Company to terminate, as of December 31, 2014, the regulatory asset accounts created pursuant to the compliance and pension cost accounting order and the non-nuclear outage accounting order. Consequently, the Company will not defer any expenditures in 2015, 2016, and 2017 related to critical electric infrastructure and domestic nuclear facilities, as allowed under the previous orders.

Non-Environmental Federal Mandated Costs Accounting Order

On December 9, 2014, pending the development of a new cost recovery mechanism, the Alabama PSC issued an accounting order authorizing the deferral as a regulatory asset of up to \$50 million of costs associated with non-environmental federal mandates that would otherwise impact rates in 2015.

On February 17, 2015, the Company filed a proposed modification to Rate CNP Environmental with the Alabama PSC to include compliance costs for both environmental and non-environmental mandates. The non-environmental costs that would be recovered through the revised mechanism concern laws, regulations, and other mandates directed at the utility industry involving the security, reliability, safety, sustainability, or similar considerations impacting the Company's facilities or operations. If approved as requested, the effective date for the revised mechanism would be March 20, 2015, upon which the regulatory asset balance would be reclassified to the under recovered balance for Rate CNP Environmental, and the related customer rates would not become effective before January 2016. The ultimate outcome of this matter cannot be determined at this time.

Income Tax Matters

Bonus Depreciation

On December 19, 2014, the Tax Increase Prevention Act of 2014 (TIPA) was signed into law. The TIPA retroactively extended several tax credits through 2014 and extended 50% bonus depreciation for property placed in service in 2014 (and for certain long-term production-period projects to be placed in service in 2015). The extension of 50% bonus depreciation had a positive impact on the Company's cash flows and, combined with bonus depreciation allowed in 2014 under the American Taxpayer Relief Act of 2012, resulted in approximately \$165 million of positive cash flows for the 2014 tax year. The estimated cash flow benefit of bonus depreciation related to TIPA is expected to be approximately \$65 million to \$70 million for the 2015 tax year.

Other Matters

In accordance with accounting standards related to employers' accounting for pensions, the Company recorded pension costs of \$23 million in 2014, \$47 million in 2013 and \$6 million in 2012. Postretirement benefit costs for the Company were \$4 million, \$7 million, and \$10 million in 2014, 2013, and 2012, respectively. Such amounts are dependent on several factors including trust earnings and changes to the plans. A portion of pension and postretirement benefit costs is capitalized based on construction-related labor charges. Pension and postretirement benefit costs are a component of the regulated rates and generally do not have a long-term effect on net income. For more information regarding pension and postretirement benefits, see Note 2 to the financial statements.

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 air quality and water standards, has occurred throughout the U.S. This litigation has included claims for damages alleged to have been caused by CO₂ and other emissions, CCR, and alleged exposure to hazardous materials, and/or requests for injunctive relief in connection with such matters.

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 or in Note 3 to the financial statements, management does not anticipate that the ultimate liabilities, if any, arising from such current proceedings would have a material effect on the Company's financial statements. See Note 3 to the financial statements for a discussion of various other contingencies, regulatory matters, and other matters being litigated which may affect future earnings potential.

ACCOUNTING POLICIES

Application of Critical Accounting Policies and Estimates

The Company prepares its financial statements in accordance with GAAP. Significant accounting policies are described in Note 1 to the financial statements. In the application of these policies, certain estimates are made that may have a material impact on the Company's results of operations and related disclosures. Different assumptions and measurements could produce estimates that are significantly different from those recorded in the financial statements. Senior management has reviewed and discussed the following critical accounting policies and estimates with the Audit Committee of Southern Company's Board of Directors.

Electric Utility Regulation

The Company is subject to retail regulation by the Alabama PSC and wholesale regulation by the FERC. 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, AROs, and pension and postretirement benefits have less of a direct impact on the Company's results of operations and financial condition 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 any requirement to refund these regulatory liabilities based on

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

applicable regulatory guidelines and GAAP. 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 subject it to environmental, litigation, 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 GAAP, records reserves for those matters where a non-tax-related loss is considered probable and reasonably estimable. 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 position, results of operations, or cash flows.

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, healthcare 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 consider 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.

For purposes of its December 31, 2014 measurement date, the Company adopted new mortality tables for its pension plans and retiree life and medical plans, which reflect increased life expectancies in the U.S. The adoption of new mortality tables increased the projected benefit obligations for the Company's pension plans and other postretirement benefit plans by approximately \$156 million and \$22 million, respectively. The adoption of new mortality tables will increase net periodic costs related to the Company's pension plans and other postretirement benefit plans in 2015 by \$20 million and \$2 million, respectively.

A 25 basis point change in any significant assumption (discount rate, salaries, or long-term return on plan assets) would result in an \$8 million or less change in total annual benefit expense and a \$113 million or less change in projected obligations.

Recently Issued Accounting Standards

On May 28, 2014, the Financial Accounting Standards Board issued ASC 606, Revenue from Contracts with Customers. ASC 606 revises the accounting for revenue recognition and is effective for fiscal years beginning after December 15, 2016. The Company continues to evaluate the requirements of ASC 606. The ultimate impact of the new standard has not yet been determined.

FINANCIAL CONDITION AND LIQUIDITY

Overview

The Company's financial condition remained stable at December 31, 2014. The Company's cash requirements primarily consist of funding ongoing operations, common stock dividends, capital expenditures, and debt maturities. Capital expenditures and other investing activities include investments to comply with environmental regulations and for restoration following major storms. Operating cash flows provide a substantial portion of the Company's cash needs. For the three-year period from 2015 through 2017, the Company's projected common stock dividends, capital expenditures, and debt maturities are expected to exceed operating cash flows. Projected capital expenditures in that period include investments to maintain existing generation facilities, to add environmental equipment for existing generating units, to add or change fuel sources for certain existing units, and to expand and improve transmission and distribution facilities. The Company plans to finance future cash needs in excess of its operating cash flows primarily through debt and equity issuances. The Company intends to continue to monitor its access to short-

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

term and long-term capital markets as well as its bank credit arrangements to meet future capital and liquidity needs. See "Sources of Capital," "Financing Activities," and "Capital Requirements and Contractual Obligations" herein for additional information.

The Company's investments in the qualified pension plan and the nuclear decommissioning trust funds increased in value as of December 31, 2014 as compared to December 31, 2013. No contributions to the qualified pension plan were made for the year ended December 31, 2014. No mandatory contributions to the qualified pension plan are anticipated for the year ending December 31, 2015. The Company's funding obligations for the nuclear decommissioning trust fund are based on the site study, and the next study is expected to be conducted in 2018. See Notes 1 and 2 to the financial statements under "Nuclear Decommissioning" and "Pension Plans," respectively, for additional information.

Net cash provided from operating activities totaled \$1.7 billion for 2014, a decrease of \$205 million as compared to 2013. The decrease in cash provided from operating activities was primarily due to an increase in income tax payments and the timing of fossil fuel stock purchases, partially offset by the timing of payment of accounts payable. Net cash provided from operating activities totaled \$1.9 billion for 2013, an increase of \$538 million as compared to 2012. The increase in cash provided from operating activities was primarily due to changes in timing of fossil fuel stock purchases and payment of accounts payable, and collection of fuel cost recovery revenues.

Net cash used for investing activities totaled \$1.6 billion for 2014, \$1.1 billion for 2013, and \$0.9 billion for 2012. In 2014, these additions were primarily due to gross property additions related to environmental, distribution, transmission, steam generation, and nuclear fuel. In 2013, these additions were primarily due to gross property additions related to steam generation, distribution, and transmission equipment. In 2012, these additions were primarily due to gross property additions related to nuclear fuel and transmission, distribution, and steam generating equipment.

Net cash used for financing activities totaled \$164 million in 2014 primarily due to the payment of common stock dividends, and issuances and redemptions of securities. Net cash used for financing activities totaled \$614 million in 2013 primarily due to the payment of common stock dividends, and the issuance and a maturity of senior notes. Fluctuations in cash flow from financing activities vary from year to year based on capital needs and the maturity or redemption of securities.

Significant balance sheet changes for 2014 included an increase of \$854 million in property, plant, and equipment primarily due to additions to environmental, distribution, transmission, and steam generation. Other significant changes included increases of \$454 million in securities due within one year and \$418 million in other regulatory assets, deferred related to pension and other postretirement benefits.

The Company's ratio of common equity to total capitalization, including short-term debt, was 45.6% in 2014 and 44.3% in 2013. See Note 6 to the financial statements for additional information.

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. The Company has primarily utilized funds from operating cash flows, short-term debt, security issuances, and equity contributions from Southern Company. However, the amount, type, and timing of any future financings, if needed, will depend upon prevailing market conditions, regulatory approval, and other factors.

Security issuances are subject to regulatory approval by the Alabama PSC. Additionally, with respect to the public offering of securities, the Company files registration statements with the SEC under the Securities Act of 1933, as amended. The amounts of securities authorized by the Alabama PSC 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 in the Southern Company system.

The Company's current liabilities sometimes exceed current assets because of the Company's debt due within one year and the periodic use of short-term debt as a funding source primarily to meet scheduled maturities of long-term debt, as well as cash needs, which can fluctuate significantly due to the seasonality of the business.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

At December 31, 2014, the Company had approximately \$273 million of cash and cash equivalents. Committed credit arrangements with banks at December 31, 2014 were as follows:

Expires ^(a)			Total	Unused <i>(in millions)</i>	Executable Term-Loans		Due Within One Year	
2015	2016	2018			One Year	Two Years	Term Out	No Term Out
\$ 228	\$ 50	\$ 1,030	\$ 1,308	\$ 1,308	\$ 58	\$ —	\$ 58	\$ 170

(a) No credit arrangements expire in 2017.

See Note 6 to the financial statements under "Bank Credit Arrangements" for additional information.

Most of these bank credit arrangements contain covenants that limit debt levels and contain cross default provisions to other indebtedness (including guarantee obligations) of the Company. Such cross default provisions to other indebtedness would trigger an event of default if the Company defaulted on indebtedness or guarantee obligations over a specified threshold. The Company is currently in compliance with all such covenants. None of the bank credit arrangements contain material adverse change clauses at the time of borrowings. The Company expects to renew its bank credit arrangements as needed, prior to expiration.

A portion of the unused credit with banks is allocated to provide liquidity support to the Company's variable rate pollution control revenue bonds and commercial paper borrowings. As of December 31, 2014, the Company had \$784 million of outstanding variable rate pollution control revenue bonds requiring liquidity support. In addition, at December 31, 2014, the Company had \$280 million of fixed rate pollution control revenue bonds outstanding that were required to be remarketed within the next 12 months.

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. The Company may meet short-term cash needs through its commercial paper program. 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. The obligations of each company under these arrangements are several and there is no cross-affiliate credit support.

Details of short-term borrowings were as follows:

	Short-term Debt at the End of the Period		Short-term Debt During the Period ^(a)		
	Amount Outstanding <i>(in millions)</i>	Weighted Average Interest Rate	Average Outstanding <i>(in millions)</i>	Weighted Average Interest Rate	Maximum Amount Outstanding <i>(in millions)</i>
December 31, 2014:					
Commercial paper	\$—	—%	\$13	0.2%	\$300
December 31, 2013:					
Commercial paper	\$—	—%	\$11	0.2%	\$90
December 31, 2012:					
Commercial paper	\$—	—%	\$6	0.2%	\$57

(a) Average and maximum amounts are based upon daily balances during the twelve-month periods ended December 31, 2014, 2013, and 2012.

The Company believes that the need for working capital can be adequately met by utilizing commercial paper programs, lines of credit, and cash.

Financing Activities

In August 2014, the Company issued \$400 million aggregate principal amount of Series 2014A 4.150% Senior Notes due August 15, 2044. The proceeds were used for general corporate purposes, including the Company's continuous construction program.

During 2014, the Company entered into forward-starting interest rate swaps to hedge exposure to interest rate changes related to an anticipated debt issuance. The notional amount of the swaps totaled \$200 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

In December 2014, the Company incurred obligations related to the issuance of \$254 million of The Industrial Development Board of the Town of Columbia, Pollution Control Revenue Refunding Bonds (Alabama Power Company Project), Series 2014 – A, 2014 – B, 2014 – C, and 2014 – D due December 1, 2037. The proceeds were used to refund, in December 2014, approximately \$254 million of The Industrial Development Board of the Town of Columbia, Pollution Control Revenue Refunding Bonds (Alabama Power Company Project), Series 1995 – A, 1995 – B, 1995 – C, 1995 – D, 1995 – E, 1996 – A, 1999 – A, 1999 – B, and 1999 – C.

Subsequent to December 31, 2014, the Company announced the redemption of \$250 million aggregate principal amount of its Series DD 5.65% Senior Notes due March 15, 2035, which will occur on March 16, 2015.

In addition to any financings that may be necessary to meet capital requirements and contractual obligations, 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 below BBB- and/or Baa3. These contracts are primarily for physical electricity purchases, fuel purchases, fuel transportation and storage, and energy price risk management. At December 31, 2014, the maximum potential collateral requirements under these contracts at a rating below BBB- and/or Baa3 were approximately \$365 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 and the variable rate pollution control revenue bond market.

Market Price Risk

Due to cost-based rate regulation and other various cost recovery mechanisms, the Company continues to have 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. 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.

To mitigate future exposure to changes in interest rates, the Company enters into derivatives that have been designated as hedges. The weighted average interest rate on \$984 million of long-term variable interest rate exposure at January 1, 2015 was 0.71%. If the Company sustained a 100 basis point change in interest rates for all long-term variable interest rate exposure, the change would affect annualized interest expense by approximately \$10 million at January 1, 2015. See Note 1 to the financial statements under "Financial Instruments" and Note 11 to the financial statements for additional information.

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 and financial hedge contracts for natural gas purchases. The Company continues to manage a retail fuel-hedging program implemented per the guidelines of the Alabama PSC. The Company had no material change in market risk exposure for the year ended December 31, 2014 when compared to the year ended December 31, 2013.

In addition, Rate ECR allows the recovery of specific costs associated with the sales of natural gas that become necessary due to operating considerations at the Company's electric generating facilities. Rate ECR also allows recovery of the cost of financial instruments used for hedging market price risk up to 75% of the budgeted annual amount of natural gas purchases. The Company may not engage in natural gas hedging activities that extend beyond a rolling 42-month window. Also, the premiums paid for natural gas financial options may not exceed 5% of the Company's natural gas budget for that year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

The changes in fair value of energy-related derivative contracts are substantially attributable to both the volume and the price of natural gas. For the years ended December 31, the changes in fair value of energy-related derivative contracts, the majority of which are composed of regulatory hedges, were as follows:

	2014 Changes	2013 Changes
	Fair Value	
	<i>(in millions)</i>	
Contracts outstanding at the beginning of the period, assets (liabilities), net	\$ (1)	\$ (13)
Contracts realized or settled	(7)	10
Current period changes ^(a)	(44)	2
Contracts outstanding at the end of the period, assets (liabilities), net	\$ (52)	\$ (1)

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

The net hedge volumes of energy-related derivative contracts, for the years ended December 31 were as follows:

	2014	2013
	mmBtu Volume	
	<i>(in millions)</i>	
Commodity – Natural gas swaps	54	64
Commodity – Natural gas options	2	5
Total hedge volume	56	69

The weighted average swap contract cost above market prices was approximately \$0.89 per mmBtu as of December 31, 2014 and \$0.02 per mmBtu as of December 31, 2013. The change in option fair value is primarily attributable to the volatility of the market and the underlying change in the natural gas price. The majority of the natural gas hedge gains and losses are recovered through the Company's retail energy cost recovery clause.

At December 31, 2014 and 2013, substantially all of the Company's energy-related derivative contracts were designated as regulatory hedges and were related to the Company's fuel-hedging program. Therefore, 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 energy cost recovery clause. Certain other gains and losses on energy-related derivatives, designated as cash flow hedges, are initially deferred in OCI before being recognized in income in the same period as the hedged transaction. 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 and were not material for any year presented.

The Company uses over-the-counter contracts that are not exchange traded but are fair valued using prices which are market observable, and thus fall into Level 2. See Note 10 to the financial statements for further discussion of fair value measurements. The maturities of the energy-related derivative contracts, which are all Level 2 of the fair value hierarchy, at December 31, 2014 were as follows:

	Fair Value Measurements		
	December 31, 2014		
	Total Fair Value	Maturity	
		Year 1	Years 2&3
	<i>(in millions)</i>		
Level 1	\$ —	\$ —	\$ —
Level 2	(52)	(31)	(21)
Level 3	—	—	—
Fair value of contracts outstanding at end of period	\$ (52)	\$ (31)	\$ (21)

The Company is exposed to market price risk in the event of nonperformance by counterparties to energy-related and interest rate derivative contracts. The Company only enters into agreements and material transactions with counterparties that have investment

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

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. For additional information, see Note 1 to the financial statements under "Financial Instruments" and Note 11 to the financial statements.

