Southern Company

Vote Yes on Item 10 "Carbon Asset Risk" Report

Annual Meeting: May 25, 2016/ Symbol: SO

SUMMARY

As You Sow's shareholder proposal requests that Southern Company assess, quantify, and disclose the carbon asset risk that its coal investments pose to the Company. "Carbon asset risk" is the threat that, due to regulatory, market and technology changes, fossil fuel infrastructure will lose value ahead of its useful life, resulting in possibly material losses to shareholders.

Southern Company's coal fleet, and the carbon footprint it creates, is enormous. Where the United States decreased coal consumption 18% between 2008 and 2013, Southern Company increased coal consumption 4% since 2012.[1] As of 2013, Southern Company consumed the third highest level of coal of U.S. utilities, and created the third highest level of carbon pollution of U.S. utilities.[2] Indeed, Southern Company's extreme carbon emissions represent approximately 1.6% of the United States' total carbon emissions, and are rising.[3] Southern Company's carbon pollution rose in 2013 and 2014, nearly returning to 2011 levels.[4] Unlike peers who are working to peak carbon emissions, Southern Company stated that "… future emissions could be higher than historical levels".[5]

None of this is good news for shareholders; Southern Company's carbon risk appears unmanaged. Due to increasing coal costs, coal fleets nationally have become liabilities and many are being sold at a loss.[6] Similarly, the Clean Power Plan was the first of what is likely to be numerous laws requiring companies to be accountable for the carbon pollution and climate damage they create. When such regulation occurs, Southern Company and its shareholders will be extremely vulnerable. Investors deserve to know what level of financial harm Southern Company's carbon asset risk exposes them to, stress tested under various regulatory scenarios, as requested by this proposal. Without this reporting investors are simply unable to assess the risk facing the Company and consequently cannot make informed investment decisions.

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[1] Energy Information Administration. *Annual Energy Outlook. Data Browser*. Accessed April 24th, 2016. http://www.eia.gov/forecasts/aeo/data/browser/
[2] Note: data from 2013. NRDC, Ceres. *Benchmarking Utility Air Emissions*, 2015, p.17. Available at: https://www.nrdc.org/sites/default/files/benchmarking-2015.pdf.
[3] Calculated using NRDC, Ceres. *Benchmarking Utility Air Emissions* 2015, p.17. Available at: https://www.nrdc.org/sites/default/files/benchmarking-2015.pdf, and "*Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990 – 2013*", EPA, ES-7. Available at: https://www3.epa.gov/climatechange/Downloads/ghgemissions/US-GHG-Inventory-2015-Main-Text.pdf.
[4] *2015 Carbon Disclosure Report*, Southern Company, May 2015, p.2. Available at: http://www.southerncompany.com/what-doing/pdf/Carbon_Disclosure_Report_2015.pdf.
[5] *2015 Carbon Disclosure Report*, Southern Company, May 2015, p.2. Available at: http://www.southerncompany.com/what-doing/pdf/Carbon_Disclosure_Report_2015.pdf.
[6] *See section 4.*

RESOLVE CLAUSE

BE IT RESOLVED: Shareholders request that Southern Company prepare a report by September 2016, omitting proprietary information and at reasonable cost, quantifying potential financial losses to the company associated with stranding of its coal assets under a range of scenarios for climate change driven regulations that mandate greenhouse gas reductions beyond those required by the Clean Power Plan. Such report should include possible financial losses if coal gasification and/or CCS is rejected by policymakers as a technical climate mitigation strategy, or if they cannot be cost effectively implemented. Shareholders also request that Southern disclose, in the report, its total investments in CCS and coal gasification technologies.

RATIONALE FOR A YES VOTE

1. **Southern Company does not disclose its carbon asset risk to investors, let alone quantify it.**
2. **Southern Company's climate changes disclosure are poor in comparison to peers.**
3. **Regulators are now rejecting coal related rate increases.**
4. **Other utilities are rapidly shedding coal infrastructure.**
5. **Southern Company's coal asset are already being stranded, putting shareholders at risk.**

1. Southern Company does not disclose its carbon asset risk, let alone quantify it.
Southern Company does not disclose any information on its "carbon asset risk", the subject of the proposal. Investors have no way of assessing how costly Southern Company's coal plants will be in the future, or to assess the liability they represent.

