INTEGRYS ENERGY GROUP, INC.
Form 10-K
February 28, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2007

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________________ to ___________________

Commission File Number	Registrant; State of Incorporation; Address; and Telephone Number	IRS Employer Identification No.
1-11337	INTEGRYS ENERGY GROUP, INC. (A Wisconsin Corporation) 130 East Randolph Drive Chicago, IL 60601 800-699-1269	39-1775292

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $1 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes [X]
No [ ]

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes [ ] No [X]

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]	Accelerated filer [ ]
Non-accelerated filer [ ]	Smaller reporting company [ ]

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ]
No [X]

State the aggregate market value of the voting and
non-voting common equity held by non-affiliates of the Registrant.

$3,853,752,238 as of June 30, 2007

Number of shares outstanding of each class
of common stock, as of February 28, 2008

Common Stock, $1 par value, 76,424,095 shares

DOCUMENT INCORPORATED BY REFERENCE

Definitive proxy statement for the Integrys Energy Group, Inc. Annual Meeting of Shareholders to be held on May 15, 2008 is incorporated by reference into Part III.

INTEGRYS ENERGY GROUP, INC.

ANNUAL REPORT ON FORM 10-K
For the Year Ended December 31, 2007

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Acronyms Used in this Annual Report on Form 10-K

ATC	American Transmission Company LLC
DOE	United States Department of Energy
DPC	Dairyland Power Cooperative
EPA	United States Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
IBS	Integrys Business Support, LLC
ICC	Illinois Commerce Commission
ICE	Intercontinental Exchange
IRS	United States Internal Revenue Service
LIFO	Last-in, first-out
MERC	Minnesota Energy Resources Corporation
MGUC	Michigan Gas Utilities Corporation
MISO	Midwest Independent Transmission System Operator
MPSC	Michigan Public Service Commission
MPUC	Minnesota Public Utility Commission
NSG	North Shore Gas Company
NYMEX	New York Mercantile Exchange
PEC	Peoples Energy Corporation
PEP	Peoples Energy Production Company
PGL	The Peoples Gas Light and Coke Company
PSCW	Public Service Commission of Wisconsin
SEC	United States Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
UPPCO	Upper Peninsula Power Company
WDNR	Wisconsin Department of Natural Resources
WPSC	Wisconsin Public Service Corporation
WRPC	Wisconsin River Power Company

Forward-Looking Statements

In this report, Integrys Energy Group and its subsidiaries make statements concerning expectations, beliefs, plans, objectives, goals, strategies, and future events or performance. Such statements are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. Although Integrys Energy Group and its subsidiaries believe that these forward-looking statements and the underlying assumptions are reasonable, it cannot provide assurance that they will prove correct. Except to the extent required by the federal securities laws, Integrys Energy Group and its subsidiaries undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

In addition to statements regarding trends or estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations forward-looking statements included or incorporated in this report include, but are not limited to statements regarding future:

- Revenues or expenses,
- Capital expenditure projections, and
- Financing sources.

Forward-looking statements involve a number of risks and uncertainties. There are many factors that could cause actual results to differ materially from those expressed or implied in this report. Some risk factors that could cause results different from any forward-looking statement include those described in Item 1A of this Annual Report on Form 10-K for the year ended December 31, 2007. Other factors include:

- Unexpected costs and/or unexpected liabilities related to the PEC merger;
- The successful combination of the operations of Integrys Energy Group and PEC;
- Integrys Energy Group may be unable to achieve the forecasted synergies in connection with the PEC merger or it may take longer or cost more than expected to achieve these synergies;
- Resolution of pending and future rate cases and negotiations (including the recovery of deferred costs) and other regulatory decisions impacting Integrys Energy Group’s regulated businesses;
- The impact of recent and future federal and state regulatory changes, including legislative and regulatory initiatives regarding deregulation and restructuring of the electric and natural gas utility industries and possible future initiatives to address concerns about global climate change, changes in environmental, tax and other laws and regulations to which Integrys Energy Group and its subsidiaries are subject, as well as changes in application of existing laws and regulations;
- Current and future litigation, regulatory investigations, proceedings or inquiries, including but not limited to, manufactured gas plant site cleanup, and the contested case proceeding regarding the Weston 4 air permit;
- Resolution of audits or other tax disputes with the IRS and various state, local and Canadian revenue agencies;
- The effects, extent and timing of additional competition or regulation in the markets in which our subsidiaries operate;
- Available sources and costs of fuels and purchased power;
- Investment performance of employee benefit plan assets;
- Advances in technology;
- Effects of and changes in political and legal developments, as well as economic conditions and its impact on customer demand, in the United States and Canada;

Potential business strategies, including mergers, acquisitions, construction or disposition of assets or businesses, which cannot be assured to be completed timely or within budgets;
The direct or indirect effects of terrorist incidents, natural disasters or responses to such events;
The impacts of changing financial market conditions, credit ratings and interest rates on our financing efforts, and the risks associated with changing commodity prices (particularly natural gas and electricity);
Weather and other natural phenomena, in particular the effect of weather on natural gas and electricity sales;

- The effect of accounting pronouncements issued periodically by standard-setting bodies; and
- Other factors discussed elsewhere herein and in other reports filed by us from time to time with the SEC.

Forward-looking statements are subject to assumptions and uncertainties, therefore actual results may differ materially from those expressed or implied by such forward-looking statements.

PART I

ITEM 1. BUSINESS

A. GENERAL

For purposes of this Annual Report on Form 10-K, unless the context otherwise indicates, when we refer to "us," "we," "our" or "ours," we are describing Integrys Energy Group, Inc.

Integrys Energy Group, Inc.

Integrys Energy Group is domiciled in the United States and was incorporated in Wisconsin in 1993. Integrys Energy Group is a holding company for regulated utility and nonregulated business units. As of December 31, 2007, Integrys Energy Group served approximately 485,000 regulated electric utility customers and approximately 1,674,000 regulated natural gas utility customers.

See Note 24, "Segments of Business," for information on Integrys Energy Group’s foreign and domestic revenues, foreign and domestic long-lived assets, and revenues from external customers, net income (loss), and total assets by reportable segment.

Electric Utility Segment

The electric utility segment includes the regulated electric utility operations of WPSC and UPPCO. WPSC, a Wisconsin corporation, is domiciled in the United States and began operations in 1883. UPPCO, a Michigan corporation, is domiciled in the United States and began operations in 1884. For the last three years, all of the electric utility segment’s revenues were earned within the United States and all assets were located within the United States. In 2007, retail electric sales accounted for 82.4% of total revenues, while wholesale electric sales accounted for 17.6% of total revenues.

