

RATE RSE RATE STABILIZATION AND EQUALIZATION FACTOR

By orders of the Alabama Public Service Commission in Dockets #18117 and #18416.

Effective for December 1982 billings and thereafter; modified effective for July 1985 billings and thereafter; modified effective for April 1990 billings and thereafter; modified effective for April 1998 billings and thereafter; modified effective May 1, 2002 for application to March 2003 billings and thereafter; modified effective October 16, 2005 for application to January 2007 billings and thereafter.

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AVAILABILITY

Same as the specific rate incorporating this Rate RSE by reference.

APPLICABILITY

Applicable as an integral part of each rate schedule of the Company in which reference is made to this Rate RSE.

EXPLANATORY STATEMENT

It is the purpose of Rate RSE to lessen the impact, frequency and size of retail rate increase requests by permitting the Company, through the operation of a filed and approved rate, to adjust its charges more readily to achieve the rate of return allowed it in the rate order of the Commission. By provisions in the rate, the charges are increased if projections for the upcoming year show that the designated rate of return range will not be met and are decreased if such projections show that the designated rate of return range will be exceeded. Other provisions limit the impact of any one adjustment (as well as the impact of any consecutive increases), and also test whether actual results exceeded the equity return range.

APPLICATION OF RATE RSE AND CALCULATION PROCEDURES

Monthly billings on and after January 2007 shall be adjusted (increased or decreased) by the application of a rate stabilization and equalization factor ("RSE Factor") in accordance with the procedure herein described. By December 1, 2006, and by each December 1 thereafter, the Company's rate of return on projected average common equity, separated to retail electric service ("RRCE"), shall be computed annually for the upcoming twelve-month period ending December 31 (such twelve-month period being the "rate year"). The RRCE shall be computed on the basis of cost estimates and budgets prepared by the Company in the ordinary course of its business and in a manner consistent with the Uniform System of Accounts through the tabulations specified on Appendix B hereto. If the resulting RRCE is less than 13.0% or more than 14.5% (13.0% - 14.5% being "the equity return range"), then monthly bills under the respective rate schedules subject to this Rate RSE shall be increased or decreased by amounts per kilowatt-hour necessary, in total, to restore the RRCE to 13.75% (the "adjusting point" in the equity return range).

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The above-described increases and decreases are accomplished through the application of an RSE Factor, which is developed by the formula contained in Appendix A hereto. Both Appendix A and Appendix B constitute an integral part of this Rate RSE. The RSE Factor shall be revised annually for application to billings beginning January of each rate year if the RRCE computed with respect to that rate year (the "point of test") is outside of the equity return range. (For example, the revision of the RSE Factor for use beginning with January 2007 billings, will be derived from the RRCE computed for the upcoming twelve-month period ending December 31, 2007.)

For monthly billings commencing January 2007 and thereafter, the kilowatt-hour charges under the respective rate schedules shall be adjusted by applying the current annual revision (if any) of the RSE Factor to the existing kilowatt-hour charges, as theretofore adjusted for the cumulative effect of all prior RSE Factors and other adjustments (such as, for example, adjustments pursuant to Rate CNP).

ADJUSTMENT LIMITATIONS

Consecutive increases derived by the annual operation of Rate RSE shall be limited such that adjustments for any consecutive two-year period, when averaged together, do not exceed four percent (4%). Thus, the limitation governing any such consecutive increase shall be the percentage that, when combined with the percentage adjustment that was made applicable to monthly billings for the current year, produces an average of four percent (4%). Notwithstanding the foregoing, the maximum increase in any one year associated with the operation of Rate RSE shall not exceed five percent (5%) of the projected total retail revenues of the Company ("RR") for the rate year used to compute the RRCE. Hypothetical examples of the application of these limitations in the context of consecutive years include: 4.5% and 3.5%; 5.0% and 3.0%; 3.2% and 4.8%; 3.0% and 5.0%, and so forth.

PRIOR YEAR ACTUAL RESULTS

On or before March 1 of each year beginning in 2008, the Company shall submit to the Commission a calculation of its actual retail return on common equity ("actual retail return") for the immediately preceding calendar year ("review year") under this Rate RSE. This actual retail return will be calculated in the same manner as set forth under Appendix B, except that actual data will be substituted for the projected data used to develop the RRCE for the same twelve-month period. If the actual retail return derived through this calculation is above the equity return range, then the Company shall determine the amount of revenue that caused the actual retail return for the review year to exceed the top end of the designated range. The amount of revenue

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shall be determined in the manner set forth in Appendix A ("refund factor"), and, unless otherwise directed by the Commission, shall be refunded to retail customers by rate schedule. The implementation of any refunds to customers shall be accomplished through the application of credits on customer billings for the month of April following the review year.