Investors have reason to worry. Interspersed throughout Southern Company's materials are hints as to how much the Company believes its coal plants will cost. For example, Southern Company estimates that it will take up to $22 billion to comply with the new, lenient coal-ash rule.[7] Similarly, it estimates compliance with the new mercury pollution rule at $1.7-2.7 billion.[8] Unlike utility peers Southern Company has refused to disclose its estimate of compliance with the Clean Power Plan to investors, however did warn regulators that the rule could increase its customer rates $35 billion dollars by 2030 -- assuming regulators allow Southern to pass those costs on, which is uncertain.[9] This fractured picture of Southern Company's coal compliance liability, totaling near $60 billion dollars in the near to medium term, should alarm investors.

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[7] EPA Regulations Comment: *Disposal of Coal Combustion Residuals from Electric Utilities*. Comment submitted by Chris M. Hobson, Senior Vice President, Research and Environmental Affairs, Southern Company Nov, 2010. Available at: http://www.regulations.gov/#!documentDetail;D=EPA-HQ-RCRA-2009-0640-6300. For MATS estimate, see: Art Beattie, CFO *2012 Q2 Earnings Call*, Southern Company July 2012. Available at: http://seekingalpha.com/article/749651-southern-management-discusses-q2-2012-results-earnings-call-transcript?part=single.

[8] *Id*.

[9] EPA Regulations Comment: Carbon Pollution Emission Guidelines for Existing Stationary Sources. "*Southern Company – Comment*", Southern Company Dec, 2014, p.210. http://www.regulations.gov/#!documentDetail;D=EPA-HQ-OAR-2013-0602-22907.

Investors need comprehensive, quantified carbon asset risk reporting from Southern Company. These three regulations are just a few of the new laws that require companies to address the air, water, particulate matter, and toxic waste pollution coal plants cause.[10]

2. Southern Company's climate change disclosure are poor in comparison to peers.
It is particularly important to investors that Southern Company report its carbon asset risk because its overall carbon reporting is so deficient. CDP, or "Carbon Disclosure Project" reporting is the most widely adopted and effective carbon reporting method, utilized by 17 of Southern company's peers.[11] CDP reports are administered for corporations and municipalities around the world, and reviewed by the Carbon Disclosure Project, a third party nongovernmental organization.[12]

Southern Company received poor marks on its CDP report in a ranking against peers, and in response, stopped CDP reporting.[13] It now self-reports on carbon management in a document designed to mimic a CDP report but critically lacking the depth, data, and accountability found in CDP reports.[14] Southern's custom report omits key elements found in actual CDP reports, such as: an explanation of the physical and regulatory risks climate change poses to the Company's business; detailed, raw, year over year Scope 1, 2, and 3 emissions data; business opportunities created by climate change; explanation of how climate is integrated into executive compensation packages; plant by plant emissions data; disclosure of financial risk posed by climate change; and more. The information included in Southern's carbon report discusses topics generally and not necessarily in relation to the Company; in a vague, narrative format that excludes discussion of carbon asset risk. Southern's custom carbon report contains little raw data, and only offers a bar chart for Scope 1 emissions -- those generated by Southern-owned power plants, which represents an unknown fraction of Southern Company's total emissions.

3. Regulators are now rejecting coal related rate increases.
In the past, utility regulators generally granted rate increases utilities requested for coal operations. However, in recent years, apparently recognizing the U.S. power sector's rapid transition to low carbon resources, regulators have begun to frequently reject rate increases for utility coal infrastructure, leaving the costs to shareholders. For example:

- **Oklahoma rejected a $1 billion OGE rate hike purportedly to pay for Clean Power Plan compliance equipment**.[15]

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[10] *Regulations Update*, AEP 2015. Available at: https://aepsustainability.com/performance/environmental/regulations/update.aspx.
[11] CDP. *CDP S&P 500 Climate Change Report 2015* p.50 https://www.cdp.net/CDPResults/CDP-USA-climate-change-report-2015.pdf
[12] CDP. "*What We Do"* https://www.cdp.net/en-US/WhatWeDo/Pages/investors.aspx
[13] Cusick, "*Investor groups want Southern Co. to report more GHG data and risks*", E&E Publishing, May 2015. Available at: http://www.eenews.net/stories/1060017953.
[14] Southern Company. *Carbon Disclosure Report* 2014 http://www.southerncompany.com/what-doing/pdf/Carbon_Disclosure_Report.pdf
[15] Hardzinski, "*Oklahoma Corporation Commission Rejects $1.1 Billion Rate Hike Proposal By OG&E*", December 5, 2015. Available at: http://kgou.org/post/oklahoma-corporation-commission-rejects-11-billion-rate-hike-proposal-oge#stream/0.