Capital Requirements and Contractual Obligations

The Company's construction program consists of a base level capital investment and capital expenditures to comply with existing environmental statutes and regulations. Over the next three years, the Company estimates spending, as part of its base level capital investment, \$515 million on Plant Farley (including nuclear fuel), \$892 million on distribution facilities, and \$556 million on transmission additions. These base level capital investment amounts also include capital expenditures related to contractual purchase commitments for nuclear fuel and capital expenditures covered under long-term service agreements. Costs related to proposed water and final CCR rules are not included in the construction program base level capital investment. In addition, these estimated expenditures do not include any potential compliance costs that may arise from the EPA's proposed rules that would limit CO₂ emissions from new, existing, and modified or reconstructed fossil-fuel-fired electric generating units. See "Global Climate Issues" for additional information. The Company's base level construction program investments including investments to comply with existing environmental statutes and regulations and the estimated incremental compliance costs related to the proposed water and final CCR rules over the 2015 through 2017 three-year period, based on the final CCR rule which will continue to regulate CCR as non-hazardous solid waste, are estimated as follows:

	2015	2016	2017
Construction program:		<i>(in millions)</i>	
Base capital	\$ 1,114	\$ 857	\$ 1,092
Existing environmental statutes and regulations	417	171	53
Total construction program base level capital investment	\$ 1,531	\$ 1,028	\$ 1,145
Estimated incremental environmental compliance investments:			
Proposed water and final CCR rules	\$ 4	\$ 88	\$ 239

See FUTURE EARNINGS POTENTIAL – "Environmental Matters – Environmental Statutes and Regulations" for additional information.

The construction program is 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; changes in load projections; changes in environmental statutes and regulations; the outcome of any legal challenges to the environmental rules; changes in generating plants, including unit retirements and replacements and adding or changing fuel sources at existing units, to meet regulatory requirements; changes in the expected environmental compliance program; changes in FERC rules and regulations; Alabama PSC approvals; changes in legislation; the cost and efficiency of construction labor, equipment, and materials; project scope and design changes; storm impacts; 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, 2014, in addition to the funds required for the Company's construction program, approximately \$454 million will be required by the end of 2015 for maturities of long-term debt. Subsequent to December 31, 2014, the Company announced the redemption of \$250 million aggregate principal amount of its Series DD 5.65% Senior Notes due March 15, 2035 that will occur on March 16, 2015, which increased the total funds required for maturities of long-term debt by the end of 2015 to \$704 million. The Company plans to continue, when economically feasible, to retire higher cost securities and replace these obligations with lower cost capital if market conditions permit.

As a result of NRC requirements, the Company has external trust funds for nuclear decommissioning costs; however, the Company currently has no additional funding requirements. For additional information, see Note 1 to the financial statements under "Nuclear Decommissioning."

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 Alabama PSC and the FERC.

Other funding requirements related to obligations associated with scheduled maturities of long-term debt, as well as the related interest, derivative obligations, preferred and preference stock dividends, leases, and other purchase commitments are detailed in the contractual obligations table that follows. See Notes 1, 2, 6, 7, and 11 to the financial statements for additional information.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

Contractual Obligations

	2015	2016- 2017	2018- 2019	After 2019	Total
	<i>(in millions)</i>				
Long-term debt ^(a) —					
Principal	\$ 454	\$ 761	\$ 200	\$ 5,216	\$ 6,631
Interest	259	503	435	3,436	4,633
Preferred and preference stock dividends ^(b)	39	79	79	—	197
Financial derivative obligations ^(c)	40	21	—	—	61
Operating leases ^(d)	16	24	11	17	68
Capital Lease	—	1	1	3	5
Purchase commitments —					
Capital ^(e)	1,343	2,281	—	—	3,624
Fuel ^(f)	1,297	1,705	867	529	4,398
Purchased power ^(g)	68	144	156	854	1,222
Other ^(h)	45	81	81	365	572
Pension and other postretirement benefit plans ⁽ⁱ⁾	18	33	—	—	51
Total	\$ 3,579	\$ 5,633	\$ 1,830	\$ 10,420	\$ 21,462

(a) All amounts are reflected based on final maturity dates. The Company plans to continue, when economically feasible, 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, 2015, as reflected in the statements of capitalization. Fixed rates include, where applicable, the effects of interest rate derivatives employed to manage interest rate risk.

(b) Preferred and preference stock do not mature; therefore, amounts are provided for the next five years only.

(c) Includes derivative liabilities related to cash flow hedges of forecasted debt, as well as energy-related derivatives. For additional information, see Notes 1 and 11 to the financial statements.

(d) Excludes PPAs that are accounted for as leases and are included in purchased power.

(e) The Company provides estimated capital expenditures for a three-year period, including capital expenditures and compliance costs associated with existing environmental regulations. Such amounts exclude the Company's estimates of potential incremental environmental compliance investment to comply with proposed water and final CCR rules, which are approximately \$4 million, \$88 million, and \$239 million for 2015, 2016, and 2017, respectively. These amounts also exclude contractual purchase commitments for nuclear fuel and capital expenditures covered under long-term service agreements, which are reflected separately. At December 31, 2014, significant purchase commitments were outstanding in connection with the construction program. See FUTURE EARNINGS POTENTIAL – "Environmental Matters – Environmental Statutes and Regulations" for additional information.

(f) Includes commitments to purchase coal, nuclear fuel, and natural gas, as well as the related transportation and storage. In most cases, these contracts contain provisions for price escalation, minimum purchase levels, and other financial commitments. Natural gas purchase commitments are based on various indices at the time of delivery. Amounts reflected for natural gas purchase commitments have been estimated based on the New York Mercantile Exchange future prices at December 31, 2014.

(g) Estimated minimum long-term obligations for various long-term commitments for the purchase of capacity and energy. Amounts are related to the Company's certificated PPAs which include MWs purchased from gas-fired and wind-powered facilities.

(h) Includes long-term service agreements and contracts for the procurement of limestone. Long-term service agreements include price escalation based on inflation indices.

(i) The Company forecasts contributions to the pension and other postretirement benefit plans over a three-year period. The Company anticipates no mandatory contributions to the qualified pension plan during the next three years. Amounts presented represent estimated benefit payments for the nonqualified pension plans, estimated non-trust benefit payments for the other postretirement benefit plans, and estimated contributions to the other postretirement benefit plan trusts, all of which will be made from the Company's corporate assets. See Note 2 to the financial statements for additional information related to the pension and other postretirement benefit plans, including estimated benefit payments. Certain benefit payments will be made through the related benefit plans. Other benefit payments will be made from the Company's corporate assets.

Cautionary Statement Regarding Forward-Looking Statements

The Company's 2014 Annual Report contains forward-looking statements. Forward-looking statements include, among other things, statements concerning retail rates, economic recovery, fuel and environmental cost recovery and other rate actions, current and proposed environmental regulations and related compliance plans and estimated expenditures, access to sources of capital, projections for the qualified pension plan, postretirement benefit plan, and nuclear decommissioning trust fund contributions, financing activities, filings with state and federal regulatory authorities, impact of the TIPA, estimated sales and purchases under power sale and purchase agreements, and estimated construction and other plans and 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 changes, including legislative and regulatory initiatives regarding deregulation and restructuring of the electric utility industry, environmental laws including regulation of water, CCR, and emissions of sulfur, nitrogen, CO₂, soot, particulate matter, hazardous air pollutants, including mercury, 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, pending EPA civil action against the Company, and IRS and state tax audits;
- 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 last recession, population and business growth (and declines), the effects of energy conservation and efficiency measures, including from the development and deployment of alternative energy sources such as self-generation and distributed generation technologies, and any potential economic impacts resulting from federal fiscal decisions;
- available sources and costs of fuels;
- effects of inflation;
- the ability to control costs and avoid cost overruns during the development and construction of facilities, to construct facilities in accordance with the requirements of permits and licenses, and to satisfy any operational and environmental performance standards;
- investment performance of the Company's employee and retiree benefit plans and nuclear decommissioning trust funds;
- 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;
- the inherent risks involved in operating nuclear generating facilities, including environmental, health, regulatory, natural disaster, terrorism, or financial risks;
- the ability to successfully operate generating, transmission, and distribution facilities and the successful performance of necessary corporate functions;
- 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 cyber intrusion or terrorist incidents and the threat of terrorist incidents;
- interest rate fluctuations and financial market conditions and the results of financing efforts;
- changes in the Company's credit ratings, including impacts on interest rates, access to capital markets, and collateral requirements;
- the impacts of any sovereign financial issues, including impacts on interest rates, access to capital markets, impacts on currency exchange rates, counterparty performance, and the economy in general;
- the ability of the Company to obtain additional generating capacity at competitive prices;

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)
Alabama Power Company 2014 Annual Report

- catastrophic events such as fires, earthquakes, explosions, floods, tornadoes, hurricanes and other storms, 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.

[This page intentionally left blank]

STATEMENTS OF INCOME

For the Years Ended December 31, 2014, 2013, and 2012

Alabama Power Company 2014 Annual Report

	2014	2013	2012
	<i>(in millions)</i>		
Operating Revenues:			
Retail revenues	\$ 5,249	\$ 4,952	\$ 4,933
Wholesale revenues, non-affiliates	281	248	277
Wholesale revenues, affiliates	189	212	111
Other revenues	223	206	199
Total operating revenues	5,942	5,618	5,520
Operating Expenses:			
Fuel	1,605	1,631	1,503
Purchased power, non-affiliates	185	100	73
Purchased power, affiliates	200	129	182
Other operations and maintenance	1,468	1,289	1,287
Depreciation and amortization	603	645	639
Taxes other than income taxes	356	348	340
Total operating expenses	4,417	4,142	4,024
Operating Income	1,525	1,476	1,496
Other Income and (Expense):			
Allowance for equity funds used during construction	49	32	19
Interest income	15	16	16
Interest expense, net of amounts capitalized	(255)	(259)	(287)
Other income (expense), net	(22)	(36)	(24)
Total other income and (expense)	(213)	(247)	(276)
Earnings Before Income Taxes	1,312	1,229	1,220
Income taxes	512	478	477
Net Income	800	751	743
Dividends on Preferred and Preference Stock	39	39	39
Net Income After Dividends on Preferred and Preference Stock	\$ 761	\$ 712	\$ 704

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

STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2014, 2013, and 2012
Alabama Power Company 2014 Annual Report

	2014		2013		2012
			<i>(in millions)</i>		
Net Income	\$ 800	\$	751	\$	743
Other comprehensive income (loss):					
Qualifying hedges:					
Changes in fair value, net of tax of \$(3), \$-, and \$(7), respectively	(5)		—		(11)
Reclassification adjustment for amounts included in net income, net of tax of \$1, \$1, and \$1, respectively	2		1		2
Total other comprehensive income (loss)	(3)		1		(9)
Comprehensive Income	\$ 797	\$	752	\$	734

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

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2014, 2013, and 2012
Alabama Power Company 2014 Annual Report

	2014	2013	2012
	<i>(in millions)</i>		
Operating Activities:			
Net income	\$ 800	\$ 751	\$ 743
Adjustments to reconcile net income to net cash provided from operating activities —			
Depreciation and amortization, total	724	816	767
Deferred income taxes	270	198	164
Allowance for equity funds used during construction	(49)	(32)	(19)
Pension, postretirement, and other employee benefits	(61)	9	(21)
Stock based compensation expense	11	10	9
Other, net	17	(38)	(24)
Changes in certain current assets and liabilities —			
-Receivables	(58)	2	23
-Fossil fuel stock	61	146	(132)
-Materials and supplies	(17)	19	(21)
-Other current assets	(11)	5	(4)
-Accounts payable	157	35	(77)
-Accrued taxes	(199)	(23)	(12)
-Accrued compensation	50	(23)	(3)
-Retail fuel cost over recovery	5	42	1
-Other current liabilities	9	(3)	(18)
Net cash provided from operating activities	1,709	1,914	1,376
Investing Activities:			
Property additions	(1,457)	(1,107)	(867)
Nuclear decommissioning trust fund purchases	(245)	(280)	(194)
Nuclear decommissioning trust fund sales	244	279	193
Cost of removal net of salvage	(77)	(47)	(33)
Change in construction payables	(10)	(13)	12
Other investing activities	(22)	26	(45)
Net cash used for investing activities	(1,567)	(1,142)	(934)
Financing Activities:			
Proceeds —			
Capital contributions from parent company	28	24	27
Pollution control bonds	254	—	—
Senior notes issuances	400	300	1,000
Redemptions —			
Pollution control revenue bonds	(254)	—	(1)
Senior notes	—	(250)	(950)
Payment of preferred and preference stock dividends	(39)	(39)	(39)
Payment of common stock dividends	(550)	(644)	(684)
Other financing activities	(3)	(5)	(2)
Net cash used for financing activities	(164)	(614)	(649)
Net Change in Cash and Cash Equivalents	(22)	158	(207)
Cash and Cash Equivalents at Beginning of Year	295	137	344
Cash and Cash Equivalents at End of Year	\$ 273	\$ 295	\$ 137
Supplemental Cash Flow Information:			
Cash paid during the period for —			
Interest (net of \$18, \$11 and \$7 capitalized, respectively)	\$ 231	\$ 243	\$ 273
Income taxes (net of refunds)	436	296	309
Noncash transactions — accrued property additions at year-end	8	18	31

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

BALANCE SHEETS
At December 31, 2014 and 2013
Alabama Power Company 2014 Annual Report

Assets	2014	2013
	<i>(in millions)</i>	
Current Assets:		
Cash and cash equivalents	\$ 273	\$ 295
Receivables —		
Customer accounts receivable	345	341
Unbilled revenues	138	142
Under recovered regulatory clause revenues	74	—
Other accounts and notes receivable	23	30
Affiliated companies	37	54
Accumulated provision for uncollectible accounts	(9)	(8)
Fossil fuel stock, at average cost	268	329
Materials and supplies, at average cost	406	375
Vacation pay	65	63
Prepaid expenses	244	57
Other regulatory assets, current	84	54
Other current assets	5	6
Total current assets	1,953	1,738
Property, Plant, and Equipment:		
In service	23,080	22,092
Less accumulated provision for depreciation	8,522	8,114
Plant in service, net of depreciation	14,558	13,978
Nuclear fuel, at amortized cost	348	332
Construction work in progress	1,006	748
Total property, plant, and equipment	15,912	15,058
Other Property and Investments:		
Equity investments in unconsolidated subsidiaries	66	54
Nuclear decommissioning trusts, at fair value	756	714
Miscellaneous property and investments	84	80
Total other property and investments	906	848
Deferred Charges and Other Assets:		
Deferred charges related to income taxes	525	519
Prepaid pension costs	—	276
Deferred under recovered regulatory clause revenues	31	25
Other regulatory assets, deferred	1,063	645
Other deferred charges and assets	162	142
Total deferred charges and other assets	1,781	1,607
Total Assets	\$ 20,552	\$ 19,251

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

BALANCE SHEETS
At December 31, 2014 and 2013
Alabama Power Company 2014 Annual Report

Liabilities and Stockholder's Equity	2014	2013
	<i>(in millions)</i>	
Current Liabilities:		
Securities due within one year	\$ 454	\$ —
Accounts payable —		
Affiliated	248	198
Other	443	339
Customer deposits	87	85
Accrued taxes —		
Accrued income taxes	2	11
Other accrued taxes	37	33
Accrued interest	66	61
Accrued vacation pay	54	53
Accrued compensation	131	74
Other regulatory liabilities, current	2	37
Other current liabilities	80	41
Total current liabilities	1,604	932
Long-Term Debt (See accompanying statements)	6,176	6,233
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	3,874	3,603
Deferred credits related to income taxes	72	75
Accumulated deferred investment tax credits	125	133
Employee benefit obligations	326	195
Asset retirement obligations	829	730
Other cost of removal obligations	744	828
Other regulatory liabilities, deferred	239	259
Deferred over recovered regulatory clause revenues	47	15
Other deferred credits and liabilities	79	61
Total deferred credits and other liabilities	6,335	5,899
Total Liabilities	14,115	13,064
Redeemable Preferred Stock (See accompanying statements)	342	342
Preference Stock (See accompanying statements)	343	343
Common Stockholder's Equity (See accompanying statements)	5,752	5,502
Total Liabilities and Stockholder's Equity	\$ 20,552	\$ 19,251
Commitments and Contingent Matters (See notes)		

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

STATEMENTS OF CAPITALIZATION
At December 31, 2014 and 2013
Alabama Power Company 2014 Annual Report