Natural Gas Utility Segment

The natural gas utility segment includes the regulated natural gas utility operations of WPSC, MGUC, MERC, PGL, and NSG. MGUC and MERC, both Delaware corporations, are domiciled in the United States and began operations upon acquisition of their natural gas distribution operations in Michigan and Minnesota, respectively, from Aquila, Inc. in April 2006, and July 2006, respectively. PGL and NSG, both Illinois corporations, are domiciled in the United States and began operations in 1855 and 1900, respectively. Integrys Energy Group acquired PGL and NSG in February 2007 in the PEC merger.

Integrys Energy Services

Integrys Energy Services, a Wisconsin corporation, is domiciled in the United States and was established in 1994. Integrys Energy Services is a diversified energy supply and services company serving residential, commercial, industrial, and wholesale customers in developed competitive markets in the United States and Canada. In 2007, Integrys Energy Services opened an office in Denver, Colorado, to expand its operation into the Western Systems Coordinating Council markets. Integrys Energy Services anticipates future operations in all viable competitive markets in the United States and Canadian natural gas and electric markets.

Holding Company and Other Segment

The Holding Company and Other segment includes the operations of the Integrys Energy Group holding company and the PEC holding company, along with any nonutility activities at WPSC, MGUC, MERC, UPPCO, PGL, and NSG. Also included in the Holding Company and Other segment is WPS Investments, LLC, a nonutility company which holds the investment of Integrys Energy Group and its subsidiaries in ATC. On December 31, 2007, WPS Investments was owned 15.85% by WPSC, 3.37% by UPPCO and

80.78% by Integrys Energy Group. Equity earnings from our investments in ATC, WRPC, and Guardian Pipeline, LLC (prior to its sale in 2006) are included in the Holding Company and Other segment.

For more information regarding revenues, net income, and total assets for Integrys Energy Group's reportable segments, see Note 24, "Segments of Business."

B. REGULATED ELECTRIC OPERATIONS

Integrys Energy Group's regulated electric operations are provided through WPSC and UPPCO. WPSC's regulated electric operations generate and distribute electric energy mainly to northeastern Wisconsin and a small portion of Michigan's Upper Peninsula. UPPCO provides electric energy in Michigan's Upper Peninsula. Wholesale electric service is provided to various customers, including municipal utilities, electric cooperatives, energy marketers, other investor-owned utilities, and municipal joint action agencies.

Regulated Electric Segment OperatingStatistics

	2007	2006	2005
Operating revenues (millions)			
Residential	$ 381.8	$ 353.0	$ 355.1
Commercial and industrial	607.0	548.8	491.7
Resale and other	257.3	197.6	190.3
Total	$ 1,246.1	$ 1,099.4	$ 1,037.1
Kilowatt-hour sales (millions)			
Residential	3,173.6	3,144.8	3,127.4
Commercial and industrial	8,750.9	8,645.2	8,641.8
Resale and other	4,067.3	4,135.3	3,890.9
Total	15,991.8	15,925.3	15,660.1
Customers served (approximate, end of period)			
Residential	424,400	421,000	424,100
Commercial and industrial	59,600	59,100	51,600
Resale and other	1,000	900	1,300
Total	485,000	481,000	477,000

In 2007, Integrys Energy Group's regulated electric facilities reached a firm net design peak of 2,305 megawatts on July 31, 2007. As a result of continually reaching demand peaks in the summer months, primarily due to air conditioning load, the summer period is the most relevant for Integrys Energy Group's regulated electric utility capacity. WPSC expects future supply reserves to meet the minimum 18% planning reserve margin criteria through 2008 as required by the PSCW. The PSCW has opened a docket to review the adequacy of the 18% reserve margin requirement. The MPSC has not established minimum guidelines for future supply reserves.

WPSC and UPPCO had adequate capacity to meet all firm electric load obligations during 2007 and expect to have adequate capacity to meet all obligations during 2008. Both WPSC and UPPCO are members of the MISO, which operates a financial and physical electric wholesale market in the Midwest, and offer their generation and bid their customer load into the market. For further information on MISO, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Other Future Considerations.

Facilities

For a complete listing of Integrys Energy Group's regulated electric facilities, see Item 2 - Properties, in this Annual Report on Form 10-K. To see Integrys Energy Group's electric utility plant asset book value, see Note 5, "Property, Plant, and Equipment."

Power Purchase Agreements

Integrys Energy Group' regulated electric facilities enter into short and long-term power purchase agreements to meet a portion of electric energy supply needs. For more information on these power purchase agreements, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital

Resources, Contractual Obligations.

Fuel Supply

Electric Supply Mix

Integrys Energy Group's regulated electric supply mix for 2007 and 2006 was:

Energy Source	2007		2006	
Company-owned generating plants				
Coal		52.4%		57.3%
Natural gas and fuel oil		2.2%		1.4%
Hydroelectric		1.3%		1.5%
Wind		0.1%		0.1%
Purchased power				
Kewaunee (nuclear)	19.3%		17.6%	
Fox Energy Center, LLC and Combined Locks Energy Center, LLC (natural gas)	3.4%		6.1%	
Hydroelectric	2.4%		3.3%	
Other (including MISO)	18.9%		12.7%	
Total purchased power		44.0%		39.7%

Fuel Costs

Integrys Energy Group's regulated electric fuel costs for its generating units for 2007 and 2006 were:

Fuel Cost by Source (Per Million Btus)	2007	2006
Coal	$ 1.47	$ 1.30
Natural gas	7.36	7.19
Fuel oil	13.95	13.60

Coal Supply and Deliveries

Coal is the primary fuel source for Integrys Energy Group's regulated electric generation facilities, the majority of which is from the Powder River Basin mines located in Wyoming. This low sulfur coal has been our least-cost coal source from any of the subbituminous coal-producing regions in the United States. Integrys Energy Group's regulated electric fuel portfolio strategy is to maintain a 25- to 40-day supply of coal at each plant site.

Historically, WPSC has purchased coal directly from the producer for its wholly owned plants. Wisconsin Power and Light purchases coal for the jointly owned Edgewater and Columbia plants and is reimbursed by WPSC for its share of the coal costs. WPSC currently has contracts in place for coal transportation for 90% of its 2008 coal transportation requirements. For more information on coal purchases and coal deliveries under contract, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources, Contractual Obligations and Note 17, "Commitments and Contingencies."

Natural Gas Supply - Generation

Through a power purchase agreement, WPSC is committed to provide fuel for 500 megawatts of the Fox Energy Center, a natural gas-fired combined cycle generation facility owned by a third party with a total combined electric capacity of approximately 580 megawatts. In addition, WPSC supplies natural gas through its natural gas distribution system to its approximately 429 megawatts of natural gas-fired combustion turbine generation facilities. For more information on WPSC's natural gas supply under contract, see Item 7 - Management's Discussion and Analysis of

Financial Condition and Results of Operation - Liquidity and Capital Resources, Contractual Obligations and Note 17, "Commitments and Contingencies."