- **Virginia rejected Appalachia Power's request for a coal gasification plant like Kemper, finding it neither sound nor prudent, and saying that the coal liquefaction plant would "create an extraordinary risk that it cannot allow Virginia customers to assume."[16]**
- New Mexico denied a rate hike that would have prolonged the life of its coal plants.[17]
- Michigan denied the permits needed for a new coal plant.[18]
- Ohio regulators initially rejected the AEP and FirstEnergy bailouts, agreeing only after significant concessions from the utilities including major investments in renewable energy, energy efficiency, and a carbon reduction target of 90% carbon reduction by 2045 for First Energy.[19]

Oklahoma's denial of OGE's rate request is especially significant. It suggests utilities' assumption that they will be able to pass Clean Power Plan compliance costs onto ratepayers may be wrong, which would dramatically escalate utilities' stranded asset risk. There is additional evidence to support this concern, such as Mississippi's indefinite delay of Southern Company's request for cost recovery on the Kemper Plant.[20] Similarly, Mississippi's Supreme Court cancelled $200 million in fees from the Kemper coal plant and refunded the capital back to ratepayers.[21] Even limited cost recovery could expose shareholders to billions more in charges related to Kemper.

4. Other utilities are rapidly shedding coal infrastructure.

Where Southern has gone to extraordinary lengths to prolong the life of its coal assets, for example sinking $2 billion since the 60s into amorphous "carbon capture and storage" "research and development", peers are simply shedding coal fleets as quickly as possible and moving on.[22] For example:

- Ameren ***paid*** Dynegy $200 million to take Ameren's merchant coal fleet, enabling Ameren to remove $825 million in toxic assets related to its coal fleet from its books.[23]

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[16] Edwards, "*Proposed coal plant denied*", Richmond Times-Dispatch, April 15, 2008. Available at: http://www.richmond.com/news/article_edb70433-c17c-5020-b6ee-475b9116c766.html.

[17] St. Cyr, "*PNM's Electricity Rate Increase Rejected*", Santa Fe Reporter, May 13, 2015. Available at: http://www.sfreporter.com/santafe/article-10372-pnms-electricity-rate-increase-rejected.html.

[18] Paulman. "*Michigan regulators deny permit for proposed coal plant*", Midwest Energy News May 21, 2010. Available at: http://midwestenergynews.com/2010/05/21/michigan-state-agency-denies-permit-for-proposed-coal-plant/.

[19] Knox, "*Ohio regulators approve income guarantees for AEP and FirstEnergy*", Columbus Business First March 31, 2016. Available at: http://www.bizjournals.com/columbus/news/2016/03/31/ohio-regulators-approve-income-guarantees-for-aep.html; *see also* "*FirstEnergy's electric security plan*", Ohio Public Utility Commission, March 31, 2016. Available at: http://www.puco.ohio.gov/puco/index.cfm/be-informed/consumer-topics/firstenergy-s-electric-security-plan/#sthash.SpVTbg7a.dpbs.

[20] "*Mississippi Power denied rate increase for Kemper IGCC power project*", Power Engineering, August 1, 2012. Available at: http://www.power-eng.com/articles/2012/08/mississippi-power-denied-rate-increase-for-kemper-igcc-power-project.html.

[21] "Supreme Court says PSC blew it on Kemper power plant, orders refund", Mississippi Business Journal, February 13, 2015. Available at: http://msbusiness.com/2015/02/supreme-court-says-psc-blew-kemper-power-plant-orders-refund/.

[22] "Southern Company leading global carbon capture research and development network for U.S.", Southern Company February 24, 2016. Available at: http://www.prnewswire.com/news-releases/southern-company-leading-global-carbon-capture-research-and-development-network-for-us-300225531.html#323_268999603_15611_-1_1456346515889.

[23] Polson, "*Dynegy Agrees to Buy Ameren Plants in Illinois for No Cash*", Bloomberg March 14, 2013. *Available at:* http://www.bloomberg.com/news/articles/2013-03-14/dynegy-to-buy-ameren-power-plants-in-illinois-for-no-cash.