	2014	2013	2014	2013
	<i>(in millions)</i>		<i>(percent of total)</i>	
Long-Term Debt:				
Long-term debt payable to affiliated trusts —				
Variable rate (3.36% at 1/1/15) due 2042	\$ 206	\$ 206		
Long-term notes payable —				
0.55% due 2015	400	400		
5.20% due 2016	200	200		
5.50% to 5.55% due 2017	525	525		
5.13% due 2019	200	200		
3.375% to 6.125% due 2020-2044	3,950	3,550		
Total long-term notes payable	5,275	4,875		
Other long-term debt —				
Pollution control revenue bonds —				
0.28% to 5.00% due 2034	367	367		
Variable rate (0.03% at 1/1/15) due 2015	54	54		
Variable rates (0.04% to 0.06% at 1/1/15) due 2017	36	36		
Variable rates (0.01% to 0.06% at 1/1/15) due 2021-2038	694	694		
Total other long-term debt	1,151	1,151		
Capitalized lease obligations	5	5		
Unamortized debt discount, net	(7)	(4)		
Total long-term debt (annual interest requirement — \$259 million)	6,630	6,233		
Less amount due within one year	454	—		
Long-term debt excluding amount due within one year	6,176	6,233	49.0%	50.2%
Redeemable Preferred Stock:				
<u>Cumulative redeemable preferred stock</u>				
\$100 par or stated value — 4.20% to 4.92%				
Authorized — 3,850,000 shares				
Outstanding — 475,115 shares	48	48		
\$1 par value — 5.20% to 5.83%				
Authorized — 27,500,000 shares				
Outstanding — 12,000,000 shares: \$25 stated value (annual dividend requirement — \$18 million)	294	294		
Total redeemable preferred stock	342	342	2.7	2.7
Preference Stock:				
Authorized — 40,000,000 shares				
Outstanding — \$1 par value — 5.63% to 6.50% — 14,000,000 shares (noncumulative): \$25 stated value (annual dividend requirement — \$21 million)	343	343	2.7	2.8
Common Stockholder's Equity:				
Common stock, par value \$40 per share —				
Authorized — 40,000,000 shares				
Outstanding — 30,537,500 shares	1,222	1,222		
Paid-in capital	2,304	2,262		
Retained earnings	2,255	2,044		
Accumulated other comprehensive loss	(29)	(26)		
Total common stockholder's equity	5,752	5,502	45.6	44.3
Total Capitalization	\$ 12,613	\$ 12,420	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, 2014, 2013, and 2012
Alabama Power Company 2014 Annual Report

	Number of Common Shares Issued	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	<i>(in millions)</i>					
Balance at December 31, 2011	31	\$ 1,222	\$ 2,182	\$ 1,956	\$ (18)	\$ 5,342
Net income after dividends on preferred and preference stock	—	—	—	704	—	704
Capital contributions from parent company	—	—	45	—	—	45
Other comprehensive income (loss)	—	—	—	—	(9)	(9)
Cash dividends on common stock	—	—	—	(684)	—	(684)
Balance at December 31, 2012	31	1,222	2,227	1,976	(27)	5,398
Net income after dividends on preferred and preference stock	—	—	—	712	—	712
Capital contributions from parent company	—	—	35	—	—	35
Other comprehensive income (loss)	—	—	—	—	1	1
Cash dividends on common stock	—	—	—	(644)	—	(644)
Balance at December 31, 2013	31	1,222	2,262	2,044	(26)	5,502
Net income after dividends on preferred and preference stock	—	—	—	761	—	761
Capital contributions from parent company	—	—	42	—	—	42
Other comprehensive income (loss)	—	—	—	—	(3)	(3)
Cash dividends on common stock	—	—	—	(550)	—	(550)
Balance at December 31, 2014	31	\$ 1,222	\$ 2,304	\$ 2,255	\$ (29)	\$ 5,752

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

NOTES TO FINANCIAL STATEMENTS
Alabama Power Company 2014 Annual Report

Index to the Notes to Financial Statements

<u>Note</u>		<u>Page</u>
1	Summary of Significant Accounting Policies.....	35
2	Retirement Benefits.....	42
3	Contingencies and Regulatory Matters.....	52
4	Joint Ownership Agreements.....	56
5	Income Taxes.....	57
6	Financing.....	59
7	Commitments.....	62
8	Stock Compensation.....	63
9	Nuclear Insurance.....	64
10	Fair Value Measurements.....	65
11	Derivatives.....	68
12	Quarterly Financial Information (Unaudited).....	73

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

Alabama Power Company (the Company) is a wholly owned subsidiary of The Southern Company (Southern Company), which is the parent company of four traditional operating companies, Southern Power, SCS, SouthernLINC Wireless, Southern Company Holdings, Inc. (Southern Holdings), Southern Nuclear, and other direct and indirect subsidiaries. The traditional operating companies – the Company, Georgia Power, Gulf Power, and Mississippi Power – are vertically integrated utilities providing electric service in four Southeastern states. The Company operates as a vertically integrated utility providing electricity to retail and wholesale customers within its traditional service territory located in the State of Alabama in addition to wholesale customers in the Southeast. Southern Power constructs, acquires, owns, and manages generation assets, including renewable energy projects, 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 primarily for Southern Company's investments in leveraged leases. Southern Nuclear operates and provides services to the Southern Company system's nuclear power plants, including the Company's Plant Farley.

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

The Company is subject to regulation by the FERC and the Alabama PSC. The Company follows GAAP in the U.S. and complies with the accounting policies and practices prescribed by its regulatory commissions. The preparation of financial statements in conformity with GAAP requires the use of estimates, and the actual results may differ from those estimates. Certain prior years' data presented in the financial statements have been reclassified to conform to the current year presentation.

Recently Issued Accounting Standards

On May 28, 2014, the Financial Accounting Standards Board issued ASC 606, Revenue from Contracts with Customers. ASC 606 revises the accounting for revenue recognition and is effective for fiscal years beginning after December 15, 2016. The Company continues to evaluate the requirements of ASC 606. The ultimate impact of the new standard has not yet been determined.

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, operations, purchasing, accounting, finance and treasury, tax, information technology, marketing, auditing, insurance and pension administration, human resources, systems and procedures, digital wireless communications, and other services with respect to business and operations, construction management, and power pool transactions. Costs for these services amounted to \$400 million, \$340 million, and \$340 million during 2014, 2013, and 2012, respectively. Cost allocation methodologies used by SCS prior to the repeal of the Public Utility Holding Company Act of 1935, as amended, were approved by the SEC. Subsequently, additional cost allocation methodologies have been reported to the FERC and management believes they are reasonable. The FERC permits services to be rendered at cost by system service companies.

The Company has an agreement with Southern Nuclear under which the following nuclear-related services are rendered to the Company at cost: general executive and advisory services, general operations, management and technical services, administrative services including procurement, accounting, employee relations, systems and procedures services, strategic planning and budgeting services, and other services with respect to business and operations. Costs for these services amounted to \$234 million, \$211 million, and \$218 million during 2014, 2013, and 2012, respectively.

The Company jointly owns Plant Greene County with Mississippi Power. The Company has an agreement with Mississippi Power under which the Company operates Plant Greene County, and Mississippi Power reimburses the Company for its proportionate share of non-fuel expenses, which were \$13 million in 2014, \$13 million in 2013, and \$12 million in 2012. Also, Mississippi Power reimburses the Company for any direct fuel purchases delivered from one of the Company's transfer facilities, which were \$34 million in 2014, \$27 million in 2013, and \$28 million in 2012. See Note 4 for additional information.

The Company has an agreement with Gulf Power under which the Company has made transmission system upgrades to ensure firm delivery of energy under a non-affiliate PPA. In 2009, Gulf Power entered into a PPA for the capacity and energy from a combined cycle plant located in Autauga County, Alabama. The total cost committed by the Company related to the upgrades is approximately \$85 million, of which approximately \$29 million was spent in 2014. The transmission improvements were completed in 2014. The Company expects to recover a majority of these costs through a tariff with Gulf Power until 2023. The remainder of these costs will be recovered through normal rate mechanisms.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

The Company provides incidental services to and receives such services from other Southern Company subsidiaries which are generally minor in duration and amount. Except as described herein, the Company neither provided nor received any material services to or from affiliates in 2014, 2013, or 2012.

Also, see Note 4 for information regarding the Company's ownership in a PPA and a gas pipeline ownership agreement with SEGCO.

The traditional operating companies, including the Company and Southern Power, 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 7 under "Fuel and Purchased Power Agreements" for additional information.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

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:

	2014	2013	Note
	<i>(in millions)</i>		
Deferred income tax charges	\$ 525	\$ 519	(a,k)
Loss on reacquired debt	80	86	(b)
Vacation pay	65	63	(c,j)
Under/(over) recovered regulatory clause revenues	57	(18)	(d)
Fuel-hedging losses	53	8	(e)
Other regulatory assets	49	52	(f)
Asset retirement obligations	(125)	(132)	(a)
Other cost of removal obligations	(744)	(828)	(a)
Deferred income tax credits	(72)	(75)	(a)
Fuel-hedging gains	(1)	(8)	(e)
Nuclear outage	56	51	(d)
Natural disaster reserve	(84)	(96)	(h)
Other regulatory liabilities	(8)	(11)	(d,g)
Retiree benefit plans	882	461	(i,j)
Regulatory deferrals	13	20	(l)
Nuclear fuel disposal fee	(8)	—	(m)
Total regulatory assets (liabilities), net	\$ 738	\$ 92	

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

- (a) Asset retirement and removal assets and liabilities are recorded, deferred income tax assets are recovered, and deferred income tax liabilities are amortized over the related property lives, which may range up to 50 years. Asset retirement and removal assets and liabilities will be settled and trued up following completion of the related activities.
- (b) Recovered over the remaining life of the original issue, which may range up to 50 years.
- (c) Recorded as earned by employees and recovered as paid, generally within one year. This includes both vacation and banked holiday pay.
- (d) Recorded and recovered or amortized as approved or accepted by the Alabama PSC over periods not exceeding 10 years.
- (e) Fuel-hedging assets and liabilities are recorded over the life of the underlying hedged purchase contracts, which generally do not exceed three years. Upon final settlement, actual costs incurred are recovered through the energy cost recovery clause.
- (f) Comprised of components including generation site selection/evaluation costs, PPA capacity, and other miscellaneous assets. Recorded as accepted by the Alabama PSC. Capitalized upon initialization of related construction projects, if applicable.
- (g) Comprised of components including mine reclamation and remediation liabilities and other liabilities. Recorded as accepted by the Alabama PSC. Mine reclamation and remediation liabilities will be settled following completion of the related activities.
- (h) Utilized as storm restoration and potential reliability-related expenses are incurred, as approved by the Alabama PSC.
- (i) Recovered and amortized over the average remaining service period which may range up to 15 years. See Note 2 for additional information.
- (j) Not earning a return as offset in rate base by a corresponding asset or liability.
- (k) Included in the deferred income tax charges are \$18 million for 2014 and \$20 million for 2013 for the retiree Medicare drug subsidy, which is recovered and amortized, as approved by the Alabama PSC, over the average remaining service period which may range up to 15 years.
- (l) Recorded and amortized as approved by the Alabama PSC for a period of five years.
- (m) Recorded as approved by the Alabama PSC related to potential future fees for nuclear waste disposal. The term of deferral is conditional upon resolution by the DOE. See Note 3 for additional information.

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 to income or reclassify to accumulated OCI related regulatory assets and liabilities that are not specifically recoverable through regulated rates. In addition, the Company would be required to determine if any

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

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. See Note 3 under "Retail Regulatory Matters" for additional information.

Revenues

Wholesale capacity revenues from PPAs are recognized either on a levelized basis over the appropriate contract period or the amount billable under the contract terms. 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. Electric rates for the Company include provisions to adjust billings for fluctuations in fuel costs, fuel hedging, the energy component of purchased power costs, and certain other 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. The Company continuously monitors the under/over recovered balances and files for revised rates as required or when management deems appropriate, depending on the rate. See Note 3 under "Retail Regulatory Matters – Rate ECR" and "Retail Regulatory Matters – Rate CNP" 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. Fuel expense generally includes fuel transportation costs and the cost of purchased emissions allowances as they are used. Fuel expense also includes the amortization of the cost of nuclear fuel and a charge, based on nuclear generation, for the permanent disposal of spent nuclear fuel.

See Note 3 under "Retail Regulatory Matters – Nuclear Waste Fund Fee Accounting Order" for additional information.

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. Federal ITCs 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 any 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 cost of equity funds used during construction.

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

	2014	2013
	<i>(in millions)</i>	
Generation	\$ 11,670	\$ 11,314
Transmission	3,579	3,287
Distribution	6,196	5,934
General	1,623	1,545
Plant acquisition adjustment	12	12
Total plant in service	\$ 23,080	\$ 22,092

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 other operations and maintenance expenses as incurred or performed with the exception of nuclear refueling costs, which are recorded in accordance with specific Alabama PSC orders.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Nuclear Outage Accounting Order

In accordance with an Alabama PSC order, nuclear outage operations and maintenance expenses for the two units at Plant Farley are deferred to a regulatory asset when the charges actually occur and are then amortized over a subsequent 18-month period with the fall outage costs amortization beginning in January of the following year and the spring outage costs amortization beginning in July of the same year.

Depreciation and Amortization

Depreciation of the original cost of utility plant in service is provided primarily by using composite straight-line rates, which approximated 3.3% in 2014 and 3.2% in 2013 and 2012. Depreciation studies are conducted periodically to update the composite rates and the information is provided to the Alabama PSC and the FERC. When property subject to composite 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 are 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.

In 2014, the Company submitted a depreciation study to the FERC and received authorization to use the recommended rates beginning January 2015. The study was also provided to the Alabama PSC.

Asset Retirement Obligations and Other Costs of Removal

Asset retirement obligations (ARO) 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 accounting guidance from the Alabama 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 for AROs primarily relates to the decommissioning of the Company's nuclear facility, Plant Farley. In addition, the Company has retirement obligations related to various landfill sites, underground storage tanks, asbestos removal, disposal of polychlorinated biphenyls in certain transformers, and disposal of sulfur hexafluoride gas in certain substation breakers. The Company also has identified retirement obligations related to certain transmission and distribution facilities and certain wireless communication towers. However, liabilities for the removal of these assets have not been recorded because the settlement timing for the retirement obligations related to these assets is indeterminable and, therefore, the fair value of the retirement obligations cannot be reasonably estimated. A liability for these AROs will be recognized when sufficient information becomes available to support a reasonable estimation of the ARO. 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 Alabama PSC, and are reflected in the balance sheets. See "Nuclear Decommissioning" herein for additional information on amounts included in rates.

Details of the AROs included in the balance sheets are as follows:

	2014	2013
	<i>(in millions)</i>	
Balance at beginning of year	\$ 730	\$ 589
Liabilities incurred	1	—
Liabilities settled	(3)	(1)
Accretion	45	40
Cash flow revisions	56	102
Balance at end of year	\$ 829	\$ 730

The cash flow revisions in 2014 are primarily related to the Company's AROs associated with asbestos at its steam generation facilities. The cash flow revisions in 2013 are primarily related to revisions to the nuclear decommissioning ARO based on the Company's updated decommissioning study.

On December 19, 2014, the EPA issued the Disposal of Coal Combustion Residuals from Electric Utilities final rule (CCR Rule), but has not yet published it in the Federal Register. The CCR Rule will regulate the disposal of CCR, including coal ash and gypsum, as non-hazardous solid waste in landfills and surface impoundments at active generating power plants. The ultimate

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

impact of the CCR Rule cannot be determined at this time and will depend on the Company's ongoing review of the CCR Rule, the results of initial and ongoing minimum criteria assessments, and the outcome of legal challenges. The cost and timing of potential ash pond closure and ongoing monitoring activities that may be required in connection with the CCR Rule is also uncertain; however, the Company has developed a preliminary nominal dollar estimate of costs associated with closure and groundwater monitoring of ash ponds in place of approximately \$311 million and ongoing post-closure care of approximately \$49 million. The Company will record AROs for the estimated closure costs required under the CCR Rule during 2015. SEGCO, which is jointly owned with Georgia Power, will also record an ARO for ash ponds commonly used at Plant E.C. Gaston. The Company's results of operations, cash flows, and financial condition could be significantly impacted if such costs are not recovered through regulated rates.

Nuclear Decommissioning

The NRC requires licensees of commercial nuclear power reactors to establish a plan for providing reasonable assurance of funds for future decommissioning. The Company has external trust funds (Funds) to comply with the NRC's regulations. Use of the Funds is restricted to nuclear decommissioning activities. The Funds are managed and invested in accordance with applicable requirements of various regulatory bodies, including the NRC, the FERC, and the Alabama PSC, as well as the IRS. While the Company is allowed to prescribe an overall investment policy to the Funds' managers, the Company and its affiliates are not allowed to engage in the day-to-day management of the Funds or to mandate individual investment decisions. Day-to-day management of the investments in the Funds is delegated to unrelated third party managers with oversight by the management of the Company. The Funds' managers are authorized, within certain investment guidelines, to actively buy and sell securities at their own discretion in order to maximize the return on the Funds' investments. The Funds are invested in a tax-efficient manner in a diversified mix of equity and fixed income securities and are reported as trading securities.

The Company records the investment securities held in the Funds at fair value, as disclosed in Note 10, as management believes that fair value best represents the nature of the Funds. Gains and losses, whether realized or unrealized, are recorded in the regulatory liability for AROs in the balance sheets and are not included in net income or OCI. Fair value adjustments and realized gains and losses are determined on a specific identification basis.

At December 31, 2014, investment securities in the Funds totaled \$754 million, consisting of equity securities of \$583 million, debt securities of \$163 million, and \$8 million of other securities. At December 31, 2013, investment securities in the Funds totaled \$713 million, consisting of equity securities of \$566 million, debt securities of \$131 million, and \$16 million of other securities. These amounts exclude receivables related to investment income and pending investment sales and payables related to pending investment purchases.