WPSC has received approval from the PSCW for its Energy Market Risk Management Plan to govern its activities in the energy markets. The order permits activities to limit exposure to the volatility of natural gas prices affecting its electric generation, as well as the use of financial transmission rights for the use of managing energy congestion costs. The plan provides for the use of financial futures contracts for natural gas and the use of financial options that cap the price of natural gas for a portion of WPSC's forecasted natural gas fuel generation requirements and natural gas price sensitive purchased power contracts.

Regulatory Matters

Integrys Energy Group's electric utility operations are regulated by the PSCW, MPSC, and FERC.

For additional information, see Note 23, "Regulatory Environment."

Hydroelectric Licenses

WPSC, UPPCO, and WRPC (a company in which we have 50% ownership), have long-term licenses from FERC for all of their hydroelectric facilities.

UPPCO has announced its decision to restore Silver Lake as a reservoir to support power generation, pending approval of an economically feasible design by the FERC. The FERC has required that a board of consultants evaluate and oversee the design approval process. UPPCO continues to work with its Board of Directors and the FERC to develop an economically feasible design.

For more information on Silver Lake, see Note 17, "Commitments and Contingencies."

Other Matters

Customer Segmentation

In 2007, paper production facilities and one wholesale customer (a private utility that primarily provides power to paper mills) accounted for 9.3% of Integrys Energy Group's regulated electric utility revenues. Residential sales accounted for 30.6% of Integrys Energy Group's regulated electric utility revenues in 2007.

Seasonality

Integrys Energy Group's regulated electric utility sales in Wisconsin generally follow a seasonal pattern due to the air conditioning requirements of customers that are primarily impacted by the variability of summer temperatures. Regulated electric utility sales in Michigan follow no significant seasonal trend due to cooler climate conditions in the Upper Peninsula of Michigan.

Generally during the winter months, the purchase price of fuel (natural gas and fuel oil) for heating load and generation production is heavily influenced by weather and the availability of baseload generation units within the MISO energy market. Sustained colder-than-normal weather and unexpected extended generation outages can influence fuel supply and demand, impacting the production costs at Integrys Energy Group's natural gas and oil-fired facilities, as well as natural gas supply commitments under power purchase agreements. For Integrys Energy Group's electric segment, the impact on utility production costs is managed through WPSC's Energy Market Risk Management Plan.

Competition

The retail electric utility market in Wisconsin is regulated by the PSCW. Retail electric customers currently do not have the ability to choose their electric supplier. However, in order to increase sales, utilities work to attract new commercial/industrial customers into their service territory. As a result, there is competition among utilities to keep energy rates low. Wisconsin utilities have continued to refine regulated tariffs in order to provide customers with the true cost of electric energy to each class of customer by reducing or eliminating rate subsidies among different ratepayer classes. Although Wisconsin electric energy markets are regulated, utilities still face competition from other energy sources.

Michigan electric energy markets are open to competition; however, an active competitive market has not yet developed in the Upper Peninsula of Michigan primarily due to a lack of excess generation and transmission system capacity.

Working Capital Requirements

For information on capital requirements related to Integrys Energy Group's regulated electric utility operations see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources.

C. REGULATED NATURAL GAS UTILITY OPERATIONS

Integrys Energy Group provides regulated natural gas utility service to Chicago and northeastern Illinois, northeastern Wisconsin, adjacent portions of Michigan's Upper Peninsula, various cities and communities throughout Minnesota, and in the southern portion of lower Michigan.

Regulated Natural Gas Segment Operating Statistics

	2007	2006	2005
Operating Revenues (millions)			
Residential	$ 1,441.7	$ 401.4	$ 291.9
Commercial and industrial	481.2	218.3	137.7
Other	180.8	57.2	92.4
Total	$ 2,103.7	$ 676.9	$ 522.0
Therms Delivered (millions)			
Residential	1,251.8	351.5	241.6
Commercial and industrial	498.6	230.7	170.8
Other	47.1	27.6	70.8
Total therm sales	1,797.5	609.8	483.2
Transportation	1,505.6	657.5	344.0
Total	3,303.1	1,267.3	827.2
Customers Served (approximate, end of period)			
Residential	1,548,400	620,500	279,300
Commercial and industrial	124,700	62,600	27,700
Other	-	-	-
Transportation customers	900	900	1,000
Total	1,674,000	684,000	308,000

Facilities

For information regarding our regulated natural gas facilities, see Item 2 - Properties in this Annual Report on Form 10-K. To see Integrys Energy Groups' natural gas utility plant asset book value, see Note 5, "Property, Plant, and Equipment."

Natural Gas Supply

Integrys Energy Group's natural gas utilities manage portfolios of natural gas supply contracts, storage services and pipeline transportation services designed to meet their varying load pattern at the lowest reasonable cost.

Integrys Energy Group's regulated natural gas subsidiaries contract for fixed-term firm natural gas supplies with various natural gas suppliers each year to meet the November through March winter period demand of firm system sales customers. Integrys Energy Group's regulated natural gas supply requirements are met through a combination of physical fixed price purchases, storage (contracted and owned), natural gas call options and physical index purchases, and through the purchase of additional natural gas supplies on the monthly spot market through fixed-term firm contracts to supplement natural gas supplies and minimize risk. During periods of colder than normal weather, purchasing natural gas in the daily spot market may be necessary. Integrys Energy Group's regulated natural gas operations contract for domestic natural gas supplies and limit their purchases to minimize potential stranded natural gas supply contract costs.

Under current regulatory practice, the ICC, PSCW, MPUC, and MPSC allow Integrys Energy Groups' regulated natural gas utilities to pass the prudently incurred cost of natural gas on to customers on a dollar-for-dollar basis through purchased gas adjustment clauses. Changes in the cost of natural gas are reflected in both natural gas revenues and natural gas purchases, thus having little or no impact on net income.

For further information on Integrys Energy Group's regulated natural gas utility supply and transportation contracts, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources, Contractual Obligations and Note 17, "Commitments and Contingencies."

Integrys Energy Group's natural gas utilities contract with various underground storage facilities for underground natural gas storage capacity and have company-owned storage. Besides providing the ability to manage significant changes in daily natural gas demand, storage also provides Integrys Energy Group with the ability to purchase natural gas at high load factors on a year-round basis, thus lowering supply cost volatility. Integrys Energy Group has approximately 397 million therms of firm natural gas storage capacity under contract and approximately 314 million therms of firm natural gas storage capacity located in its distribution system.

Regulatory Matters

The natural gas retail rates of Integrys Energy Group are regulated by the ICC, PSCW, MPSC, and MPUC. PGL utilizes its storage and pipeline supply assets as a natural gas hub. This activity is regulated by the FERC and consists of providing wholesale transportation and storage services in interstate commerce.