OTHER LIMITATIONS AND PROVISIONS

Capital Structure. The common equity ratio of Alabama Power Company at April 30, 1985 was 36.0%. With Rate RSE in effect and with expected increases in retained earnings, the Company's common equity ratio would be expected to improve toward higher levels more common in the industry. It is, however, possible to increase common equity by infusions of capital investment and the intent of Rate RSE is to provide a measure of rate stabilization and equalization. Rate RSE will therefore be further restricted in its operation so that increases in the Company's common equity ratio in excess of 2-1/2 percentage points in any twelve-month period used to compute the RRCE will not be recognized in the operation of the rate. Further, if any increase attributable to infusions of equity investment capital (and not attributable to net increases in retained earnings or retirement of outstanding debt) shall cause the Company's common equity ratio to exceed 45%, then such increase will not be recognized in the operation of the rate.

Jurisdictional Allocations. In the computation of RRCE and the RSE Factor, it is necessary for jurisdictional purposes that allocations be made as between electric and nonelectric operations and then as between retail electric service and electric service other than retail. For the applications of this Rate RSE, the Company will prepare and file by May 1 of each year, a cost-of-service study based upon data from the prior calendar year. The most recently filed cost-of-service study shall be used in the computation of RRCE, RSE Factor, and the Refund Factor. Corrections or revisions proposed thereto, if not accepted by the Company, may be made the subject of a limited complaint proceeding under the Special Rules Governing Operation of this Rate. If such a complaint proceeding is instituted and not completed before the next annual RSE computation, the lower of the existing factors or the newly filed factors shall be used in computations under this rate until such complaint proceeding is resolved.



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COMMISSION-REQUIRED ADJUSTMENTS

Advertising Expense. In its decision in Alabama Power Company v. Alabama Public Service Commission, 359 So. 2d 776 (Ala. 1978), the Supreme Court of Alabama recognized advertising expense as an allowable expense for a utility company in a ratemaking proceeding. However, as an additional constraint upon expenditures by the Company, in each computation under Rate RSE one-half (1/2) of the amounts in Accounts 909 and 930.1 will be disallowed.

Lobbying Expense. The expenses of lobbying are appropriately charged to Account 426.4 and will not be charged to the ratepayer in any computation of this Rate RSE or otherwise.

Donations. In its decisions in Alabama Power Co. v. Alabama Public Service Commission, 359 So. 2d 776 (Ala. 1978) and Alabama Power Co. v. Alabama Public Service Commission, 390 So. 2d 1017 (Ala. 1980), the Supreme Court of Alabama has ruled that charitable donations (Account 426.1) cannot be proper expenses of a utility company for ratemaking purposes. Unless and until this matter is dealt with otherwise by legislation or subsequent court rulings, the Company will not undertake to move such expenditures from "below-the-line" to "above-the-line" status in any computation under this Rate RSE or in any ratemaking proceeding.

Civic Club Dues. Civic club dues are properly charged to Account 426.5 and will not be charged to the ratepayer in any computation of this Rate RSE or otherwise.

SPECIAL RULES

The Special Rules Governing Operation of Rates RSE and CNP constitute an integral part of this rate.

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DEVELOPMENT OF RSE FACTOR

The rate stabilization and equalization factor (RSE Factor) will be initially developed, and thereafter changed whenever, at the point of test, the retail return on common equity (RRCE) is not within the equity return range. The RSE Factor shall be calculated for each respective affected rate schedule in accordance with the formula set out below and shall be applied in that schedule so as to adjust the kilowatt-hour charges as the same may have been adjusted by any previous applications of Rate RSE:

$$\text{If } \frac{(AROR - RRCE)(RCE)}{1 - T} > \frac{RR}{RR} \text{ is greater than } L\%, \text{ then } \frac{(L\% \times RR) \cdot \frac{BR_s}{BR_t}}{KWH_s} = \text{RSE Factor}^*$$

$$\text{If } \frac{(AROR - RRCE)(RCE)}{1 - T} \leq \frac{RR}{RR} \text{ is equal to, or less than } L\%, \text{ then } \frac{(AROR - RRCE)(RCE)}{1 - T} \cdot \frac{BR_s}{BR_t} = \text{RSE Factor}^*$$

*Rounded to nearest 0.0001 cent

Where, for the twelve-month period ending at the point of test,

AROR = Adjusting point of Equity Return Range.

RRCE = Projected retail return on common equity.

RCE = Projected average retail common equity.

T = Combined Federal and State income taxes = $\frac{F + S - 2 FS}{1 - FS}$

F being the statutory Federal income tax rate and S being the statutory State income tax rate.