Sales of the securities held in the Funds resulted in cash proceeds of \$244 million, \$279 million, and \$193 million in 2014, 2013, and 2012, respectively, all of which were reinvested. For 2014, fair value increases, including reinvested interest and dividends and excluding the Funds' expenses, were \$54 million, of which \$2 million related to realized gains and \$19 million related to unrealized gains related to securities held in the Funds at December 31, 2014. For 2013, fair value increases, including reinvested interest and dividends and excluding the Funds' expenses, were \$120 million, of which \$5 million related to realized gains and \$85 million related to unrealized gains related to securities held in the Funds at December 31, 2013. For 2012, fair value increases, including reinvested interest and dividends and excluding the Funds' expenses, were \$70 million, of which \$4 million related to realized gains and \$50 million related to unrealized losses related to securities held in the Funds at December 31, 2012. While the investment securities held in the Funds are reported as trading securities, the Funds continue to be managed with a long-term focus. Accordingly, all purchases and sales within the Funds are presented separately in the statements of cash flows as investing cash flows, consistent with the nature of the securities and purpose for which the securities were acquired.

Amounts previously recorded in internal reserves are being transferred into the Funds over periods approved by the Alabama PSC. The NRC's minimum external funding requirements are based on a generic estimate of the cost to decommission only the radioactive portions of a nuclear unit based on the size and type of reactor. The Company has filed a plan with the NRC designed to ensure that, over time, the deposits and earnings of the Funds will provide the minimum funding amounts prescribed by the NRC.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

At December 31, the accumulated provisions for decommissioning were as follows:

	2014	2013
	<i>(in millions)</i>	
External trust funds	\$ 754	\$ 713
Internal reserves	21	21
Total	\$ 775	734

Site study costs is the estimate to decommission a facility as of the site study year. The estimated costs of decommissioning as of December 31, 2014 based on the most current study performed in 2013 for Plant Farley are as follows:

Decommissioning periods:		
Beginning year		2037
Completion year		2076
		<i>(in millions)</i>
Site study costs:		
Radiated structures		\$ 1,362
Non-radiated structures		80
Total site study costs		\$ 1,442

The decommissioning cost estimates are based on prompt dismantlement and removal of the plant from service. The actual decommissioning costs may vary from the above estimates because of changes in the assumed date of decommissioning, changes in NRC requirements, or changes in the assumptions used in making these estimates.

For ratemaking purposes, the Company's decommissioning costs are based on the site study. Significant assumptions used to determine these costs for ratemaking were an inflation rate of 4.5% and a trust earnings rate of 7.0%. The next site study is expected to be conducted in 2018.

Amounts previously contributed to the Funds are currently projected to be adequate to meet the decommissioning obligations. The Company will continue to provide site-specific estimates of the decommissioning costs and related projections of funds in the external trust to the Alabama PSC and, if necessary, would seek the Alabama PSC's approval to address any changes in a manner consistent with NRC and other applicable requirements.

Allowance for Funds Used During Construction

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, AFUDC increases the revenue requirement and is recovered 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. All current construction costs are included in retail rates. The AFUDC composite rate as of December 31 was 8.8% in 2014, 9.1% in 2013, and 9.4% in 2012. AFUDC, net of income taxes, as a percent of net income after dividends on preferred and preference stock was 7.9% in 2014, 5.4% in 2013, and 3.3% in 2012.

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.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

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 cost of coal, natural gas, oil, transportation, and emissions allowances. Fuel is charged to inventory when purchased and then expensed, at weighted average cost, as used and recovered by the Company through energy cost recovery rates approved by the Alabama PSC. Emissions allowances granted by the 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 10 for additional information regarding fair value. Substantially all of the Company's bulk energy purchases and sales contracts that meet the definition of a derivative are excluded from fair value accounting requirements because they qualify for the "normal" scope exception, and are accounted for under the accrual method. Derivative contracts that qualify as cash flow hedges of anticipated transactions or are recoverable through the Alabama PSC-approved fuel-hedging program result in the deferral of related gains and losses in OCI or regulatory assets and liabilities, respectively, until the hedged transactions occur. If any, immaterial ineffectiveness arising from cash flow hedges is recognized currently in net income. Other derivative contracts that qualify as fair value hedges are marked to market through current period income and are recorded on a net basis in the statements of income. See Note 11 for additional information regarding derivatives.

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 had no outstanding collateral repayment obligations or rights to reclaim collateral arising from derivative instruments recognized at December 31, 2014.

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.

Variable Interest Entities

The primary beneficiary of a VIE is required to consolidate the VIE when it has both the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

The Company has established a wholly-owned trust to issue preferred securities. See Note 6 under "Long-Term Debt Payable to an Affiliated Trust" for additional information. However, the Company is not considered the primary beneficiary of the trust. Therefore, the investment in the trust is reflected as other investments, and the related loan from the trust is reflected as long-term debt in the balance sheets.

2. RETIREMENT BENEFITS

The Company has a defined benefit, trustee, pension plan covering substantially all employees. This qualified pension plan is funded in accordance with requirements of the Employee Retirement Income Security Act of 1974, as amended (ERISA). No contributions were made to the qualified pension plan during 2014. No mandatory contributions to the qualified pension plan

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

are anticipated for the year ending December 31, 2015. The Company also provides certain defined benefit pension plans 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 its other postretirement trusts to the extent required by the Alabama PSC and the FERC. For the year ending December 31, 2015, other postretirement trusts contributions are expected to total approximately \$2 million.

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 2011 for the 2012 plan year using discount rates for the pension plans and the other postretirement benefit plans of 4.98% and 4.88%, respectively, and an annual salary increase of 3.84%.

	2014	2013	2012
Discount rate:			
Pension plans	4.18%	5.02%	4.27%
Other postretirement benefit plans	4.04	4.86	4.06
Annual salary increase	3.59	3.59	3.59
Long-term return on plan assets:			
Pension plans	8.20	8.20	8.20
Other postretirement benefit plans	7.34	7.36	7.19

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 target asset allocation, an anticipated inflation rate, and the projected impact of a periodic rebalancing of each trust's portfolio.

For purposes of its December 31, 2014 measurement date, the Company adopted new mortality tables for its pension plans and retiree life and medical plans, which reflect increased life expectancies in the U.S. The adoption of new mortality tables increased the projected benefit obligations for the Company's pension plans and other postretirement benefit plans by approximately \$156 million and \$22 million, respectively.

An additional assumption used in measuring the accumulated other postretirement benefit obligations (APBO) was a weighted average medical care cost trend rate. The weighted average medical care cost trend rates used in measuring the APBO as of December 31, 2014 were as follows:

	Initial Cost Trend Rate	Ultimate Cost Trend Rate	Year That Ultimate Rate is Reached
Pre-65	9.00%	4.50%	2024
Post-65 medical	6.00	4.50	2024
Post-65 prescription	6.75	4.50	2024

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, 2014 as follows:

	1 Percent Increase	1 Percent Decrease
	<i>(in millions)</i>	
Benefit obligation	\$ 34	\$ (29)
Service and interest costs	1	(1)

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Pension Plans

The total accumulated benefit obligation for the pension plans was \$2.4 billion at December 31, 2014 and \$1.9 billion at December 31, 2013. Changes in the projected benefit obligations and the fair value of plan assets during the plan years ended December 31, 2014 and 2013 were as follows:

	2014	2013
	<i>(in millions)</i>	
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 2,112	\$ 2,218
Service cost	48	52
Interest cost	103	93
Benefits paid	(100)	(93)
Actuarial (gain) loss	429	(158)
Balance at end of year	2,592	2,112
Change in plan assets		
Fair value of plan assets at beginning of year	2,278	2,077
Actual return on plan assets	207	285
Employer contributions	11	9
Benefits paid	(100)	(93)
Fair value of plan assets at end of year	2,396	2,278
Prepaid pension costs (accrued liability)	\$ (196)	\$ 166

At December 31, 2014, the projected benefit obligations for the qualified and non-qualified pension plans were \$2.5 billion and \$123 million, respectively. All pension plan assets are related to the qualified pension plan.

Amounts recognized in the balance sheets at December 31, 2014 and 2013 related to the Company's pension plans consist of the following:

	2014	2013
	<i>(in millions)</i>	
Prepaid pension costs	\$ —	\$ 276
Other regulatory assets, deferred	827	476
Other current liabilities	(10)	(9)
Employee benefit obligations	(186)	(101)

Presented below are the amounts included in regulatory assets at December 31, 2014 and 2013 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 2015.

	2014	2013	Estimated Amortization in 2015
	<i>(in millions)</i>		
Prior service cost	\$ 12	\$ 19	\$ 6
Net (gain) loss	815	457	55
Regulatory assets	\$ 827	\$ 476	

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

The changes in the balance of regulatory assets related to the defined benefit pension plans for the years ended December 31, 2014 and 2013 are presented in the following table:

	2014	2013
	<i>(in millions)</i>	
Regulatory assets:		
Beginning balance	\$ 476	\$ 822
Net (gain) loss	389	(287)
Reclassification adjustments:		
Amortization of prior service costs	(7)	(7)
Amortization of net gain (loss)	(31)	(52)
Total reclassification adjustments	(38)	(59)
Total change	351	(346)
Ending balance	\$ 827	\$ 476

Components of net periodic pension cost were as follows:

	2014	2013	2012
	<i>(in millions)</i>		
Service cost	\$ 48	\$ 52	\$ 44
Interest cost	103	93	94
Expected return on plan assets	(168)	(157)	(162)
Recognized net (gain) loss	31	52	23
Net amortization	7	7	7
Net periodic pension cost	\$ 21	\$ 47	\$ 6

Net periodic pension cost 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, 2014, estimated benefit payments were as follows:

	Benefit Payments
	<i>(in millions)</i>
2015	\$ 127
2016	114
2017	120
2018	125
2019	129
2020 to 2024	708

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Other Postretirement Benefits

Changes in the APBO and in the fair value of plan assets during the plan years ended December 31, 2014 and 2013 were as follows:

	2014	2013
	<i>(in millions)</i>	
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 431	\$ 490
Service cost	5	6
Interest cost	20	19
Benefits paid	(27)	(24)
Actuarial (gain) loss	71	(62)
Retiree drug subsidy	3	2
Balance at end of year	503	431
Change in plan assets		
Fair value of plan assets at beginning of year	389	343
Actual return on plan assets	23	61
Employer contributions	4	7
Benefits paid	(24)	(22)
Fair value of plan assets at end of year	392	389
Accrued liability	\$ (111)	\$ (42)

Amounts recognized in the balance sheets at December 31, 2014 and 2013 related to the Company's other postretirement benefit plans consist of the following:

	2014	2013
	<i>(in millions)</i>	
Other regulatory assets, deferred	\$ 68	\$ 6
Other regulatory liabilities, deferred	(14)	(21)
Employee benefit obligations	(111)	(42)

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Presented below are the amounts included in net regulatory assets (liabilities) at December 31, 2014 and 2013 related to the other postretirement benefit plans that had not yet been recognized in net periodic other postretirement benefit cost along with the estimated amortization of such amounts for 2015.

	2014	2013	Estimated Amortization in 2015
		<i>(in millions)</i>	
Prior service cost	\$ 15	\$ 19	\$ 4
Net (gain) loss	39	(34)	2
Net regulatory assets (liabilities)	\$ 54	\$ (15)	

The changes in the balance of net regulatory assets (liabilities) related to the other postretirement benefit plans for the plan years ended December 31, 2014 and 2013 are presented in the following table:

	2014	2013
		<i>(in millions)</i>
Net regulatory assets (liabilities):		
Beginning balance	\$ (15)	\$ 89
Net gain (loss)	73	(99)
Reclassification adjustments:		
Amortization of prior service costs	(4)	(3)
Amortization of net gain (loss)	—	(2)
Total reclassification adjustments	(4)	(5)
Total change	69	(104)
Ending balance	\$ 54	\$ (15)

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

	2014	2013	2012
		<i>(in millions)</i>	
Service cost	\$ 5	\$ 6	\$ 5
Interest cost	20	19	22
Expected return on plan assets	(25)	(23)	(23)
Net amortization	4	5	6
Net periodic postretirement benefit cost	\$ 4	\$ 7	\$ 10

Future benefit payments, including prescription drug benefits, reflect expected future service and are estimated based on assumptions used to measure the APBO for the other postretirement benefit plans. Estimated benefit payments are reduced by drug subsidy receipts expected as a result of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 as follows:

	Benefit Payments	Subsidy Receipts	Total
		<i>(in millions)</i>	
2015	\$ 31	\$ (3)	\$ 28
2016	32	(3)	29
2017	32	(4)	28
2018	34	(4)	30
2019	34	(4)	30
2020 to 2024	172	(22)	150

Benefit Plan Assets

Pension plan and 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. The Company's investment policies for

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

both the pension plan and the other postretirement benefit plans cover 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 composition of the Company's pension plan and other postretirement benefit plan assets as of December 31, 2014 and 2013, along with the targeted mix of assets for each plan, is presented below:

	Target	2014	2013
Pension plan assets:			
Domestic equity	26%	30%	31%
International equity	25	23	25
Fixed income	23	27	23
Special situations	3	1	1
Real estate investments	14	14	14
Private equity	9	5	6
Total	100%	100%	100%
Other postretirement benefit plan assets:			
Domestic equity	48%	48%	47%
International equity	20	20	20
Domestic fixed income	24	26	27
Special situations	1	—	—
Real estate investments	4	4	4
Private equity	3	2	2
Total	100%	100%	100%

The investment strategy for plan assets related to the Company's qualified pension 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 and interest rates, 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.

Investment Strategies

Detailed below is a description of the investment strategies for each major asset category for the pension and other postretirement benefit plans disclosed above:

- ***Domestic equity.*** 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.*** A mix of growth stocks and value stocks with both developed and emerging market exposure, managed both actively and through passive index approaches.
- ***Fixed income.*** A mix of domestic and international bonds.
- ***Trust-owned life insurance (TOLI).*** Investments of the Company's taxable trusts aimed at minimizing the impact of taxes on the portfolio.
- ***Special situations.*** Investments in opportunistic strategies with the objective of diversifying and enhancing returns and exploiting short-term inefficiencies as well as investments in promising new strategies of a longer-term nature.
- ***Real estate investments.*** Investments 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.*** Investments in private partnerships that invest in private or public securities typically through privately-negotiated and/or structured transactions, including leveraged buyouts, venture capital, and distressed debt.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Benefit Plan Asset Fair Values

Following are the fair value measurements for the pension plan and the other postretirement benefit plan assets as of December 31, 2014 and 2013. The fair values presented are prepared in accordance with GAAP. For purposes of determining the fair value of the pension plan and other postretirement benefit 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.

Valuation methods of the primary fair value measurements disclosed in the following tables are as follows:

- **Domestic and international equity.** Investments in equity securities such as common stocks, American depositary receipts, and real estate investment trusts that trade on a public exchange are classified as Level 1 investments and are valued at the closing price in the active market. Equity investments with unpublished prices (i.e. pooled funds) are valued as Level 2, when the underlying holdings used to value the investment are comprised of Level 1 or Level 2 equity securities.
- **Fixed income.** Investments in fixed income securities are generally classified as Level 2 investments and are valued based on prices reported in the market place. Additionally, the value of fixed income securities takes into consideration certain items such as broker quotes, spreads, yield curves, interest rates, and discount rates that apply to the term of a specific instrument.
- **TOLI.** Investments in TOLI policies are classified as Level 2 investments and are valued based on the underlying investments held in the policy's separate account. The underlying assets are equity and fixed income pooled funds that are comprised of Level 1 and Level 2 securities.
- **Real estate investments and private equity.** Investments in private equity and real estate are generally classified as Level 3 as the underlying assets typically do not have observable inputs. The fund manager values the assets using various inputs and techniques depending on the nature of the underlying investments. In the case of private equity, techniques may include purchase multiples for comparable transactions, comparable public company trading multiples, and discounted cash flow analysis. Real estate managers generally use prevailing market capitalization rates, recent sales of comparable investments, and independent third-party appraisals to value underlying real estate investments. The fair value of partnerships is determined by aggregating the value of the underlying assets.

The fair values of pension plan assets as of December 31, 2014 and 2013 are presented below. These fair value measurements exclude cash, receivables related to investment income, pending investments sales, and payables related to pending investment purchases. Assets that are considered special situations investments, primarily real estate investments and private equities, are presented in the tables below based on the nature of the investment.