For additional information, see Note 23, "Regulatory Environment."

Other Matters

Seasonality

The natural gas throughput of Integrys Energy Group's regulated natural gas utilities follows a seasonal pattern due to the heating requirements of customers that is primarily impacted by the variability in winter temperatures.

Competition

Integrys Energy Group's regulated natural gas utility operations face competition with other entities and forms of energy in varying degrees, particularly for large commercial and industrial customers who have the ability to switch between natural gas and alternate fuels. Due to the volatility of natural gas prices, Integrys Energy Group has seen customers with dual fuel capability switch to alternate fuels for short periods of time, then switch back to natural gas as market rates change. Interruptible natural gas sales and natural gas transportation service is offered for customers to enable them to reduce their energy costs. Transportation customers purchase their natural gas directly from third-party natural gas suppliers at market prices and contract with Integrys Energy Group's entities to transport the natural gas from pipelines to their facilities. Additionally, some customers still purchase their natural gas commodity directly from one of Integrys Energy Group's entities but have elected to do so on an interruptible basis, as a means to reduce their costs. Customers continue to switch between firm system supply, interruptible system supply and transportation service each year as the economics and service options change.

Working Capital Requirements

For information on capital requirements related to the regulated natural gas utility operations of Integrys Energy Group see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources.

D. INTEGRYS ENERGY SERVICES

Integrys Energy Services is a diversified nonregulated energy supply and services company serving retail and wholesale customers in developed competitive markets in the United States and Canada.

Integrys Energy Services and its subsidiaries serve residential, commercial and industrial customers, "aggregated" small commercial and residential customers as well as provide standard offer service. Aggregated customers are associations or groups of customers, which have joined together to negotiate purchases of electric or natural gas energy as a larger group. In the wholesale market, Integrys Energy Services focuses on structured transactions with regulated local distribution companies, pipelines, storage companies, cooperatives, municipalities, and other nonregulated energy marketing and trading companies.

Energy revenues, volumes, and assets are as follows:

	2007	2006	2005
Revenues (Millions)			
United States	$ 4,753.8	$ 3,176.9	$ 3,149.2
Canada	2,225.9	1,982.2	2,165.7
Total	$ 6,979.7	$ 5,159.1	$ 5,314.9
Electric Volumes (Million Megawatt-Hours)			
United States	17.7	5.0	8.1
Canada	0.5	0.5	-
Total	18.2	5.5	8.1
Gas Volumes (Billion Cubic Feet)			
United States	479.0	359.1	298.7
Canada	286.0	278.4	256.8
Total	765.0	637.5	555.5
Long - Lived Assets (Millions)			
United States	$ 3,130.3	$ 2,715.7	
Canada	20.3	21.0	
Total	$ 3,150.6	$ 2,736.7	

Integrys Energy Services utilizes derivative instruments, including forwards, futures, options and swaps, to manage its exposure to market risks in accordance with limits and approvals established in its risk management and credit policies. The Market Risk Oversight Committee, comprised of cross-functional members of management and senior leadership of Integrys Energy Services and its parent company Integrys Energy Group, monitors compliance with these policies.

For more information on the trading and risk management activities of Integrys Energy Services, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation and Market Price Risk Management Activities.

Facilities

At December 31, 2007, Integrys Energy Services owned and operated electric generation facilities in the Midwest and Northeast regions of the United States with a total rated capacity of approximately 367 megawatts.

Integrys Energy Services' direct ownership of generation facilities allows for more efficient management of the market risk associated with its generation capabilities and related contracts to provide electric energy. Integrys Energy

Services focuses on effective economic dispatch and risk management strategies in order to enhance the returns of its generation facilities.

As part of the asset management strategy of Integrys Energy Group, Integrys Energy Services continues to explore opportunities regarding the future of its electric generation facilities. Opportunities include, but are not limited to purchase, sales or development of certain facilities, joint ventures and long-term contracts. Opportunities change and develop with the dynamics of the markets in which Integrys Energy Services operates.

For a complete listing of generation facilities of Integrys Energy Services, see Item 2 - Properties in this Annual Report on Form 10-K.

Fuel Supply

Integrys Energy Services' fuel inventory policy varies for each generation facility depending on the type of fuel used and available natural gas storage facilities. In 2007, Integrys Energy Services' merchant coal-fired generation facilities consisted of its Westwood and Stoneman facilities. Actual fuel needs in 2008 will depend on market conditions and operational capability of these facilities.

Integrys Energy Services' Westwood facility burns waste coal left behind by mining operations and has several year's supply on site. All fuel is located within a seven-mile radius of the plant.

The Stoneman facility currently has all of its anticipated 2008 coal needs on site.

Integrys Energy Services currently has adequate transport and supply arrangements in place for its natural gas facilities (Beaver Falls, Syracuse, and Combined Locks) for their projected needs to fulfill firm commitments in 2008.

Licenses

Integrys Energy Services is a FERC licensed power marketer with import/export authorization through the DOE. Integrys Energy Services on its own, or through certain of its subsidiaries, is registered to sell retail electric service in Connecticut, Delaware, District of Columbia, Illinois, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, Texas and Virginia in the United States and the provinces of Ontario and in Alberta in Canada.

Integrys Energy Services, on its own, or through certain of its subsidiaries, is registered to sell natural gas in the states of Illinois, Iowa, Michigan, Ohio, Pennsylvania, New York and Alberta, Canada. Integrys Energy Services also sells natural gas in Wisconsin where no license is required. Integrys Energy Services' subsidiary, Integrys Energy Services of Canada Corp., is registered to do business in the Canadian provinces of Alberta, British Columbia, Manitoba, Nova Scotia, Ontario, Quebec, and Saskatchewan.

Integrys Energy Services, or certain of its subsidiaries, are also members of the following regional transmission operators and North American Electric Reliability Council reliability regions:

- Alberta Electric System Operator;
- Independent Electricity System Operator (located in Ontario);
- Electric Reliability Council of Texas;
- ISO New England;
- MISO;
- Midwest Reliability Organization;
- New Brunswick System Operator;
- New York Independent System Operator;
- Northeast Power Coordinating Council;
- Northern Maine Independent System Administrator;

- PJM Interconnection;
- ReliabilityFirst Corporation;
- SERC Reliability Corporation;
- Texas Regional Entity; and
- Western Systems Coordinating Council

All the FERC hydroelectric facility licenses held by Integrys Energy Services' subsidiaries are current. The 33-megawatt hydroelectric facility owned in New Brunswick, Canada, is not subject to licensing.

Other Matters

Customer Segmentation

Although Integrys Energy Services is not dependent on any one customer, a significant percentage of its retail sales volume is derived from industries related to:

- Paper and allied products;
- Food and kindred products;
- Chemicals and paint; and
- Steel and foundries.