RR = Projected total retail revenues from sale of electricity for the rate year.

L% = The applicable percentage limitation for the rate year.

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BR_s = The projected base rate revenue from each respective retail rate schedule for the rate year. "Base rate revenue" from any schedule excludes amounts from Rate ECR and Rate T.

BR_t = The projected total base rate revenues from all retail rate schedules for the rate year. Such base rate revenues exclude amounts from Rate ECR and Rate T.

KWH_s = The projected kilowatt-hour sales by retail rate schedule for the rate year.

DEVELOPMENT OF REFUND FACTOR

The refund factor for the review year will be developed whenever the actual retail return on common equity (ARRCE) exceeds the equity return range. The refund factor shall be calculated for each respective affected rate schedule in accordance with the formula set forth below. The application of bill credits derived hereunder (or such other disposition as may be directed by the Commission) shall fully satisfy the Company's refund requirement under this Rate RSE.

If ARRCE is greater than TROR, then
$$\frac{(ARRCE - TROR)(ARCE)}{1 - T} \frac{BR_{sa}}{KWH_{sj} BR_{ta}} = \text{Refund Factor}^*$$

*Rounded to nearest 0.0001 cent

Where, for the review year,

ARRCE = Actual retail return on common equity.

TROR = Top of equity return range.

ARCE = Actual average retail common equity.

T = Combined Federal and State income taxes =
$$\frac{F + S - 2 FS}{1 - FS}$$

F being the statutory Federal income tax rate and S being the statutory State income tax rate.

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BR_{sa} = The base rate revenue recorded from each respective retail rate schedule. "Base rate revenue" from any schedule excludes amounts from Rate ECR and Rate T.

BR_{ta} = The total base rate revenues recorded from all retail rate schedules. Such base rate revenues exclude amounts from Rate ECR and Rate T.

KWH_{sj} = The kilowatt-hour sales recorded for each respective retail rate schedule for the following month of January.

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DETERMINATION OF PROJECTED AVERAGE RETAIL COMMON EQUITY (RCE) AS OF DECEMBER 31, _____:

		<u>Column 1</u> <u>Total Amount</u> <small>(Projected 12-mo. avg. bal.)</small>		<u>Column 2</u> <u>Non-Electric</u> <small>(Projected 12-mo. avg. bal.)</small>
Investment				
1. Electric Plant in Service (Account 101)	\$	_____	(E)	
2. Electric Plant Held for Future Use (Account 105)		_____		
3. Construction Work in Progress-Electric (Account 107)		_____		
4. Accumulated Provision for Depreciation and Amortization of Electric Utility Plant-Credit (Accounts 108 & 111)		_____	(E)	
5. Electric Plant Acquisition Adjustments (Account 114)		_____		
6. Steam Heat Plant (Account 118)		_____	\$	_____
7. Accumulated Provision for Depreciation of Steam Heat Plant-Credit (Account 119)		_____		_____
8. Nuclear Fuel-Net (Account 120)		_____		_____
9. Nonutility Property (Account 121)		_____		_____
10. Accumulated Provision for Depreciation and Amortization of Nonutility Property-Credit (Account 122)		_____		_____
11. Fuel Stock (Account 151)		_____		_____
12. Materials and Supplies (Account 154)		_____		_____
13. Merchandise (Account 155)		_____		_____
14. Total	\$	=====	\$	=====

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DETERMINATION OF PROJECTED AVERAGE RETAIL COMMON EQUITY (RCE) AS OF DECEMBER 31, _____:

	<u>Column 1</u> <u>Total Amount</u> (Projected 12-mo. avg. bal.)	<u>Column 2</u> <u>Non-Electric</u> (Projected 12-mo. avg. bal.)
balance)		
15. Electric Investment Percent (Line 14, [Col. 1 - Col. 2 less UPS Investment of \$ _____] ÷ Col. 1)	_____ % (D)	
16. Retail Electric Investment Factor	_____ %	
17. Retail Investment Separation Factor (Line 15 x Line 16)	_____ %	
18. Common Equity (Accounts 201, 211, 216)	\$ _____	
19. Retail Common Equity (Line 17 x Line 18)	\$ _____	

DETERMINATION OF PROJECTED RETAIL NET INCOME FOR THE 12 MONTHS ENDED DECEMBER 31, _____:

	<u>Total Electric</u> (Projected 12 mos. ended)	<u>Retail Electric</u> (Projected 12 mos. ended)
Electric Operating Revenue:		
1. Sale of Electricity (Accounts 440-448)	\$ _____	\$ _____ (A)
2. Other Operating Revenues (Accounts 450-456)	_____	_____ (B)
3. Total Operating Revenues (Line 1 + Line 2)	_____	_____
Electric Expenses:		
4. Electric Operation and Maintenance Expenses (Accounts 401 and 402)	_____	
5. Electric Depreciation and Amortization Expenses (Accounts 403-407)	_____	
6. Taxes Other than Income Taxes (Account 408.1)	_____	
7. Other Revenue Credits (Accounts 447-160, 447-210, 447-220, 447-280, 447-501, 447-570, 454 except 454-006, and 456 except 456-010)	_____	
8. Electric Expenses Other than Income Taxes (Lines 4, 5, and 6 - Line 7)	_____	

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DETERMINATION OF PROJECTED RETAIL NET INCOME FOR THE 12 MONTHS ENDED DECEMBER 31, _____:

	<u>Total Electric</u> (Projected 12 mos. ended)	<u>Retail Electric</u> (Projected 12 mos. ended)
9. Operating Income before Income Taxes (Line 3 - Line 8)	_____	
10. Income Taxes (Accounts 409-411)	_____	
11. Retail Expense Allocation Factor	_____ %	
12. Retail Expenses Other Than Income Taxes (Line 8 - UPS Expenses of \$) x Line 11		_____ (D)
13. Retail Operating Income before Income Taxes (Line 3 - Line 12)		_____
14. Retail Income Taxes (Line 13 ÷ Line 9) x Line 10		_____
15. Net Retail Electric Operating Income (Line 13 - Line 14)		_____
Allowance for Funds Used During Construction		
16. Electric Allowance for Funds Used During Construction (AFUDC) - Gross	_____	
17. Retail Electric Allocation Factor	_____ %	
18. Retail Electric AFUDC (Line 16 - UPS Investment AFUDC of \$) x Line 17		_____ (D)
Interest Income		
19. Interest Revenue (Accounts 419-020, 030,040) (net of tax)	_____	
20. Retail Interest Income (Line 19 x Retail Investment Separation Factor)	_____ % (C)	_____

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DETERMINATION OF PROJECTED RETAIL NET INCOME FOR THE 12 MONTHS ENDED DECEMBER 31, _____:

	<u>Total Electric</u> (Projected 12 mos. total)	<u>Retail Electric</u> (Projected 12 mos. total)
Interest Expense and Preferred Dividends:		
21. Interest Expense (Accounts 427-431)	_____	
22. Preferred Dividends (Account 437)	_____	
23. Total Interest Expense and Preferred Dividends ([Line 21 + Line 22] Retail Investment Separation Factor)	_____	%(C) _____
Commission-Required Adjustments		
24. Commission-Required Adjustments (net of tax)	_____	
25. Retail Commission-Required Adjustments (Line 24 x Retail Expense Allocation Factor)	_____	% _____
Retail Net Income Available for Common Equity (RNI)		
26. Retail Net Income Available for Common Equity (Line 15 + Line 18 + Line 20 - Line 23 + Line 25)		\$ =====

Retail Return on Average Common Equity

$$\frac{\text{RNI}}{\text{RCE}} = \text{RRCE} \quad \frac{\$---}{\$---} = \text{---}\%$$

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Notes:

- Note (A): To conform with cost-of-service procedures, the total of subaccount 447-160 (Sales for Resale-Territorial-Other Nonassociated Companies), subaccount 447-210 (Power Pool – Associated Companies), subaccount 447-220 (Power Pool – Nonassociated Companies), subaccount 447-280 (Power Pool – AEC Energy Account), subaccount 447-501 (Sales for Resale – Nonterritorial – Long Term), and subaccount 447-570 (Sales for Resale – Nonterritorial – Short Term) are excluded from Line 1 and are included in Line 7.
- Note (B): To conform with cost-of-service procedures, the total of Account 451, subaccount 454-006 (Rent from Leased Property on Customers' Premises-Other), and subaccount 456-010 (Miscellaneous Electric Revenues-Return Check Charge) are included on Line 2. The remaining subaccounts for Accounts 454 and 456 are included on Line 7.
- Note (C): Developed on Line 17 of retail common equity computation.
- Note (D): To conform with cost-of-service procedures and to afford proper recognition of investment and associated allowance for funds and expenses associated with Unit Power Sales to Nonassociated Utilities, the investment and associated allowance for funds and expenses associated with such sales have been accounted for on Line 15 of RCE calculation and on Lines 12 and 18 of RNI calculation.
- Note (E): For purposes of Rate RSE, the capitalization of asset retirement costs shall be excluded from Account 101 (Electric Plant in Service) and the associated depreciation shall be excluded from Account 108 (Accumulated Provision for Depreciation of Electric Utility Plant) pursuant to the adoption of Financial Accounting Standard 143 – Accounting for Asset Retirement Obligations.