	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
As of December 31, 2014:				
	<i>(in millions)</i>			
Assets:				
Domestic equity*	\$ 421	\$ 174	\$ —	\$ 595
International equity*	264	244	—	508
Fixed income:				
U.S. Treasury, government, and agency bonds	—	173	—	173
Mortgage- and asset-backed securities	—	47	—	47
Corporate bonds	—	280	—	280
Pooled funds	—	127	—	127
Cash equivalents and other	1	163	—	164
Real estate investments	73	—	277	350
Private equity	—	—	141	141
Total	\$ 759	\$ 1,208	\$ 418	\$ 2,385

* 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.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

As of December 31, 2013:	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	<i>(in millions)</i>			
Assets:				
Domestic equity*	\$ 374	\$ 219	\$ —	\$ 593
International equity*	287	265	—	552
Fixed income:				
U.S. Treasury, government, and agency bonds	—	156	—	156
Mortgage- and asset-backed securities	—	41	—	41
Corporate bonds	—	255	—	255
Pooled funds	—	123	—	123
Cash equivalents and other	—	58	—	58
Real estate investments	68	—	261	329
Private equity	—	—	149	149
Total	\$ 729	\$ 1,117	\$ 410	\$ 2,256
Liabilities:				
Derivatives	\$ —	\$ (1)	\$ —	\$ (1)
Total	\$ 729	\$ 1,116	\$ 410	\$ 2,255

* 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, 2014 and 2013 were as follows:

	2014		2013	
	Real Estate Investments	Private Equity	Real Estate Investments	Private Equity
	<i>(in millions)</i>			
Beginning balance	\$ 261	\$ 149	\$ 220	\$ 155
Actual return on investments:				
Related to investments held at year end	6	5	19	2
Related to investments sold during the year	8	(4)	8	13
Total return on investments	14	1	27	15
Purchases, sales, and settlements	2	(9)	14	(21)
Ending balance	\$ 277	\$ 141	\$ 261	\$ 149

The fair values of other postretirement benefit plan assets as of December 31, 2014 and 2013 are presented below. These fair value measurements exclude cash, receivables related to investment income, pending investments sales, and payables related to pending investment purchases. Assets that are considered special situations investments, primarily real estate investments and private equities, are presented in the tables below based on the nature of the investment.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

As of December 31, 2014:	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	<i>(in millions)</i>			
Assets:				
Domestic equity*	\$ 76	\$ 8	\$ —	\$ 84
International equity*	13	12	—	25
Fixed income:				
U.S. Treasury, government, and agency bonds	—	10	—	10
Mortgage- and asset-backed securities	—	2	—	2
Corporate bonds	—	14	—	14
Pooled funds	—	6	—	6
Cash equivalents and other	—	8	—	8
Trust-owned life insurance	—	217	—	217
Real estate investments	5	—	13	18
Private equity	—	—	7	7
Total	\$ 94	\$ 277	\$ 20	\$ 391

* 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.

As of December 31, 2013:	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	<i>(in millions)</i>			
Assets:				
Domestic equity*	\$ 67	\$ 11	\$ —	\$ 78
International equity*	14	13	—	27
Fixed income:				
U.S. Treasury, government, and agency bonds	—	17	—	17
Mortgage- and asset-backed securities	—	2	—	2
Corporate bonds	—	12	—	12
Pooled funds	—	6	—	6
Cash equivalents and other	—	10	—	10
Trust-owned life insurance	—	211	—	211
Real estate investments	4	—	13	17
Private equity	—	—	7	7
Total	\$ 85	\$ 282	\$ 20	\$ 387

* 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, 2014 and 2013 were as follows:

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

	2014		2013	
	Real Estate Investments	Private Equity	Real Estate Investments	Private Equity
	<i>(in millions)</i>			
Beginning balance	\$ 13	\$ 7	\$ 11	\$ 8
Actual return on investments:				
Related to investments held at year end	—	—	1	—
Related to investments sold during the year	—	—	—	—
Total return on investments	—	—	1	—
Purchases, sales, and settlements	—	—	1	(1)
Ending balance	\$ 13	\$ 7	\$ 13	\$ 7

Employee Savings Plan

The Company also sponsors a 401(k) defined contribution plan covering substantially all employees. The Company provides an 85% matching contribution on up to 6% of an employee's base salary. Total matching contributions made to the plan for 2014, 2013, and 2012 were \$21 million, \$20 million, and \$19 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 air quality and water standards, has occurred throughout the U.S. This litigation has included claims for damages alleged to have been caused by CO₂ and other emissions, CCR, and alleged exposure to hazardous materials, and/or requests for injunctive relief in connection with such matters. 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 ultimate liabilities, if any, arising from such current proceedings would have a material effect on the Company's financial statements.

Environmental Matters

New Source Review Actions

As part of a nationwide enforcement initiative against the electric utility industry which began in 1999, the EPA brought civil enforcement actions in federal district court against the Company alleging violations of the New Source Review (NSR) provisions of the Clean Air Act at certain coal-fired electric generating units, including a unit co-owned by Mississippi Power. These civil actions seek penalties and injunctive relief, including orders requiring installation of the best available control technologies at the affected units. The case against the Company (including claims involving a unit co-owned by Mississippi Power) has been actively litigated in the U.S. District Court for the Northern District of Alabama, resulting in a settlement in 2006 of the alleged NSR violations at Plant Miller; voluntary dismissal of certain claims by the EPA; and a grant of summary judgment for the Company on all remaining claims and dismissal of the case with prejudice in 2011. In September 2013, the U.S. Court of Appeals for the Eleventh Circuit affirmed in part and reversed in part the 2011 judgment in favor of the Company, and the case has been transferred back to the U.S. District Court for the Northern District of Alabama for further proceedings.

The Company believes it complied with applicable laws and regulations 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, depending on the date of the alleged violation. An adverse outcome could require substantial capital expenditures that cannot be determined at this time and could possibly require payment of substantial penalties. Such expenditures could affect future results of operations, cash flows, and financial condition if such costs are not recovered through regulated rates. The 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 could incur substantial costs to clean up

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

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. Amounts for cleanup and ongoing monitoring costs were not material for any year presented. The Company may be liable for some or all required cleanup costs for additional sites that may require environmental remediation.

Nuclear Fuel Disposal Costs

Acting through the DOE and pursuant to the Nuclear Waste Policy Act of 1982, the U.S. government entered into a contract with the Company that requires the DOE to dispose of spent nuclear fuel and high level radioactive waste generated at Plant Farley beginning no later than January 31, 1998. The DOE has yet to commence the performance of its contractual and statutory obligation to dispose of spent nuclear fuel. Consequently, the Company has pursued and continues to pursue legal remedies against the U.S. government for its partial breach of contract.

As a result of the first lawsuit, the Company recovered approximately \$17 million, representing the vast majority of the Company's direct costs of the expansion of spent nuclear fuel storage facilities at Plant Farley from 1998 through 2004. In 2012, the award was credited to cost of service for the benefit of customers.

On December 12, 2014, the Court of Federal Claims entered a judgment in favor of the Company in its second spent nuclear fuel lawsuit seeking damages for the period from January 1, 2005 through December 31, 2010. The Company was awarded approximately \$26 million. No amounts have been recognized in the financial statements as of December 31, 2014. The final outcome of this matter cannot be determined at this time; however, no material impact on the Company's net income is expected.

On March 4, 2014, the Company filed a third lawsuit against the U.S. government for the costs of continuing to store spent nuclear fuel at Plant Farley for the period from January 1, 2011 through December 31, 2013. Damages will continue to accumulate until the issue is resolved or storage is provided. No amounts have been recognized in the financial statements as of December 31, 2014 for any potential recoveries from the third lawsuit. The final outcome of this matter cannot be determined at this time; however, no material impact on the Company's net income is expected.

At Plant Farley, on-site dry spent fuel storage facilities are operational and can be expanded to accommodate spent fuel through the expected life of the plant.

Retail Regulatory Matters

Rate RSE

Rate RSE adjustments are based on forward-looking information for the applicable upcoming calendar year. Rate adjustments for any two-year period, when averaged together, cannot exceed 4.0% and any annual adjustment is limited to 5.0%. If the Company's actual retail return is above the allowed weighted cost of equity (WCE) range, customer refunds will be required; however, there is no provision for additional customer billings should the actual retail return fall below the WCE range. Prior to 2014, retail rates remained unchanged when the retail ROE was projected to be between 13.0% and 14.5%.

During 2013, the Alabama PSC held public proceedings regarding the operation and utilization of Rate RSE. In August 2013, the Alabama PSC voted to issue a report on Rate RSE that found that the Company's Rate RSE mechanism continues to be just and reasonable to customers and the Company, but recommended the Company modify Rate RSE as follows:

- Eliminate the provision of Rate RSE establishing an allowed range of ROE.
- Eliminate the provision of Rate RSE limiting the Company's capital structure to an allowed equity ratio of 45%.
- Replace these two provisions with a provision that establishes rates based upon the WCE range of 5.75% to 6.21%, with an adjusting point of 5.98%. If calculated under the previous Rate RSE provisions, the resulting WCE would range from 5.85% to 6.53%, with an adjusting point of 6.19%.
- Provide eligibility for a performance-based adder of seven basis points, or 0.07%, to the WCE adjusting point if the Company (i) has an "A" credit rating equivalent with at least one of the recognized rating agencies or (ii) is in the top one-third of a designated customer value benchmark survey.

Substantially all other provisions of Rate RSE were unchanged.

In August 2013, the Company filed its consent to these recommendations with the Alabama PSC. The changes became effective for calendar year 2014. In November 2013, the Company made its Rate RSE submission to the Alabama PSC of projected data for calendar year 2014; projected earnings were within the specified WCE range and, therefore, retail rates under Rate RSE remained unchanged for 2014. In 2012 and 2013, retail rates under Rate RSE remained unchanged from 2011. Under the terms of Rate RSE, the maximum possible increase for 2015 is 5.00%.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

On December 1, 2014, the Company submitted the required annual filing under Rate RSE to the Alabama PSC. The Rate RSE increase was 3.49%, or \$181 million annually, effective January 1, 2015. The revenue adjustment includes the performance based adder of 0.07%. Under the terms of Rate RSE, the maximum increase for 2016 cannot exceed 4.51%.

Rate CNP

The Company's retail rates, approved by the Alabama PSC, provide for adjustments to recognize the placing of new generating facilities into retail service under Rate CNP. The Company may also recover retail costs associated with certificated PPAs under Rate CNP PPA. On March 4, 2014, the Alabama PSC issued a consent order that the Company leave in effect the current Rate CNP PPA factor for billings for the period April 1, 2014 through March 31, 2015. It is anticipated that no adjustment will be made to Rate CNP PPA in 2015. As of December 31, 2014, the Company had an under recovered certificated PPA balance of \$56 million, of which \$27 million is included in under recovered regulatory clause revenues and \$29 million is included in deferred under recovered regulatory clause revenues in the balance sheet.

In 2011, the Alabama PSC approved and certificated a PPA of approximately 200 MWs of electricity from wind-powered generating facilities that became operational in 2012. In 2012, the Alabama PSC approved and certificated a second PPA of approximately 200 MWs of electricity from other wind-powered generating facilities which became operational in 2014. The terms of the PPAs permit the Company to use the energy and retire the associated environmental attributes in service of its customers or to sell the environmental attributes, separately or bundled with energy. The Company has elected the normal purchase normal sale (NPNS) scope exception under the derivative accounting rules for its two wind PPAs, which total approximately 400 MWs. The NPNS exception allows the PPAs to be recorded at a cost, rather than fair value, basis. The industry's application of the NPNS exception to certain physical forward transactions in nodal markets was previously under review by the SEC at the request of the electric utility industry. In June 2014, the SEC requested the Financial Accounting Standards Board to address the issue through the Emerging Issues Task Force (EITF). Any accounting decisions will now be subject to EITF deliberations. The outcome of the EITF's deliberations cannot be determined at this time. If the Company is ultimately required to record these PPAs at fair value, an offsetting regulatory asset or regulatory liability will be recorded.

Rate CNP Environmental allows for the recovery of the Company's retail costs associated with environmental laws, regulations, or other such mandates. Rate CNP Environmental is based on forward-looking information and provides for the recovery of these costs pursuant to a factor that is calculated annually. Environmental costs to be recovered include operations and maintenance expenses, depreciation, and a return on certain invested capital. There was no adjustment to Rate CNP Environmental in 2014. In August 2013, the Alabama PSC approved the Company's petition requesting a revision to Rate CNP Environmental that allows recovery of costs related to pre-2005 environmental assets previously being recovered through Rate RSE. The Rate CNP Environmental increase effective January 1, 2015 was 1.5%, or \$75 million annually, based upon projected billings. As of December 31, 2014, the Company had an under recovered environmental clause balance of \$49 million, of which \$47 million is included in under recovered regulatory clause revenues and \$2 million is included in deferred under recovered regulatory clause revenues in the balance sheet.

Rate ECR

The Company has established energy cost recovery rates under the Company's Rate ECR as approved by the Alabama PSC. Rates are based on an estimate of future energy costs and the current over or under recovered balance. Revenues recognized under Rate ECR and recorded on the financial statements are adjusted for the difference in actual recoverable fuel costs and amounts billed in current regulated rates. The difference in the recoverable fuel costs and amounts billed give rise to the over or under recovered amounts recorded as regulatory assets or liabilities. The Company, along with the Alabama PSC, continually monitors the over or under recovered cost balance to determine whether an adjustment to billing rates is required. Changes in the Rate ECR factor have no significant effect on the Company's net income, but will impact operating cash flows. Currently, the Alabama PSC may approve billing rates under Rate ECR of up to 5.910 cents per KWH. In December 2014, the Alabama PSC issued a consent order that the Company leave in effect for 2015 the energy cost recovery rates which began in 2011. Therefore, the Rate ECR factor as of January 1, 2015 remained at 2.681 cents per KWH. Effective with billings beginning in January 2016, the Rate ECR factor will be 5.910 cents per KWH, absent a further order from the Alabama PSC.

The Company's over recovered fuel costs at December 31, 2014 totaled \$47 million as compared to over recovered fuel costs of \$42 million at December 31, 2013. At December 31, 2014, \$47 million is included in deferred over recovered regulatory clause revenues. These classifications are based on estimates, which include such factors as weather, generation availability, energy demand, and the price of energy. A change in any of these factors could have a material impact on the timing of any recovery or return of fuel costs.

Rate NDR

Based on an order from the Alabama PSC, the Company maintains a reserve for operations and maintenance expenses to cover the cost of damages from major storms to its transmission and distribution facilities. The order approves a separate monthly Rate NDR charge to customers consisting of two components. The first component is intended to establish and maintain a

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

reserve balance for future storms and is an on-going part of customer billing. The second component of the Rate NDR charge is intended to allow recovery of any existing deferred storm-related operations and maintenance costs and any future reserve deficits over a 24-month period. The Alabama PSC order gives the Company authority to record a deficit balance in the NDR when costs of storm damage exceed any established reserve balance. Absent further Alabama PSC approval, the maximum total Rate NDR charge consisting of both components is \$10 per month per non-residential customer account and \$5 per month per residential customer account. The Company has the authority, based on an order from the Alabama PSC, to accrue certain additional amounts as circumstances warrant. The order allows for reliability-related expenditures to be charged against the additional accruals when the NDR balance exceeds \$75 million. The Company may designate a portion of the NDR to reliability-related expenditures as a part of an annual budget process for the following year or during the current year for identified unbudgeted reliability-related expenditures that are incurred. Accruals that have not been designated can be used to offset storm charges. Additional accruals to the NDR will enhance the Company's ability to deal with the financial effects of future natural disasters, promote system reliability, and offset costs retail customers would otherwise bear.

As revenue from the Rate NDR charge is recognized, an equal amount of operations and maintenance expenses related to the NDR will also be recognized. As a result, the Rate NDR charge will not have an effect on net income but will impact operating cash flows.

Environmental Accounting Order

Based on an order from the Alabama PSC, the Company is allowed to establish a regulatory asset to record the unrecovered investment costs, including the unrecovered plant asset balance and the unrecovered costs associated with site removal and closure associated with future unit retirements caused by environmental regulations. These costs would be amortized over the affected unit's remaining useful life, as established prior to the decision regarding early retirement.

As part of its environmental compliance strategy, the Company plans to retire Plant Gorgas Units 6 and 7. These units represent 200 MWs of the Company's approximately 12,200 MWs of generating capacity. The Company also plans to cease using coal at Plant Barry Units 1 and 2 (250 MWs), but such units will remain available on a limited basis with natural gas as the fuel source. Additionally, the Company expects to cease using coal at Plant Barry Unit 3 (225 MWs) and Plant Greene County Units 1 and 2 (300 MWs) and begin operating those units solely on natural gas. These plans are expected to be effective no later than April 2016.

In accordance with an accounting order from the Alabama PSC, the Company will transfer the unrecovered plant asset balances to a regulatory asset at their respective retirement dates. The regulatory asset will be amortized through Rate CNP Environmental over the remaining useful lives, as established prior to the decision for retirement. As a result, these decisions will not have a significant impact on the Company's financial statements.

Nuclear Waste Fund Accounting Order

In November 2013, the U.S. District Court for the District of Columbia ordered the DOE to cease collecting spent fuel depository fees from nuclear power plant operators until such time as the DOE either complies with the Nuclear Waste Policy Act of 1982 or until the U.S. Congress enacts an alternative waste management plan. In accordance with the court's order, the DOE submitted a proposal to the U.S. Congress to change the fee to zero. On March 18, 2014, the U.S. Court of Appeals for the District of Columbia Circuit denied the DOE's request for rehearing of the November 2013 panel decision ordering that the DOE propose the nuclear waste fund fee be changed to zero. The DOE formally set the fee to zero effective May 16, 2014.

On August 5, 2014, the Alabama PSC issued an order to provide for the continued recovery from customers of amounts associated with the permanent disposal of nuclear waste from the operation of Plant Farley. In accordance with the order, effective May 16, 2014, the Company is authorized to recover from customers an amount equal to the prior fee and to record the amounts in a regulatory liability account (approximately \$14 million annually). At December 31, 2014, the Company recorded an \$8 million regulatory liability which is included in other regulatory liabilities deferred in the balance sheet. Upon the DOE meeting the requirements of the Nuclear Waste Policy Act of 1982 and a new spent fuel depository fee being put in place, the accumulated balance in the regulatory liability account will be available for purposes of the associated cost responsibility. In the event the balance is later determined to be more than needed, those amounts would be used for the benefit of customers, subject to the approval of the Alabama PSC. The ultimate outcome of this matter cannot be determined at this time.