Although Integrys Energy Services' concentration of sales in any single market sector has been generally decreasing as it continues its expansion into markets in the western portion of the United States, with the PEC merger there has been a significant concentration of sales in the Illinois market.

Seasonality

Integrys Energy Services believes that its business, in the aggregate, is not seasonal, even though certain products sell more heavily in some seasons than in others. Sales of natural gas generally peak in the winter months, while sales of electric energy generally peak in the summer months. Generally in the summer months, the demand for electric energy is high, which increases the price at which energy can be sold. In periods of high residential fuel consumption (generally the winter months), the purchase price of oil and natural gas increases, which increases the production costs at Integrys Energy Services’ natural gas- and oil-fired generation facilities. Integrys Energy Services' business can be volatile as a result of market conditions and the related market opportunities available to its customers.

Competition

Integrys Energy Services is a nonregulated energy marketer that competes against regulated utilities, large energy trading companies and other energy marketers. Integrys Energy Services competes with other energy providers on the basis of price, reliability, service, financial strength, consumer convenience, performance and reputation.

Working Capital

In addition to equity infusions, long-term debt and short-term debt provided by its parent company (Integrys Energy Group), Integrys Energy Services also has access to credit lines up to $175 million from independent financial institutions, $150 million of which is guaranteed by Integrys Energy Group. The working capital needs of Integrys Energy Services vary significantly over time due to volatility in commodity prices (including margin calls), levels of natural gas inventories, the structure of wholesale transactions, the price of natural gas, and alternative energy options available to its customers. Integrys Energy Group provides guarantees for Integrys Energy Services' commodity transactions. These guarantees provide the credit support needed to participate in the nonregulated energy market.

See Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation for additional information regarding working capital needs of nonregulated operations.

E. ENVIRONMENTAL MATTERS

For information on environmental matters related to Integrys Energy Group and any of its subsidiaries, see Note 17, "Commitments and Contingencies."

F. CAPITAL REQUIREMENTS

For information on capital requirements related to Integrys Energy Group, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operation - Liquidity and Capital Resources.

G. EMPLOYEES

Integrys Energy Group and its subsidiaries had 5,231 employees at December 31, 2007, of which approximately 45% are union employees.

Local 310 of the International Union of Operating Electricians represents approximately 46% of WPSC's 2,158 employees. The current Local 310 collective bargaining agreement expires on October 17, 2009.

Approximately 59% of PGL's 1,534 employees are represented by Local 18007 of the Utility Workers Union of America. The current collective bargaining agreement with PGL union employees expires on April 30, 2008. Negotiations are ongoing for renewal of the agreement.

Local 31 of the International Brotherhood of Electrical Workers, AFL CIO, represents approximately 19% of the 225 employees at MERC. The current collective bargaining agreement will expire on May 31, 2011.

Approximately 67% of NSG's 203 employees are represented by Local 2285 of the International Brotherhood of Electrical Workers. The current collective bargaining agreement with NSG union employees expires on June 30, 2008. Negotiations are ongoing for renewal of the agreement.

MGUC has labor contracts with two unions; Local 12295 of the United Steelworkers of America, AFL CIO CLC, and Local 417 of the Utility Workers Union of America, AFL CIO, which represent approximately 66% of MGUC's 177 employees. The Local 12295 of the United Steelworkers of America, AFL CIO CLC, contract will expire on January 15, 2010. The Local 417 of the Utility Workers Union of America, AFL CIO, collective bargaining agreement will expire on February 15, 2012.

Local 510 of the International Brotherhood of Electrical Workers, AFL CIO, represents approximately 77% of the 163 employees at UPPCO. The current collective bargaining agreement expires on April 18, 2009.

H. AVAILABLE INFORMATION

Integrys Energy Group files with the SEC its:

- Annual Report on Form 10-K;
- Quarterly Reports on Form 10-Q;
- Proxy statement;
- Registration statements, including prospectuses;
- Current Reports on Form 8-K; and

- Any amendments to these documents.

Integrys Energy Group makes these reports available free of charge, on Integrys Energy Group's Internet Web site, as soon as reasonably practicable after they are filed with the SEC. Integrys Energy Group's

Internet address is www.integrysgroup.com. Statements and amendments posted on Integrys Energy Group's Web site do not include access to exhibits and supplemental schedules electronically filed with the reports or amendments. Integrys Energy Group is not including the information contained on or available through their Web sites as a part of, or incorporating such information by reference into, this Annual Report on Form 10-K.

You may also obtain materials filed with the SEC by Integrys Energy Group at the SEC Public Reference Room at 100 F Street, N.E., Washington, DC 20549. To obtain information on the operation of the Public Reference Room, you may call 1-800-SEC-0330. You may also view reports, proxy statements and other information regarding Integrys Energy Group (including exhibits), filed with the SEC, at its Web site at www.sec.gov.

ITEM 1A. RISK FACTORS

You should carefully consider the following risk factors, as well as the other information included or incorporated by reference in this Annual Report on Form 10-K, when making an investment decision. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known or that we currently believe to be immaterial may also adversely affect us.

We may not successfully integrate recent or future acquisitions into our operations or otherwise achieve the anticipated benefits of those acquisitions.

As part of our growth strategy, we continue to pursue a disciplined acquisition strategy. While we expect to identify cost savings and growth opportunities before we acquire companies or assets, we may not be able to achieve these anticipated benefits due to, among other things:

- Delays or difficulties in completing the integration of acquired companies or assets;
- Higher than expected costs or a need to allocate additional resources to manage unexpected operating difficulties;
- Parameters imposed or delays caused by regulatory agencies;
- Reliance on inaccurate assumptions in evaluating the expected benefits of a given acquisition;
- Inability to retain key employees or customers of acquired companies; and
- Assumption of liabilities not identified in the due diligence process.

These risks apply to our 2006 acquisitions of natural gas distribution operations in Michigan and Minnesota, as well as the 2007 merger with PEC.

The integration of PEC presents significant challenges and we are incurring significant transaction, merger-related and restructuring costs that may result in a decline in the anticipated potential benefits of the merger with PEC.

Integrys Energy Group expects the merger with PEC to generate potential pre-tax cost synergy savings of $106 million on an annualized basis by the end of the fifth full year of operations following completion of the merger (excluding costs of integration). These savings may not be realized within the time periods or amounts contemplated.

In addition to the risks noted above related to other potential or future acquisitions, the difficulties of combining the previously independent operations of Integrys Energy Group and PEC include, but are not limited to, the following:

- combining the best practices of two companies, including utility operations, non-regulated energy marketing operations and staff functions;
- the necessity of coordinating geographically separated organizations, systems and facilities;
- integrating personnel with diverse business backgrounds and organizational cultures;
- reducing the costs associated with each company's operations; and
- preserving important relationships of both companies and resolving potential conflicts that may arise.