- Dominion put $1 billion in compliance equipment into Brayton Point Plant, only to sell it at a loss.[24]
- Though AEP received a government bailout of its Ohio coal plants, it is ***still*** trying to sell them.[25]
- Duke just completed the sale of its Ohio plants.[26]
- NRG posted a $6 billion loss resulting from its struggling Texas coal plants.[27]

Southern is not immune to these trends. While it has retired some coal, it is still over 50% coal, which represents a very high level of coal given the Company's scale.[28]

5. Southern Company's coal assets are already being stranded.

Southern's coal assets are already being stranded. Southern Company attempted to build a medium sized 582 MW coal plant utilizing "coal liquefaction" technology which turns coal to gas. The plant, "Kemper", was originally intended to allow for the burning of coal at a lower rate of carbon emissions, has so far resulted in ***over $2 billion in losses to shareholders.***[29] Originally estimated to cost $2.01 billion, the project is now at $6.5B, --- $4.4 billion over budget.[30] Target start dates for operation have been continually pushed back for three years; the most recent delays resulted in Southern forfeiting and returning $234 million in tax credits.[31] Every month Kemper is delayed, it costs Southern $43 million.[32] The delays appear to be technical, and seems related to the untested nature of "coal liquefaction" technology.[33] Southern's Mississippi regulator recently unsealed documents related to the Kemper facility's cost overruns which may soon provide investors with more transparency.[34] The project also resulted in a credit downgrade for Southern's Mississippi subsidiary, Mississippi Power, due to the plant's staggering liabilities.[35] Kemper is but one example of how Southern's massive investments in coal

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24 Edes, "*Dominion sells Brayton Point power station*", Boston Globe, March 12, 2013. Available at: https://www.bostonglobe.com/business/2013/03/11/dominion-sells-three-power-plants-including-brayton-point-somerset/eZWyzMDg5907wcQ5PirK5H/story.html.

25 Gearino. "*AEP leaning toward selling Ohio power plants*", Columbus Dispatch, April 22, 2015. Available at: http://www.dispatch.com/content/stories/business/2015/04/21/aep-leans-toward-selling-Ohio-power-plants.html.

26 "*Duke Energy completes sale of its non-regulated Midwest generation business to Dynegy*", Duke Energy April 2, 2015. Available at: https://www.duke-energy.com/news/releases/2015040202.asp.

27 Blum, "NRG Energy posts $6 billion loss", Fuel Fix, February 29, 2016. *Available at*: http://fuelfix.com/blog/2016/02/29/nrg-energy-posts-6-billion-loss/. See also: Malik, "*NRG Energy Tumbles on Dividend Cut, Texas-Driven Charge*", Bloomberg February 29, 2016. Available at: http://washpost.bloomberg.com/Story?docId=1376-O3BFB3SYF01W01-6KRMTV9EG3E07PF9R27H8HVOSF.

28 *2015 Carbon Disclosure Report*, Southern Company, May 2015, p.2. Available at: http://www.southerncompany.com/what-doing/pdf/Carbon_Disclosure_Report_2015.pdf.

29 Kunkel, "*Southern Company's Kemper County Folly: A 'Clean Coal' Electricity Plant in Mississippi Offers an Abject Lesson in Costly Failure*", IEEFA July 15, 2015. Available at: http://ieefa.org/southern-companys-kemper-county-folly/

30 *Kemper County Energy Facility, Costs Through January 2016*, Southern Company 2016. Available at: http://www.mississippipower.com/pdf/kemper/Kemper-Cost-Breakdown.pdf.

31 Chediak, "Southern Encounters Challenges in Starting Kemper Coal Plant", Bloomberg January 5, 2016. Available at:

32 *Id.*

33 *Id.*

34 "*PSC to Release Kemper Oversight Documents Online*", Mississippi Public Service Commission, March 24, 2016: http://www.psc.state.ms.us/commissioners/southern/press%20releases/2016/PSC%20to%20Release%20Kemper%20Oversight%20Documents%20Online.pdf.

35 "*Moody's changes Mississippi Power outlook to negative; affirms Southern's ratings*". Moody's, Feb 19, 2015. Available at: https://www.moodys.com/research/Moodys-changes-Mississippi-Power-outlook-to-negative-affirms-Southerns-ratings--PR_318759.

have led to stunning losses for shareholders. Investors deserve to have a full accounting of Southern Company's coal liabilities, and its plans to protect shareholders from losses related to them.

CONCLUSION

Southern's coal infrastructure, and the carbon pollution is creates, are both very risky for shareholders and represent an unknown level of financial risk to the Company. Investors deserve to see the data from a stress test of Southern's coal fleet under varying levels of carbon regulation, as requested by the proposal. Only then can investors understand to risk the company represents; have enough information to make an informed investing decisions; and have sufficient information to evaluate whether Management's response, or lack thereof, is sound. Proponents urge a "Yes" vote on Item 10.