Compliance and Pension Cost Accounting Order

In 2012, the Alabama PSC approved an accounting order to defer to a regulatory asset account certain compliance-related operations and maintenance expenditures for the years 2013 through 2017, as well as the incremental increase in operations expense related to pension cost for 2013. These deferred costs would have been amortized over a three-year period beginning in January 2015. The compliance related expenditures were related to (i) standards addressing Critical Infrastructure Protection issued by the North American Electric Reliability Corporation, (ii) cyber security requirements issued by the NRC, and (iii) NRC guidance addressing the readiness at nuclear facilities within the U.S. for severe events.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

On November 3, 2014, the Alabama PSC issued an accounting order authorizing the Company to fully amortize the balances in certain regulatory asset accounts, including the \$28 million of compliance and pension costs accumulated at December 31, 2014. This amortization expense was offset by the amortization of the regulatory liability for other cost of removal obligations. See "Cost of Removal Accounting Order" herein for additional information. The cost of removal accounting order requires the Company to terminate, as of December 31, 2014, the regulatory asset accounts created pursuant to the compliance and pension cost accounting order. Consequently, the Company will not defer any expenditures in 2015, 2016, and 2017 related to critical electric infrastructure and domestic nuclear facilities under these orders.

Non-Nuclear Outage Accounting Order

In August 2013, the Alabama PSC approved an accounting order to defer to a regulatory asset account certain operations and maintenance expenses associated with planned outages at non-nuclear generation facilities in 2014 and to amortize those expenses over a three-year period beginning in 2015.

On November 3, 2014, the Alabama PSC issued an accounting order authorizing the Company to fully amortize the balances in certain regulatory asset accounts, including the \$95 million of non-nuclear outage costs accumulated at December 31, 2014. This amortization expense was reflected in other operations and maintenance and was offset by the amortization of the regulatory liability for other cost of removal obligations. See "Cost of Removal Accounting Order" herein for additional information. The cost of removal accounting order requires the Company to terminate, as of December 31, 2014, the regulatory asset accounts created pursuant to the non-nuclear outage accounting order.

Cost of Removal Accounting Order

In accordance with an accounting order issued on November 3, 2014 by the Alabama PSC, at December 31, 2014, the Company fully amortized the balance of \$123 million in certain regulatory asset accounts and offset this amortization expense with the amortization of \$120 million of the regulatory liability for other cost of removal obligations. The regulatory asset account balances amortized as of December 31, 2014 represented costs previously deferred under a compliance and pension cost accounting order as well as a non-nuclear outage accounting order, as discussed herein.

Non-Environmental Federal Mandated Costs Accounting Order

On December 9, 2014, pending the development of a new cost recovery mechanism, the Alabama PSC issued an accounting order authorizing the deferral as a regulatory asset of up to \$50 million of costs associated with non-environmental federal mandates that would otherwise impact rates in 2015.

On February 17, 2015, the Company filed a proposed modification to Rate CNP Environmental with the Alabama PSC to include compliance costs for both environmental and non-environmental mandates. The non-environmental costs that would be recovered through the revised mechanism concern laws, regulations, and other mandates directed at the utility industry involving the security, reliability, safety, sustainability, or similar considerations impacting the Company's facilities or operations. If approved as requested, the effective date for the revised mechanism would be March 20, 2015, upon which the regulatory asset balance would be reclassified to the under recovered balance for Rate CNP Environmental, and the related customer rates would not become effective before January 2016. The ultimate outcome of this matter cannot be determined at this time.

4. JOINT OWNERSHIP AGREEMENTS

The Company and Georgia Power own equally all of the outstanding capital stock of SEGCO, which owns electric generating units with a total rated capacity of 1,020 MWs, as well as associated transmission facilities. The capacity of these units is sold equally to the Company and Georgia Power under a power contract. The Company and Georgia Power make payments sufficient to provide for the operating expenses, taxes, interest expense, and ROE. The Company's share of purchased power totaled \$84 million in 2014, \$88 million in 2013, and \$109 million in 2012 and is included in "Purchased power from affiliates" in the statements of income. The Company accounts for SEGCO using the equity method.

In addition, the Company has guaranteed unconditionally the obligation of SEGCO under an installment sale agreement for the purchase of certain pollution control facilities at SEGCO's generating units, pursuant to which \$25 million principal amount of pollution control revenue bonds are outstanding. The Company has guaranteed \$100 million principal amount of unsecured senior notes issued by SEGCO for general corporate purposes. These senior notes mature on December 1, 2018. The Company had guaranteed \$50 million principal amount of unsecured senior notes issued by SEGCO for general corporate purposes, which matured on May 15, 2013. Georgia Power has agreed to reimburse the Company for the pro rata portion of such obligations corresponding to its then proportionate ownership of stock of SEGCO if the Company is called upon to make such payment under its guarantee.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

At December 31, 2014, the capitalization of SEGCO consisted of \$106 million of equity and \$125 million of long-term debt on which the annual interest requirement is \$3 million. In addition, SEGCO had short-term debt outstanding of \$42 million. SEGCO paid dividends of \$3 million in 2014, \$7 million in 2013, and \$14 million in 2012, of which one-half of each was paid to the Company. In addition, the Company recognizes 50% of SEGCO's net income.

SEGCO plans to add natural gas as the primary fuel source for 1,000 MWs of its generating capacity in 2015. A natural gas pipeline was constructed and will be placed in service in 2015. The Company, which owns and operates a generating unit adjacent to the SEGCO generating units, has entered into a joint ownership agreement with SEGCO for the ownership of the gas pipeline. The Company will own 14% of the pipeline with the remaining 86% owned by SEGCO. At December 31, 2014, the Company's portion of the construction work in progress associated with the pipeline is \$15 million.

In addition to the Company's ownership of SEGCO and joint ownership of the natural gas pipeline, the Company's percentage ownership and investment in jointly-owned coal-fired generating plants at December 31, 2014 were as follows:

Facility	Total MW Capacity	Company Ownership	Plant in Service	Accumulated Depreciation	Construction Work in Progress
				<i>(in millions)</i>	
Greene County Plant Miller	500	60.00% ⁽¹⁾	\$ 164	\$ 96	\$ 1
Units 1 and 2	1,320	91.84% ⁽²⁾	1,512	561	14

(1) Jointly owned with an affiliate, Mississippi Power.

(2) Jointly owned with PowerSouth Energy Cooperative, Inc.

The Company has contracted to operate and maintain the jointly-owned facilities as agent for their co-owners. The Company's proportionate share of its plant operating expenses is included in operating expenses in the statements of income and the Company is responsible for providing its own financing.

5. INCOME TAXES

On behalf of the Company, Southern Company files a consolidated federal income tax return and combined state income tax returns for the States of Alabama, Georgia, and Mississippi. In addition, the Company files a separate company income tax return for the State of Tennessee. Under a joint consolidated income tax allocation agreement, each Southern Company subsidiary's current and deferred tax expense is computed on a stand-alone basis and no subsidiary is allocated more current expense than would be paid if it filed a separate income tax return. In accordance with IRS regulations, each company is jointly and severally liable for the federal tax liability.

Current and Deferred Income Taxes

Details of income tax provisions are as follows:

	2014	2013	2012
		<i>(in millions)</i>	
Federal —			
Current	\$ 198	\$ 243	\$ 262
Deferred	225	160	137
	423	403	399
State —			
Current	44	36	51
Deferred	45	39	27
	89	75	78
Total	\$ 512	\$ 478	\$ 477

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

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:

	2014	2013
	<i>(in millions)</i>	
Deferred tax liabilities —		
Accelerated depreciation	\$ 3,429	\$ 3,187
Property basis differences	457	458
Premium on reacquired debt	30	33
Employee benefit obligations	215	209
Regulatory assets associated with employee benefit obligations	366	198
Asset retirement obligations	59	38
Regulatory assets associated with asset retirement obligations	285	265
Other	156	128
Total	4,997	4,516
Deferred tax assets —		
Federal effect of state deferred taxes	219	205
Unbilled fuel revenue	42	41
Storm reserve	27	32
Employee benefit obligations	400	231
Other comprehensive losses	19	18
Asset retirement obligations	344	303
Other	90	108
Total	1,141	938
Total deferred tax liabilities, net	3,856	3,578
Portion included in current assets/(liabilities), net	18	25
Accumulated deferred income taxes	\$ 3,874	\$ 3,603

The application of bonus depreciation provisions in current tax law has significantly increased deferred tax liabilities related to accelerated depreciation.

At December 31, 2014, the tax-related regulatory assets to be recovered from customers were \$526 million. These assets are primarily attributable to tax benefits flowed through to customers in prior years, deferred taxes previously recognized at rates lower than the current enacted tax law, and taxes applicable to capitalized interest.

At December 31, 2014, the tax-related regulatory liabilities to be credited to customers were \$72 million. These liabilities are primarily attributable to unamortized ITCs.

In accordance with regulatory requirements, deferred federal ITCs are amortized over the average life 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 \$8 million in 2014, 2013 and 2012. At December 31, 2014, all ITCs available to reduce federal income taxes payable had been utilized.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Effective Tax Rate

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

	2014	2013	2012
Federal statutory rate	35.0%	35.0%	35.0%
State income tax, net of federal deduction	4.4	4.0	4.1
Non-deductible book depreciation	1.1	1.0	0.9
Differences in prior years' deferred and current tax rates	(0.1)	(0.1)	(0.1)
AFUDC equity	(1.3)	(0.9)	(0.5)
Other	(0.1)	(0.1)	(0.3)
Effective income tax rate	39.0%	38.9%	39.1%

Unrecognized Tax Benefits

The Company had no unrecognized tax benefits during 2014. Changes in unrecognized tax benefits in prior years were as follows:

	2013	2012
	<i>(in millions)</i>	
Unrecognized tax benefits at beginning of year	\$ 31	\$ 32
Tax positions from current periods	—	5
Tax positions from prior periods	(31)	(4)
Reductions due to settlements	—	(2)
Balance at end of year	\$ —	\$ 31

The decrease in tax positions from prior periods for 2013 relates primarily to the tax accounting method change for repairs-generation assets, which did not impact the effective tax rate. See "Tax Method of Accounting for Repairs" herein for additional information.

These amounts are presented on a gross basis without considering the related federal or state income tax impact. The Company classifies interest on tax uncertainties as interest expense. Accrued interest for unrecognized tax benefits was immaterial for all periods presented. The Company did not accrue any penalties on uncertain tax positions.

The IRS has finalized its audits of Southern Company's consolidated federal income tax returns through 2012. Southern Company has filed its 2013 federal income tax return and has received a partial acceptance letter from the IRS; however, the IRS has not finalized its audit. Southern Company is a participant in the Compliance Assurance Process of the IRS. The audits for the Company's state income tax returns have either been concluded, or the statute of limitations has expired, for years prior to 2010.

Tax Method of Accounting for Repairs

In 2011, the IRS published regulations on the deduction and capitalization of expenditures related to tangible property that generally apply for tax years beginning on or after January 1, 2014. Additionally, in April 2013, the IRS issued Revenue Procedure 2013-24, which provides guidance for taxpayers related to the deductibility of repair costs associated with generation assets. Based on a review of the regulations, Southern Company incorporated provisions related to repair costs for generation assets into its consolidated 2012 federal income tax return and reversed all related unrecognized tax positions. In September 2013, the IRS issued Treasury Decision 9636, "Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property," which are final tangible property regulations applicable to taxable years beginning on or after January 1, 2014. Southern Company continues to review this guidance; however, these regulations are not expected to have a material impact on the Company's financial statements.

6. FINANCING

Long-Term Debt Payable to an Affiliated Trust

The Company has formed a wholly-owned trust subsidiary for the purpose of issuing preferred securities. The proceeds of the related equity investments and preferred security sales were loaned back to the Company through the issuance of junior subordinated notes totaling \$206 million as of December 31, 2014 and 2013, which constitute substantially all of the assets of

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

this trust and are reflected in the balance sheets as long-term debt payable. The Company considers that the mechanisms and obligations relating to the preferred securities issued for its benefit, taken together, constitute a full and unconditional guarantee by it of the trust's payment obligations with respect to these securities. At each of December 31, 2014 and 2013, trust preferred securities of \$200 million were outstanding. See Note 1 under "Variable Interest Entities" for additional information on the accounting treatment for this trust and the related securities.

Securities Due Within One Year

At December 31, 2014, the Company had \$454 million of senior notes and pollution control revenue bonds due within one year. At December 31, 2013, the Company had no scheduled maturities of senior notes or pollution control revenue bonds due within one year.

Maturities of senior notes and pollution control revenue bonds through 2019 applicable to total long-term debt are as follows: \$454 million in 2015; \$200 million in 2016; \$561 million in 2017; and \$200 million in 2019. There are no scheduled maturities in 2018.

Subsequent to December 31, 2014, the Company announced the redemption of \$250 million aggregate principal amount of its Series DD 5.65% Senior Notes due March 15, 2035 that will occur on March 16, 2015.

Pollution Control Revenue Bonds

Pollution control obligations represent loans to the Company from public authorities of funds or installment purchases of pollution control and solid waste disposal facilities financed by funds derived from sales by public authorities of revenue bonds. The Company is required to make payments sufficient for the authorities to meet principal and interest requirements of such bonds. In December 2014, the Company incurred obligations related to the issuance of \$254 million of The Industrial Development Board of the Town of Columbia, Pollution Control Revenue Refunding Bonds (Alabama Power Company Project), Series 2014 – A, Series 2014 – B, Series 2014 – C, and Series 2014 – D due December 1, 2037. The proceeds were used to refund in December 2014 approximately \$254 million of The Industrial Development Board of the Town of Columbia, Pollution Control Revenue Refunding Bonds (Alabama Power Company Project), Series 1995 – A, 1995 – B, 1995 – C, 1995 – D, 1995 – E, 1996 – A, 1999 – A, 1999 – B, and 1999 – C.

The amount of tax-exempt pollution control revenue bonds outstanding at December 31, 2014 and 2013 was \$1.2 billion, respectively.

Senior Notes

In August 2014, the Company issued \$400 million aggregate principal amount of Series 2014A 4.150% Senior Notes due August 15, 2044. The proceeds were used for general corporate purposes, including the Company's continuous construction program.

During 2014, the Company entered into forward-starting interest rate swaps to hedge exposure to interest rate changes related to an anticipated debt issuance. The notional amount of the swaps totaled \$200 million.

At December 31, 2014 and 2013, the Company had \$5.3 billion and \$4.9 billion of senior notes outstanding, respectively. As of December 31, 2014, the Company did not have any outstanding secured debt.

Outstanding Classes of Capital Stock

The Company currently has preferred stock, Class A preferred stock, preference stock, and common stock authorized and outstanding. 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 and involuntary dissolution. The preferred stock and Class A preferred stock of the Company contain a feature that allows the holders to elect a majority of the Company's board of directors if preferred dividends are not paid for four consecutive quarters. Because such a potential redemption-triggering event is not solely within the control of the Company, the preferred stock and Class A preferred stock is presented as "Redeemable Preferred Stock" in a manner consistent with temporary equity under applicable accounting standards. The preference stock does not contain such a provision that would allow the holders to elect a majority of the Company's board. The Company's preference stock ranks senior to the common stock with respect to the payment of dividends and voluntary or involuntary dissolution.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

The Company's preferred stock is subject to redemption at a price equal to the par value plus a premium. The Company's Class A preferred stock is subject to redemption at a price equal to the stated capital. Certain series of the Company's preference stock are subject to redemption at a price equal to the stated capital plus a make-whole premium based on the present value of the liquidation amount and future dividends to the first stated capital redemption date and the other series of preference stock are subject to redemption at a price equal to the stated capital. All series of the Company's preferred stock currently are subject to redemption at the option of the Company. Information for each outstanding series is in the table below:

Preferred/Preference Stock	Par Value/ Stated Capital Per Share	Shares Outstanding	Redemption Price Per Share
4.92% Preferred Stock	\$100	80,000	\$103.23
4.72% Preferred Stock	\$100	50,000	\$102.18
4.64% Preferred Stock	\$100	60,000	\$103.14
4.60% Preferred Stock	\$100	100,000	\$104.20
4.52% Preferred Stock	\$100	50,000	\$102.93
4.20% Preferred Stock	\$100	135,115	\$105.00
5.83% Class A Preferred Stock	\$25	1,520,000	Stated Capital
5.20% Class A Preferred Stock	\$25	6,480,000	Stated Capital
5.30% Class A Preferred Stock	\$25	4,000,000	Stated Capital
5.625% Preference Stock	\$25	6,000,000	Stated Capital
6.450% Preference Stock	\$25	6,000,000	*
6.500% Preference Stock	\$25	2,000,000	*

* Prior to 10/01/2017: Stated Value Plus Make-Whole Premium; after 10/01/2017: Stated Capital

Dividend Restrictions

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

Assets Subject to Lien

During 2014, all outstanding pollution control revenue bonds pursuant to which the Company granted liens on certain property were redeemed. There are no agreements or other arrangements among the Southern Company system 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 other subsidiaries.