The process of combining operations could cause an interruption of, or loss of momentum in, the activities of one or more of the businesses of Integrys Energy Group and the possible loss of key personnel. The diversion of management's attention and any delays or difficulties encountered in connection with the integration of the two companies' operations could have an adverse effect on the business, results of operations, financial condition, or prospects of Integrys Energy Group, Integrys Energy Group is incurring and expects in the future to continue to incur integration and restructuring costs associated with combining its operations with PEC, as well as transaction fees and other costs related to the merger. The estimated total pre-tax cost of achieving anticipated merger

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synergies and cost savings is approximately $155 million (excluding internal labor costs), most of which will be incurred through 2010. Although Integrys Energy Group expects the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, to offset incremental transaction, merger-related and restructuring costs over time, net benefits may not be achieved in the near term.

Integrys Energy Group has recorded goodwill that could become impaired and adversely affect the company's operating results.

The merger with PEC and the acquisition of natural gas distribution operations in Minnesota and Michigan are accounted for as purchases by Integrys Energy Group in accordance with generally accepted accounting principles. Under the purchase method of accounting, the assets and liabilities acquired have been recorded at their respective fair values at the date of acquisition and added to those of Integrys Energy Group. The reported financial condition and results of operations of Integrys Energy Group reflect PEC balances and results after completion of the merger, but such financial statements have not been and will not be restated retroactively to reflect the historical financial position or results of operations of PEC for periods prior to the merger. The earnings of Integrys Energy Group also reflect purchase accounting adjustments.
Under the purchase method of accounting, the total purchase price is allocated to tangible assets and liabilities and identifiable intangible assets based on their estimated fair market values as of the date the merger was completed. The excess cost of the acquisition over those estimated fair market values is recorded as goodwill. As a result of the application of purchase accounting, these transactions resulted in a significant amount of goodwill. To the extent the value of goodwill or intangibles becomes impaired, Integrys Energy Group may be required to incur material charges relating to such impairment. Such a potential impairment charge could have a material impact on the operating results of Integrys Energy Group.

We are subject to changes in government regulation, which may have a negative impact on our business, financial position, and results of operations.

The rates our regulated utilities are allowed to charge for their retail and wholesale services are some of the most important items influencing our business, financial position, results of operations, and liquidity.

We are subject to comprehensive regulation by several federal and state regulatory agencies, which significantly influences our operating environment and may affect our ability to recover costs from utility customers. In particular, the PSCW, ICC, MPSC, MPUC, FERC, SEC, EPA, Minnesota Office of Pipeline Safety, WDNR, and the Illinois Environmental Protection Agency regulate many aspects of our utility operations, including siting and construction of facilities, conditions of service, the issuance of securities and the rates that we can charge customers. We are required to have numerous permits, approvals and certificates from these agencies to operate our business.

We are unable to predict the impact on our businesses and operating results from the future regulatory activities of any of these agencies. However, changes in regulations or the imposition of additional regulations may require us to incur additional expenses or change business operations, which may have an adverse impact on our results of operations. In addition, federal regulatory reforms may produce unexpected changes and costs in the public utility industry.

A reduction in our credit ratings could materially and adversely affect our business, financial position, results of operations, and liquidity.

We cannot be sure that any of our credit ratings will remain in effect for any given period of time or that a credit rating will not be lowered by a rating agency if, in its judgment, circumstances in the future so warrant. Any downgrade could:

- Increase our borrowing costs;
- Require us to pay a higher interest rate in future financings and possibly reduce the potential pool of creditors;
- Increase our borrowing costs under certain of our existing credit facilities;
- Limit our access to the commercial paper market;
- Limit the availability of adequate credit support for Integrys Energy Services' operations; and
- Require provision of additional credit assurance to contract counterparties.

We may not complete construction projects within estimated project costs.

Subsidiaries of Intergrys Energy Group undertake very large and complex construction projects, subject to numerous unpredictable events that could affect our ability to timely complete construction within estimated costs. We may not be able to meet these construction estimates due to, among other things:

- Fluctuating or unanticipated construction costs;
- Supply delays;
- Legal claims; and
- Environmental regulation.

Our operations are subject to risks beyond our control, including but not limited to weather, terrorist attacks or related acts of war.

Our revenues are affected by the demand for electricity and natural gas. That demand can vary greatly based upon:

- Weather conditions, seasonality, and temperature extremes;
- Fluctuations in economic activity and growth in our regulated service areas, as well as areas in which our nonregulated subsidiaries operate; and
- The amount of additional energy available from current or new competitors.

Weather conditions directly influence the demand for electricity and natural gas and affect the price of energy commodities.

In addition, the cost of repairing damage to our facilities due to storms, natural disasters, wars, terrorist acts and other catastrophic events, in excess of reserves established for such repairs, may adversely impact our results of operations, financial condition, and cash flows. The occurrence or risk of occurrence of future terrorist activity and the high cost or potential unavailability of insurance to cover such terrorist activity may impact our results of operations and financial condition in unpredictable ways. These actions could also result in disruptions of power and fuel markets. In addition, our natural gas distribution system and pipelines could be directly or indirectly harmed by future terrorist activity.

Costs of environmental compliance, liabilities, fines, penalties, and litigation could exceed our estimates.

Compliance with current and future federal and state environmental laws and regulations may result in increased capital, operating and other costs, including remediation and containment expenses and monitoring obligations. Integrys Energy Group cannot predict with certainty the amount and timing of all future expenditures (including the potential or magnitude of fines or penalties) related to environmental matters because of the difficulty of estimating clean-up and compliance costs and the possibility that changes will be made to the current environmental laws and regulations.

On March 15, 2005, the EPA adopted the Clean Air Mercury Rule, which is intended to reduce mercury emissions from coal-fired generation plants. On February 8, 2007, a court decision vacated the federal rule. As a result, future impacts on Integrys Energy Group or its subsidiaries resulting from future federal or state regulation regarding mercury emissions is uncertain. The EPA has also issued the Clean Air Interstate Rule requiring reductions of sulfur dioxide and nitrogen oxide emissions. In addition, the possibility exists of future initiatives to address concerns about global climate change (such as the potential regulation of greenhouse gases emitted from generation facilities). Integrys Energy Group cannot be certain how these rules will affect it. There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liabilities on all potentially responsible parties.

Citizen groups that feel there are compliance issues not sufficiently enforced by environmental regulatory agencies may also bring citizen enforcement actions against us. Such actions could seek penalties, injunctive relief and costs of litigation.

Fluctuating commodity prices may reduce regulated and nonregulated energy margins.

Our regulated energy margins are directly affected by commodity costs related to coal, natural gas, and other fuels used in the electric generation process. The commodity price of market purchases of electricity and natural gas may also directly affect margins in our regulated electric and natural gas segments.