Bank Credit Arrangements

At December 31, 2014, committed credit arrangements with banks were as follows:

Expires^(a)					Executable Term-Loans		Due Within One Year	
2015	2016	2018	Total	Unused	One Year	Two Years	Term Out	No Term Out
				<i>(in millions)</i>				
\$ 228	\$ 50	\$1,030	\$1,308	\$ 1,308	\$ 58	\$ —	\$ 58	\$ 170

(a) No credit arrangements expire in 2017.

The Company expects to renew its bank credit agreements as needed, prior to expiration. Most of the bank credit arrangements require payment of a commitment fee based on the unused portion of the commitments or the maintenance of compensating balances with the banks. Commitment fees average less than ¹/₁₀ of 1% for the Company. Compensating balances are not legally restricted from withdrawal.

Most of the Company's bank credit arrangements contain covenants that limit the Company's debt to 65% of total capitalization, as defined in the arrangements. For purposes of calculating these covenants, any long-term notes payable to affiliated trusts are excluded from debt but included in capitalization. Exceeding this debt level would result in a default under the credit arrangements. At December 31, 2014, the Company was in compliance with the debt limit covenants.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

A portion of the unused credit with banks is allocated to provide liquidity support to the Company's variable rate pollution control revenue bonds and commercial paper program. The amount of variable rate pollution control revenue bonds outstanding requiring liquidity support was \$784 million as of December 31, 2014. In addition, at December 31, 2014, the Company had \$280 million of fixed rate pollution control revenue bonds outstanding that were required to be remarketed within the next 12 months.

The Company borrows through commercial paper programs that have the liquidity support of the committed bank credit arrangements described above. The Company may also make short-term borrowings through various other arrangements with banks. At December 31, 2014 and 2013, there was no short-term debt outstanding. At December 31, 2014, the Company had regulatory approval to have outstanding up to \$2 billion of short-term borrowings.

7. COMMITMENTS

Fuel and Purchased Power Agreements

To supply a portion of the fuel requirements of its generating plants, the Company has entered into various long-term commitments for the procurement and delivery of fossil and nuclear fuel which are not recognized on the balance sheets. In 2014, 2013, and 2012, the Company incurred fuel expense of \$1.6 billion, \$1.6 billion, and \$1.5 billion, respectively, the majority of which was purchased under long-term commitments. The Company expects that a substantial amount of its future fuel needs will continue to be purchased under long-term commitments.

In addition, the Company has entered into various long-term commitments for the purchase of capacity and electricity, some of which are accounted for as operating leases. Total capacity expense under PPAs accounted for as operating leases was \$37 million, \$30 million, and \$33 million for 2014, 2013, and 2012, respectively. Total estimated minimum long-term obligations at December 31, 2014 were as follows:

	Operating Lease PPAs
	<i>(in millions)</i>
2015	\$ 37
2016	39
2017	40
2018	41
2019	43
2020 and thereafter	137
Total commitments	\$ 337

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 traditional operating companies and Southern Power. Under these agreements, each of the traditional operating companies and Southern Power may be jointly and severally liable. 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 entered into rental agreements for coal railcars, vehicles, and other equipment with various terms and expiration dates. Total rent expense was \$18 million in 2014, \$21 million in 2013, and \$24 million in 2012. Of these amounts, \$14 million, \$18 million, and \$19 million for 2014, 2013, and 2012, respectively, relate to the railcar leases and are recoverable through the Company's Rate ECR. As of December 31, 2014, estimated minimum lease payments under operating leases were as follows:

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

	Minimum Lease Payments		
	Railcars	Vehicles & Other	Total
		<i>(in millions)</i>	
2015	\$ 13	\$ 3	\$ 16
2016	11	3	14
2017	7	3	10
2018	5	1	6
2019	5	—	5
2020 and thereafter	17	—	17
Total	\$ 58	\$ 10	\$ 68

In addition to the above rental commitments payments, the Company has potential obligations upon expiration of certain leases with respect to the residual value of the leased property. These leases have terms expiring through 2023 with maximum obligations under these leases of \$5 million in 2015, \$4 million in 2016, and \$12 million in 2020 and thereafter. There are no obligations under these leases in 2017, 2018, and 2019. At the termination of the leases, the lessee may either exercise its purchase option, or the property can be sold to a third party. The Company expects that the fair market value of the leased property would substantially reduce or eliminate the Company's payments under the residual value obligations.

Guarantees

The Company has guaranteed the obligation of SEGCO for \$25 million of pollution control revenue bonds issued in 2001, which mature in June 2019, and also \$100 million of senior notes issued in November 2013, which mature in December 2018. Georgia Power has agreed to reimburse the Company for the pro rata portion of such obligations corresponding to Georgia Power's then proportionate ownership of SEGCO's stock if the Company is called upon to make such payment under its guarantee. See Note 4 for additional information.

8. STOCK COMPENSATION

Stock Options

Southern Company provides non-qualified stock options through its Omnibus Incentive Compensation Plan to a large segment of the Company's employees ranging from line management to executives. As of December 31, 2014, there were approximately 1,000 current and former employees of the Company participating in the stock option program. The prices of options were at the fair market value of the shares on the dates of grant. These options 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 Omnibus Incentive Compensation Plan. Stock options held by employees of a company undergoing a change in control vest upon the change in control.

For the years ended December 31, 2014, 2013, and 2012, employees of the Company were granted stock options for 2,027,298 shares, 1,319,038 shares, and 1,099,315 shares, respectively. The weighted average grant-date fair value of stock options granted during 2014, 2013, and 2012, derived using the Black-Scholes stock option pricing model, was \$2.20, \$2.93, and \$3.39, respectively.

For the years ended December 31, 2014, 2013, and 2012, total compensation cost for stock option awards recognized in income was \$5 million, \$4 million, and \$4 million, respectively, with the related tax benefit also recognized in income of \$2 million, \$2 million, and \$1 million, respectively. The compensation cost and tax benefits related to the grant of Southern Company stock options to the Company's employees and the exercise of stock options are recognized in the Company's financial statements with a corresponding credit to equity, representing a capital contribution from Southern Company. No cash proceeds are received by the Company upon the exercise of stock options. As of December 31, 2014, there was \$1 million of 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 15 months.

The total intrinsic value of options exercised during the years ended December 31, 2014, 2013, and 2012 was \$21 million, \$11 million, and \$28 million, respectively. The actual tax benefit realized by the Company for the tax deductions from stock option exercises totaled \$8 million, \$4 million, and \$11 million for the years ended December 31, 2014, 2013, and 2012, respectively.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

As of December 31, 2014, the aggregate intrinsic value for the options outstanding and options exercisable was \$55 million and \$37 million, respectively.

Performance Shares

Southern Company provides performance share award units through its Omnibus Incentive Compensation Plan to a large segment of the Company's employees ranging from line management to executives. The performance share units granted under the plan vest at the end of a three-year performance period which equates to the requisite service period. Employees that retire prior to the end of the three-year period receive a pro rata number of shares, issued at the end of the performance period, based on actual months of service prior to retirement. The value of the award units is based on Southern Company's total shareholder return (TSR) over the three-year performance period which measures Southern Company's relative performance against a group of industry peers. The performance shares are delivered in common stock following the end of the performance period based on Southern Company's actual TSR and may range from 0% to 200% of the original target performance share amount.

Performance share units held by employees of a company undergoing a change in control vest upon the change in control.

For the years ended December 31, 2014, 2013, and 2012, employees of the Company were granted performance share units of 176,070, 141,355, and 131,820, respectively. The weighted average grant-date fair value of performance share units granted during 2014, 2013, and 2012, determined using a Monte Carlo simulation model to estimate the TSR of Southern Company's stock among the industry peers over the performance period, was \$37.54, \$40.50, and \$41.99, respectively.

The Company recognizes compensation expense on a straight-line basis over the three-year performance period without remeasurement. Compensation expense for awards where the service condition is met is recognized regardless of the actual number of shares issued. For the years ended December 31, 2014, 2013, and 2012, total compensation cost for performance share units recognized in income was \$5 million annually, with the related tax benefit of \$2 million annually also recognized in income. The compensation cost and tax benefits related to the grant of Southern Company performance share units 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. As of December 31, 2014, there was \$5 million of total unrecognized compensation cost related to performance share award units that will be recognized over a weighted-average period of approximately 20 months.

9. NUCLEAR INSURANCE

Under the Price-Anderson Amendments Act (Act), the Company maintains agreements of indemnity with the NRC that, together with private insurance, cover third-party liability arising from any nuclear incident occurring at Plant Farley. The Act provides funds up to \$13.6 billion for public liability claims that could arise from a single nuclear incident. Plant Farley is insured against this liability to a maximum of \$375 million by American Nuclear Insurers (ANI), with the remaining coverage provided by a mandatory program of deferred premiums that could be assessed, after a nuclear incident, against all owners of commercial nuclear reactors. The Company could be assessed up to \$127 million per incident for each licensed reactor it operates but not more than an aggregate of \$19 million per incident to be paid in a calendar year for each reactor. Such maximum assessment, excluding any applicable state premium taxes, for the Company is \$255 million per incident but not more than an aggregate of \$38 million to be paid for each incident in any one year. Both the maximum assessment per reactor and the maximum yearly assessment are adjusted for inflation at least every five years. The next scheduled adjustment is due no later than September 10, 2018.

The Company is a member of Nuclear Electric Insurance Limited (NEIL), a mutual insurer established to provide property damage insurance in an amount up to \$1.5 billion for members' operating nuclear generating facilities. Additionally, the Company has NEIL policies that currently provide decontamination, excess property insurance, and premature decommissioning coverage up to \$1.25 billion for nuclear losses in excess of the \$1.5 billion primary coverage. On April 1, 2014, NEIL introduced a new excess non-nuclear policy providing coverage up to \$750 million for non-nuclear losses in excess of the \$1.5 billion primary coverage.

NEIL also covers the additional costs that would be incurred in obtaining replacement power during a prolonged accidental outage at a member's nuclear plant. Members can purchase this coverage, subject to a deductible waiting period of up to 26 weeks, with a maximum per occurrence per unit limit of \$490 million. After the deductible period, weekly indemnity payments would be received until either the unit is operational or until the limit is exhausted in approximately three years. The Company purchases limits based on the projected full cost of replacement power and has elected a 12-week deductible waiting period.

Under each of the NEIL policies, members are subject to assessments each year if losses exceed the accumulated funds available to the insurer. The current maximum annual assessments for the Company under the NEIL policies would be \$50 million.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

Claims resulting from terrorist acts are covered under both the ANI and NEIL policies (subject to normal policy limits). The aggregate, however, that NEIL will pay for all claims resulting from terrorist acts in any 12-month period is \$3.2 billion plus such additional amounts NEIL can recover through reinsurance, indemnity, or other sources.

For all on-site property damage insurance policies for commercial nuclear power plants, the NRC requires that the proceeds of such policies shall be dedicated first for the sole purpose of placing the reactor in a safe and stable condition after an accident. Any remaining proceeds are to be applied next toward the costs of decontamination and debris removal operations ordered by the NRC, and any further remaining proceeds are to be paid either to the Company or to its debt trustees as may be appropriate under the policies and applicable trust indentures. In the event of a loss, the amount of insurance available might not be adequate to cover property damage and other expenses incurred. Uninsured losses and other expenses, to the extent not recovered from customers, would be borne by the Company and could have a material effect on the Company's financial condition and results of operations.

All retrospective assessments, whether generated for liability, property, or replacement power, may be subject to applicable state premium taxes.

10. FAIR VALUE MEASUREMENTS

Fair value measurements are 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.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

As of December 31, 2014, assets and liabilities measured at fair value on a recurring basis during the period, together with the level of the fair value hierarchy in which they fall, were as follows:

As of December 31, 2014:	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	<i>(in millions)</i>			
Assets:				
Energy-related derivatives	\$ —	\$ 1	\$ —	\$ 1
Nuclear decommissioning trusts: ^(a)				
Domestic equity	403	83	—	486
Foreign equity	34	63	—	97
U.S. Treasury and government agency securities	—	34	—	34
Corporate bonds	—	111	—	111
Mortgage and asset backed securities	—	18	—	18
Other	—	5	3	8
Cash equivalents	162	—	—	162
Total	\$ 599	\$ 315	\$ 3	\$ 917
Liabilities:				
Interest rate derivatives	\$ —	\$ 8	\$ —	\$ 8
Energy-related derivatives	—	53	—	53
Total	\$ —	\$ 61	\$ —	\$ 61

(a) Excludes receivables related to investment income, pending investment sales, and payables related to pending investment purchases. See Note 1 under "Nuclear Decommissioning" for additional information.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

As of December 31, 2013, assets and liabilities measured at fair value on a recurring basis during the period, together with the level of the fair value hierarchy in which they fall, were as follows:

As of December 31, 2013:	Fair Value Measurements Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	<i>(in millions)</i>			
Assets:				
Energy-related derivatives	\$ —	\$ 7	\$ —	\$ 7
Nuclear decommissioning trusts: ^(a)				
Domestic equity	392	74	—	466
Foreign equity	35	65	—	100
U.S. Treasury and government agency securities	—	24	—	24
Corporate bonds	—	89	—	89
Mortgage and asset backed securities	—	18	—	18
Other	—	13	3	16
Cash equivalents	236	—	—	236
Total	\$ 663	\$ 290	\$ 3	\$ 956
Liabilities:				
Energy-related derivatives	\$ —	\$ 8	\$ —	\$ 8

(a) Excludes receivables related to investment income, pending investment sales, and payables related to pending investment purchases.

Valuation Methodologies

The energy-related derivatives primarily consist of over-the-counter financial products for natural gas and physical power products, including, from time to time, basis swaps. These are standard products used within the energy industry and are valued using the market approach. The inputs used are mainly from observable market sources, such as forward natural gas prices, power prices, implied volatility, and overnight index swap interest rates. Interest rate derivatives are also standard over-the-counter financial products valued using the market approach. Inputs for interest rate derivatives include LIBOR interest rates, interest rate futures contracts, and occasionally, implied volatility of interest rate options. See Note 11 for additional information on how these derivatives are used.

For fair value measurements of the investments within the nuclear decommissioning trusts, external pricing vendors are designated for each asset class with each security specifically assigned a primary pricing source. For investments held within commingled funds, fair value is determined at the end of each business day through the net asset value, which is established by obtaining the underlying securities' individual prices from the primary pricing source.

A market price secured from the primary source vendor is then evaluated by management in its valuation of the assets within the trusts. As a general approach, fixed income market pricing vendors gather market data (including indices and market research reports) and integrate relative credit information, observed market movements, and sector news into proprietary pricing models, pricing systems, and mathematical tools. Dealer quotes and other market information, including live trading levels and pricing analysts' judgment, are also obtained when available.

Investments in private equity and real estate within the nuclear decommissioning trusts are generally classified as Level 3, as the underlying assets typically do not have observable inputs. The fund manager values these assets using various inputs and techniques depending on the nature of the underlying investments. The fair value of partnerships is determined by aggregating the value of the underlying assets.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

As of December 31, 2014 and 2013, 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, were as follows:

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
As of December 31, 2014:				
<i>(in millions)</i>				
Nuclear decommissioning trusts:				
Equity – commingled funds	\$ 63	None	Daily/Monthly	Daily/7 days
Trust – owned life insurance	115	None	Daily	15 days
Debt – commingled funds	15	None	Daily	5 days
Cash equivalents:				
Money market funds	162	None	Daily	Not applicable
As of December 31, 2013:				
Nuclear decommissioning trusts:				
Equity – commingled funds	\$ 65	None	Daily/Monthly	Daily/7 days
Trust – owned life insurance	110	None	Daily	15 days
Cash equivalents:				
Money market funds	236	None	Daily	Not applicable

The nuclear decommissioning trusts include investments in TOLI. The taxable nuclear decommissioning trusts invest in the TOLI in order to minimize the impact of taxes on the portfolios and can draw on the value of the TOLI through death proceeds, loans against the cash surrender value, and/or the cash surrender value, subject to legal restrictions. The amounts reported in the table above reflect the fair value of investments the insurer has made in relation to the TOLI agreements. The nuclear decommissioning trusts do not own the underlying investments, but the fair value of the investments approximates the cash surrender value of the TOLI policies. The investments made by the insurer are in commingled funds. These commingled funds, along with other equity and debt commingled funds held in the nuclear decommissioning trusts, primarily include investments in domestic and international equity securities and predominantly high-quality fixed income securities. These fixed income securities may include U.S. Treasury and government agency fixed income securities, non-U.S. government and agency fixed income securities, domestic and foreign corporate fixed income securities, and mortgage and asset backed securities. The passively managed funds seek to replicate the performance of a related index. The actively managed funds seek to exceed the performance of a related index through security analysis and selection.

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's investment in the money market funds.

As of December 31, 2014 and 2013, other financial instruments for which the carrying amount did not equal fair value were as follows:

	Carrying Amount	Fair Value
<i>(in millions)</i>		
Long-term debt:		
2014	\$ 6,631	\$ 7,321
2013	\$ 6,228	\$ 6,534

The fair values are determined using Level 2 measurements and are based on quoted market prices for the same or similar issues or on the current rates offered to the Company.