Higher commodity prices increase energy prices and may impact customer demand for energy in the nonregulated market and increase counterparty risk. This may stress margins at our nonregulated subsidiaries.

Integrys Energy Services may experience increased expenses, including interest costs and uncollectibles, higher working capital requirements, and possibly some reduction in volumes sold as a result of any increase in the cost of fuel or purchased power. If market prices for electric energy decline below the cost of production at our nonregulated facilities, these units may be temporarily shut down.

Actual results could differ from estimates used to prepare our financial statements.

In preparing the financial statements in accordance with generally accepted accounting principles, management must often make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the date of the financial statements and during the reporting period. Some of those judgments can be subjective and complex and actual results could differ from those estimates. For more information about these estimates and assumptions, see Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" in this Annual Report on Form 10-K.

The use of derivative instruments could result in financial losses and liquidity constraints.

We use derivative instruments, including futures, forwards, options and swaps, to manage our commodity and financial market risks. In addition, we purchase and sell commodity-based contracts in the natural gas and electric energy markets for trading purposes. In the future, we could recognize financial losses on these contracts as a result of volatility in the market values of the underlying commodities or if a counterparty fails to perform under a contract. In the absence of actively quoted market prices and pricing information from external sources, the valuation of these contracts involves management's judgment or use of estimates. As a result, changes in the underlying assumptions or use of alternative valuation methods could affect the reported fair value of these contracts. Additionally, realized values could differ from values determined by management.

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For additional information concerning derivatives and commodity-based trading contracts, see Note 3, "Risk Management Activities."

We may not utilize Section 29/45K synthetic fuel production tax credits.

We have significantly reduced our consolidated federal income tax liability for the past several years through tax credits available to us under Section 29/45K of the Internal Revenue Code for the production and sale of solid synthetic fuel from coal. We have not fully utilized Section 29/45K tax credits previously available to us. Our ability to fully utilize the Section 29/45K tax credits available to us as carryovers in connection with our interest in the production facility will depend on whether the amount of our future federal taxable income and related income tax liability is sufficient to permit the use of such credits. Tax regulations providing for the creation of Section 29/45K tax credits expired at the end of 2007.

Any future disallowance of some or all of those tax credits as a result of legislative changes or examination of an open year by the IRS could materially affect our tax obligations. At this time, we cannot predict the potential for or the outcome of any IRS review.

Any change in our ability to sell electricity generated from our nonregulated facilities at market-based rates may impact earnings.

The FERC has authorized us to sell generation from our nonregulated facilities at market prices. The FERC retains the authority to modify or withdraw our market based rate authority. If the FERC determines that the market is not workably competitive, that we possess market power or that we are not charging just and reasonable rates, it may require our nonregulated subsidiaries to sell power at a price based upon the costs incurred in producing the power. Our revenues and profit margins may be negatively affected by any reduction by the FERC of the rates we may receive.

We are subject to provisions that can limit merger and acquisition opportunities for our shareholders.

The Wisconsin Public Utility Holding Company Law precludes the acquisition of 10% or more of the voting shares of a holding company of a Wisconsin public utility unless the PSCW has first determined that the acquisition is in the best interests of utility consumers, investors and the public. Those interests may, to some extent, be mutually exclusive. This provision and other requirements of the Wisconsin Public Utility Holding Company Law may delay, or reduce the likelihood of, a sale or change of control thus reducing the likelihood that shareholders will receive a takeover premium for their shares.

Provisions of our articles of incorporation and by-laws may delay or frustrate the removal of incumbent directors and may prevent or delay a merger, tender offer or proxy contest involving our company that is not approved by our board of directors, even if the shareholders believe that such events may be beneficial to their interests. In addition, the Wisconsin Business Corporation Law contains provisions that may have the effect of delaying or making more difficult attempts by others to obtain control of our company without the approval of our board of directors.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

A. REGULATED

Electric Facilities

The following table summarizes information on the electric generation facilities of Integrys Energy Group, including owned or jointly-owned facilities as of December 31, 2007:

Type	Name	Location	Fuel	Rated Capacity (Megawatts)	(a)
Steam	Pulliam (4 units)	Green Bay, WI	Coal	325.0	(c)
	Weston (3 units)	Wausau, WI	Coal	473.0	(d)
	Columbia Units 1 and 2	Portage, WI	Coal	351.9	(b)
	Edgewater Unit 4	Sheboygan, WI	Coal	101.6	(b)
Total Steam				1,251.5	
Hydroelectric	Alexander	Lincoln County, WI	Hydro	2.2	
	Caldron Falls	Marinette County, WI	Hydro	6.7	
	Castle Rock	Adams County, WI	Hydro	9.0	(b)
	Grand Rapids	Menominee County, WI	Hydro	4.0	
	Grandfather Falls	Lincoln County, WI	Hydro	17.3	
	Hat Rapids	Oneida County, WI	Hydro	0.7	
	High Falls	Marinette County, WI	Hydro	1.6	
	Jersey	Lincoln County, WI	Hydro	0.3	
	Johnson Falls	Marinette County, WI	Hydro	1.0	
	Merrill	Lincoln County, WI	Hydro	1.0	
	Otter Rapids	Vilas County, WI	Hydro	0.3	
	Peshtigo	Marinette County, WI	Hydro	0.3	
	Petenwell	Adams County, WI	Hydro	10.6	(b)
	Potato Rapids	Marinette County, WI	Hydro	0.4	
	Sandstone Rapids	Marinette County, WI	Hydro	1.1	
	Tomahawk	Lincoln County, WI	Hydro	2.4	
	Wausau	Marathon County, WI	Hydro	3.0	
	Victoria (2 units)	Ontonagon County, MI	Hydro	10.6	
	Hoist (3 units)	Marquette County, MI	Hydro	1.4	
	McClure (2 units)	Marquette County, MI	Hydro	3.8	
	Prickett (2 units)	Houghton County, MI	Hydro	0.4	
	Autrain (2 units)	Alger County, MI	Hydro	0.5	
	Cataract	Marquette County, MI	Hydro	0.3	
	Escanaba #1	Delta County, MI	Hydro	1.0	
	Escanaba #3	Delta County, MI	Hydro	1.3	
	Boney Falls	Delta County, MI	Hydro	1.4	
Total Hydroelectric				82.6	
Combustion	De Pere Energy Center	De Pere, WI	Natural Gas	161.4	
Turbine and	Eagle River	Eagle River, WI	Distillate Fuel Oil	4.2	
Diesel	Oneida Casino	Green Bay, WI	Distillate Fuel Oil	3.5	

	Juneau #31	Adams County, WI	Distillate Fuel Oil	6.7	(b)
	West Marinette #31	Marinette, WI	Natural Gas	35.4	
	West Marinette #32	Marinette, WI	Natural Gas	35.5	
	West Marinette #33	Marinette, WI	Natural Gas	52.4	(b)
	Weston #31	Marathon County, WI	Natural Gas	16.7	
	Weston #32	Marathon County, WI	Natural Gas	46.8	
	Pulliam #31	Green Bay, WI	Natural Gas	80.4	
	Portage	Houghton, MI	Oil	19.1	
	Gladstone	Gladstone, MI	Oil	19.1	
Total Combustion Turbine and Diesel				481.2	
Wind	Lincoln	Kewaunee County, WI	Wind	1.0	
	Glenmore (2 units)	Brown County, WI	Wind	-	
Total Wind				1.0	
Total System				1,816.3	

(a) Based on capacity ratings for July 2008. As a result of continually reaching demand peaks in the summer months, primarily due to air conditioning demand, the summer period is the most relevant for capacity planning purposes.