11. 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

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

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 and are presented on a gross basis. See Note 10 for additional information. In the statements of cash flows, the cash impacts of settled energy-related and interest rate derivatives are recorded as operating activities.

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 and other various cost recovery mechanisms, 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 Alabama PSC, through the use of financial derivative contracts, which is expected to continue to mitigate price volatility.

To mitigate residual risks relative to movements in electricity prices, the Company may enter 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 three 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 energy cost recovery clause.
- *Cash Flow Hedges* – Gains and losses on energy-related derivatives designated as cash flow hedges which are mainly used to hedge anticipated purchases and sales and are initially deferred in OCI before being recognized in the statements of income in the same period as the hedged transactions are reflected in earnings.
- *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, 2014, 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
<i>(in millions)</i> 56	2017	—

For cash flow hedges, the amounts expected to be reclassified from accumulated OCI to revenue and fuel expense for the 12-month period ending December 31, 2015 are immaterial.

Interest Rate Derivatives

The Company may also enter into interest rate derivatives 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 where the effective portion of the derivatives' fair value gains or losses is recorded in OCI and is reclassified into earnings at the same time the hedged transactions affect earnings. The derivatives employed as hedging instruments are structured to minimize ineffectiveness, which is recorded directly to earnings.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

At December 31, 2014, the following interest rate derivatives were outstanding:

	Notional Amount	Interest Rate Received	Weighted Average Interest Rate Paid	Hedge Maturity Date	Fair Value Gain (Loss) December 31, 2014
	<i>(in millions)</i>				<i>(in millions)</i>
Cash Flow Hedges of Forecasted Debt					
	\$200	3-month LIBOR	2.93%	October 2025	\$ (8)

The estimated pre-tax losses that will be reclassified from accumulated OCI to interest expense for the 12-month period ending December 31, 2015 are \$3 million. The Company has deferred gains and losses that are expected to be amortized into earnings through 2035.

Derivative Financial Statement Presentation and Amounts

At December 31, 2014 and 2013, the fair value of energy-related derivatives and interest rate derivatives was reflected in the balance sheets as follows:

Derivative Category	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	2014	2013	Balance Sheet Location	2014	2013
		<i>(in millions)</i>			<i>(in millions)</i>	
Derivatives designated as hedging instruments for regulatory purposes						
Energy-related derivatives:						
	Other current assets	\$ 1	\$ 5	Other current liabilities	\$ 32	\$ 3
	Other deferred charges and assets	—	2	Other deferred credits and liabilities	21	5
Total derivatives designated as hedging instruments for regulatory purposes		\$ 1	\$ 7		\$ 53	\$ 8
Derivatives designated as hedging instruments in cash flow hedges						
Interest rate derivatives:						
	Other current assets	\$ —	\$ —	Other current liabilities	\$ 8	\$ —
Total		\$ 1	\$ 7		\$ 61	\$ 8

Energy-related derivatives not designated as hedging instruments were immaterial on the balance sheets for 2014 and 2013.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

The derivative contracts of the Company are not subject to master netting arrangements or similar agreements and are reported gross on the Company's financial statements. Some of these energy-related and interest rate derivative contracts contain certain provisions that permit intra-contract netting of derivative receivables and payables for routine billing and offsets related to events of default and settlements. Amounts related to energy-related derivative contracts at December 31, 2014 and 2013 are presented in the following tables. Interest rate derivatives presented in the tables above do not have amounts available for offset and are therefore excluded from the offsetting disclosure table below.

Assets	Fair Value				
	2014	2013	Liabilities	2014	2013
	<i>(in millions)</i>			<i>(in millions)</i>	
Energy-related derivatives presented in the Balance Sheet ^(a)	\$ 1	\$ 7	Energy-related derivatives presented in the Balance Sheet ^(a)	\$ 53	\$ 8
Gross amounts not offset in the Balance Sheet ^(b)	—	(5)	Gross amounts not offset in the Balance Sheet ^(b)	—	(5)
Net energy-related derivative assets	\$ 1	\$ 2	Net energy-related derivative liabilities	\$ 53	\$ 3

(a) The Company does not offset fair value amounts for multiple derivative instruments executed with the same counterparty on the balance sheets; therefore, gross and net amounts of derivative assets and liabilities presented on the balance sheets are the same.

(b) Includes gross amounts subject to netting terms that are not offset on the balance sheets and any cash/financial collateral pledged or received.

At December 31, 2014 and 2013, 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 was as follows:

Derivative Category	Balance Sheet Location	Unrealized Losses		Unrealized Gains		
		2014	2013	2014	2013	
		<i>(in millions)</i>		<i>(in millions)</i>		
Energy-related derivatives:	Other regulatory assets, current	\$ (32)	\$ (3)	Other current liabilities	\$ 1	\$ 5
	Other regulatory assets, deferred	(21)	(5)	Other regulatory liabilities, deferred	—	2
Total energy-related derivative gains (losses)		\$ (53)	\$ (8)	\$ 1	\$ 7	

For the years ended December 31, 2014, 2013, and 2012, the pre-tax effect of interest rate derivatives designated as cash flow hedging instruments on the statements of income was 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)			
	2014	2013	2012	Amount			
	<i>(in millions)</i>			<i>(in millions)</i>			
Interest rate derivatives	\$ (8)	\$ —	\$ (18)	Interest expense, net of amounts capitalized	\$ (3)	\$ (3)	\$ (3)

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

For the years ended December 31, 2014, 2013, and 2012, the pre-tax effect of energy-related derivatives not designated as hedging instruments on the statements of income was not material.

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, 2014, the Company's collateral posted with its derivative counterparties was not material.

At December 31, 2014, the fair value of derivative liabilities with contingent features was \$18 million. However, because of joint and several liability features underlying these derivatives, the maximum potential collateral requirements arising from the

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

credit-risk-related contingent features, at a rating below BBB- and/or Baa3, were \$54 million, and include 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. If collateral is required, fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral are not offset against fair value amounts recognized for derivatives executed with the same counterparty.

The Company is exposed to losses related to financial instruments in the event of counterparties' nonperformance. 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. The Company has also established risk management policies and controls to determine and monitor the creditworthiness of counterparties in order to mitigate the Company's exposure to counterparty credit risk. Therefore, the Company does not anticipate a material adverse effect on the financial statements as a result of counterparty nonperformance.

NOTES TO FINANCIAL STATEMENTS (continued)
Alabama Power Company 2014 Annual Report

12. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial information for 2014 and 2013 is as follows:

Quarter Ended	Operating Revenues	Operating Income	Net Income After Dividends on Preferred and Preference Stock
		<i>(in millions)</i>	
March 2014	\$ 1,508	\$ 381	\$ 187
June 2014	1,437	357	173
September 2014	1,669	520	282
December 2014	1,328	267	119
March 2013	\$ 1,308	\$ 307	\$ 141
June 2013	1,392	357	173
September 2013	1,604	500	258
December 2013	1,314	312	140

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

SELECTED FINANCIAL AND OPERATING DATA 2010-2014
Alabama Power Company 2014 Annual Report

	2014	2013	2012	2011	2010
Operating Revenues (in millions)	\$ 5,942	\$ 5,618	\$ 5,520	\$ 5,702	\$ 5,976
Net Income After Dividends on Preferred and Preference Stock (in millions)	\$ 761	\$ 712	\$ 704	\$ 708	\$ 707
Cash Dividends on Common Stock (in millions)	\$ 550	\$ 644	\$ 684	\$ 774	\$ 586
Return on Average Common Equity (percent)	13.52	13.07	13.10	13.19	13.31
Total Assets (in millions)	\$ 20,552	\$ 19,251	\$ 18,712	\$ 18,477	\$ 17,994
Gross Property Additions (in millions)	\$ 1,543	\$ 1,204	\$ 940	\$ 1,016	\$ 956
Capitalization (in millions):					
Common stock equity	\$ 5,752	\$ 5,502	\$ 5,398	\$ 5,342	\$ 5,393
Preference stock	343	343	343	343	343
Redeemable preferred stock	342	342	342	342	342
Long-term debt	6,176	6,233	5,929	5,632	5,987
Total (excluding amounts due within one year)	\$ 12,613	\$ 12,420	\$ 12,012	\$ 11,659	\$ 12,065
Capitalization Ratios (percent):					
Common stock equity	45.6	44.3	44.9	45.8	44.7
Preference stock	2.7	2.8	2.9	2.9	2.9
Redeemable preferred stock	2.7	2.7	2.8	2.9	2.8
Long-term debt	49.0	50.2	49.4	48.4	49.6
Total (excluding amounts due within one year)	100.0	100.0	100.0	100.0	100.0
Customers (year-end):					
Residential	1,247,061	1,241,998	1,237,730	1,231,574	1,235,128
Commercial	197,082	196,209	196,177	196,270	197,336
Industrial	6,032	5,851	5,839	5,844	5,770
Other	753	751	748	746	782
Total	1,450,928	1,444,809	1,440,494	1,434,434	1,439,016
Employees (year-end)	6,935	6,896	6,778	6,632	6,552

SELECTED FINANCIAL AND OPERATING DATA 2010-2014 (continued)
Alabama Power Company 2014 Annual Report

	2014	2013	2012	2011	2010
Operating Revenues (in millions):					
Residential	\$ 2,209	\$ 2,079	\$ 2,068	\$ 2,144	\$ 2,283
Commercial	1,533	1,477	1,491	1,495	1,535
Industrial	1,480	1,369	1,346	1,306	1,231
Other	27	27	28	27	27
Total retail	5,249	4,952	4,933	4,972	5,076
Wholesale — non-affiliates	281	248	277	287	465
Wholesale — affiliates	189	212	111	244	236
Total revenues from sales of electricity	5,719	5,412	5,321	5,503	5,777
Other revenues	223	206	199	199	199
Total	\$ 5,942	\$ 5,618	\$ 5,520	\$ 5,702	\$ 5,976
Kilowatt-Hour Sales (in millions):					
Residential	18,726	17,920	17,612	18,650	20,417
Commercial	14,118	13,892	13,963	14,173	14,719
Industrial	23,799	22,904	22,158	21,666	20,622
Other	211	211	214	214	216
Total retail	56,854	54,927	53,947	54,703	55,974
Wholesale — non-affiliates	3,588	3,711	4,196	4,330	8,655
Wholesale — affiliates	6,713	7,672	4,279	7,211	6,074
Total	67,155	66,310	62,422	66,244	70,703
Average Revenue Per Kilowatt-Hour (cents):					
Residential	11.80	11.60	11.74	11.50	11.18
Commercial	10.86	10.63	10.68	10.55	10.43
Industrial	6.22	5.98	6.07	6.03	5.97
Total retail	9.23	9.02	9.14	9.09	9.07
Wholesale	4.56	4.04	4.58	4.60	4.76
Total sales	8.52	8.16	8.52	8.31	8.17
Residential Average Annual Kilowatt-Hour Use Per Customer	15,051	14,451	14,252	15,138	16,570
Residential Average Annual Revenue Per Customer	\$ 1,775	\$ 1,676	\$ 1,674	\$ 1,740	\$ 1,853
Plant Nameplate Capacity Ratings (year-end) (megawatts)	12,222	12,222	12,222	12,222	12,222
Maximum Peak-Hour Demand (megawatts):					
Winter	11,761	9,347	10,285	11,553	11,349
Summer	11,054	10,692	11,096	11,500	11,488
Annual Load Factor (percent)	61.4	64.9	61.3	60.6	62.6
Plant Availability (percent)*:					
Fossil-steam	82.5	87.3	88.6	88.7	92.9
Nuclear	93.3	90.7	94.5	94.7	88.4
Source of Energy Supply (percent):					
Coal	49.0	50.0	48.2	52.5	56.6
Nuclear	20.7	20.3	22.6	20.8	17.7
Hydro	5.5	8.1	4.1	4.6	5.0
Gas	15.4	15.7	16.8	15.3	14.0
Purchased power —					
From non-affiliates	3.6	2.9	2.0	0.9	1.6
From affiliates	5.8	3.0	6.3	5.9	5.1
Total	100.0	100.0	100.0	100.0	100.0

* Beginning in 2012, plant availability is calculated as a weighted equivalent availability.

DIRECTORS AND OFFICERS

Alabama Power Company 2014 Annual Report

Directors

Whit Armstrong

Managing Member,
Creeke Capital Investments, LLC

Ralph D. Cook

City Attorney,
City of Birmingham

David J. Cooper, Sr.

Vice Chairman,
Cooper/T. Smith Corporation

Mark A. Crosswhite¹

Chairman, President, and Chief
Executive Officer, Alabama Power
Company

Thomas A. Fanning²

Chairman, President, and CEO,
The Southern Company

John D. Johns²

Chairman, President, and CEO,
Protective Life Corporation

Anthony A. Joseph³

Shareholder,
Maynard, Cooper & Gale, P.C.

Patricia M. King

President,
Sunny King Automotive Group

James K. Lowder

Chairman,
The Colonial Company

Charles D. McCrary⁴

Chairman,
Alabama Power Company

Malcolm Portera

Partner,
Portera and Associates

Robert D. Powers

President,
The Eufaula Agency, Inc.

Catherine J. Randall³

Chairman,
Pettus Randall Holdings, LLC

C. Dowd Ritter

Retired Chairman and CEO,
Regions Financial Corporation

James H. Sanford

Chairman,
HOME Place Farms, Inc.

John Cox Webb, IV⁵

President,
Webb Lumber Company, Inc.

Officers

Mark A. Crosswhite¹

Chairman, President, and Chief
Executive Officer

Philip C. Raymond

Executive Vice President, Chief
Financial Officer, and Treasurer

Zeke W. Smith

Executive Vice President

Steven R. Spencer

Executive Vice President

James P. Heilbron

Senior Vice President and Senior
Production Officer

Gordon G. Martin

Senior Vice President and General
Counsel

Gregory J. Barker

Senior Vice President

Anita Allcorn-Walker

Vice President and Comptroller

Ronald Q. Patterson

Vice President and Assistant
Treasurer

Matthew W. Bowden

Vice President

C. David Cox

Vice President

Mark S. Crews

Vice President

Daniel K. Glover

Vice President

R. Myrk Harkins

Vice President

John O. Hudson III

Vice President

Richard O. Hutto

Vice President

Stacy R. Kilcoyne

Vice President

Barbara J. Knight

Vice President

R. Scott Moore

Vice President

Kenneth F. Novak

Vice President

Jonathan K. Porter

Vice President

Quentin P. Riggins

Vice President

Leslie L. Sanders

Vice President

R. Michael Saxon

Vice President

Don A. Scivley

Vice President

Julia H. Segars

Vice President

Nicholas C. Sellers

Vice President

Anthony A. Smoke⁶

Vice President

Robert L. Weaver

Vice President

Ceila H. Shorts

Corporate Secretary

Wendy M. Hoomes

Assistant Comptroller

Melissa K. Caen

Assistant Secretary and
Assistant Treasurer

Amy E. Blankenship

Assistant Secretary

Christopher R. Blake

Assistant Treasurer

Brian E. George⁷

Assistant Treasurer

¹ Elected Chairman effective
5/2014

² Resigned effective 2/2015

³ Elected effective 1/2015

⁴ Retired effective 5/2014

⁵ Retiring effective 4/2015

⁶ Elected effective 5/2014

⁷ Appointed effective 12/2014

CORPORATE INFORMATION

Alabama Power Company 2014 Annual Report

General

This annual report is submitted for general information and 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 operates as a vertically integrated utility providing electricity to retail customers within its traditional service area located within the State of Alabama and to wholesale customers in the Southeast. The Company sells electricity to more than 1.4 million customers within its service area of approximately 45,000 square miles. In 2014, retail energy sales accounted for 85 percent of the Company's total sales of 67 billion kilowatt-hours.

The Company is a wholly-owned subsidiary of The Southern Company, which is the parent company of four traditional operating companies and Southern Power Company. There is no established public trading market for the Company's common stock.

Trustee, Registrar, and Paying Agent

All series of Senior Notes and Trust Preferred Securities
The Bank of New York Mellon
Global Corporate Trust
505 North 20th Street, Suite 950
Birmingham, AL 35203

Registrar, Transfer Agent, and Dividend Paying Agent

All series of Preferred and Preference Stock
Computershare Inc.
P.O. Box 30170
College Station, TX 77842-3170
(800) 554-7626

www.computershare.com/investor

Number of Preferred Shareholders of record as of December 31, 2014 was 1,058.

Form 10-K

A copy of the Form 10-K as filed with the Securities and Exchange Commission will be provided upon written request to the office of the Corporate Secretary. For additional information, contact the office of the Corporate Secretary at (205) 257-2619.

Alabama Power Company

600 North 18th Street
Birmingham, AL 35203
(205) 257-1000
www.alabamapower.com

Auditors

Deloitte & Touche LLP
420 North 20th Street
Suite 2400
Birmingham, AL 35203

Legal Counsel

Balch & Bingham LLP
P.O. Box 306
Birmingham, AL 35201

[This page intentionally left blank]

[This page intentionally left blank]

[This page intentionally left blank]