(b) These facilities are jointly owned by WPSC and various other utilities. Wisconsin Power and Light Company operates the Columbia and Edgewater units and WPSC holds a 31.8% ownership interest in these facilities. WRPC owns and operates the Castle Rock, Petenwell and Juneau units, and WPSC holds a 50% ownership interest in WRPC. WPSC operates the West Marinette 33 unit and holds a 68% ownership interest in the facility; Marshfield Electric and Water Department has a joint ownership in the rest. The capacity indicated for each of these units is WPSC's portion of total plant capacity based on its percent of ownership.

(c) Pulliam Units 3 and 4 were retired on December 31, 2007, and capacity ratings for these facilities are not included in the table above.

(d) Weston 4 is scheduled to be placed in service in the first quarter of 2008 and, therefore, is not included in the table above. WPSC's 70% ownership in the facility will increase system rated capacity by 359.8 megawatts for a total system rated capacity of 2,176.1 megawatts.

As of December 31, 2007, Integrys Energy Group's electric utilities owned 183 distribution substations and 24,744 miles of electric distribution lines.

Natural Gas Facilities

Integrys Energy Group's natural gas properties include approximately 21,490 miles of natural gas distribution mains, 774 miles of natural gas transmission mains, and 279 natural gas distribution and transmission gate stations. Integrys Energy Group's natural gas utilities also own a 3.6 billion cubic foot natural gas storage field located in Michigan and operate a 36.5 billion cubic foot underground natural gas storage reservoir and a liquefied natural gas plant located in Illinois.

Integrys Energy Group's utility plant at WPSC, UPPCO, PGL, and NSG is subject to a first mortgage lien.

B. INTEGRYS ENERGY SERVICES

The following table summarizes information on the electric generation facilities owned by Integrys Energy Services as of December 31, 2007:

Type	Name	Location	Fuel	Rated Capacity (Megawatts)	(a)
Steam	Caribou	Caribou, ME	Oil	21.7	
	Stoneman	Cassville, WI	Coal	44.5	
	Westwood	Tremont, PA	Culm	30.0	
Total Steam				96.2	
Combined Cycle	Syracuse	Syracuse, NY	Gas/Oil	85.0	
	Beaver Falls	Beaver Falls, NY	Gas/Oil	78.9	
	Combined Locks	Combined Locks, WI	Gas	46.8	(b)
Total Combined Cycle				210.7	
Hydroelectric	Tinker	New Brunswick, Canada	Hydro	34.5	
	Squa Pan	Ashland, ME	Hydro	1.4	
	Caribou	Caribou, ME	Hydro	0.9	
Total Hydroelectric				36.8	
Combustion Turbine and Diesel	Caribou	Caribou, ME	Diesel	7.0	
	Tinker	New Brunswick, Canada	Diesel	1.0	
	Flo's Inn	Presque Isle, ME	Diesel	4.2	
	Loring	Limestone, ME	Diesel	5.2	
Total Combustion Turbine and Diesel				17.4	
Reciprocating Engine	Winnebago	Rockford, IL	Methane	6.1	(c)
Total System				367.2	

(a) Based on summer rated capacity.
(b) Combined Locks also has an additional five megawatts of capacity available at this facility through the lease of an additional steam turbine.
(c) Winnebago was placed into service on December 21, 2007.

ITEM 3. LEGAL PROCEEDINGS

For information on material legal proceedings and matters related to Integrys Energy Group and its subsidiaries, see Note 17, "Commitments and Contingencies."

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the security holders of Integrys Energy Group during the fourth quarter of 2007.

ITEM 4A. EXECUTIVE OFFICERS OF INTEGRYS ENERGY GROUP AS OF JANUARY 1, 2008

Name and Age		Position and Business Experience During Past Five Years	Effective Date
Larry L. Weyers	62	President and Chief Executive Officer	02-21-07
		Chairman, President and Chief Executive Officer	02-12-98
Thomas P. Meinz	61	Executive Vice President - External Affairs	02-21-07
		Executive Vice President - Public Affairs	09-12-04
		Senior Vice President - Public Affairs	12-24-00
Phillip M. Mikulsky	59	Executive Vice President and Chief Development Officer	02-21-07
		Executive Vice President - Development	09-12-04
		Senior Vice President - Development	02-12-98
Joseph P. O'Leary	53	Senior Vice President and Chief Financial Officer	06-04-01
Bernard J. Treml	58	Senior Vice President and Chief Human Resources Officer	02-21-07
		Senior Vice President - Human Resources	12-19-04
		Vice President - Human Resources	02-12-98
Diane L. Ford	54	Vice President and Corporate Controller	02-21-07
		Vice President - Controller and Chief Accounting Officer	07-11-99
Bradley A. Johnson	53	Vice President and Treasurer	07-18-04
		Treasurer	06-23-02
Barth J. Wolf	50	Vice President - Chief Legal Officer and Secretary	07-31-07
		Vice President - Legal Services and Chief Compliance Officer of Integrys Business Support, LLC	02-21-07
		Secretary and Manager - Legal Services	09-19-99

NOTE: All ages are as of December 31, 2007. None of the executives listed above are related by blood, marriage, or adoption to any of the other officers listed or to any director of the Registrants. Each officer holds office until his or her successor has been duly elected and qualified, or until his or her death, resignation, disqualification, or removal.

PART II

ITEM 5. MARKET FOR INTEGRYS ENERGY GROUP'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Integrys Energy Group, Inc. Common Stock Two-Year Comparison

Share Data	Dividends Per Share	Price Range High	Low
2007			
1st Quarter	$ .583	$58.04	$52.72
2nd Quarter	.660	60.63	50.11
3rd Quarter	.660	55.25	48.10
4th Quarter	.660	54.10	50.02
Total	$2.563		
2006			
1st Quarter	$ .565	$57.75	$49.02
2nd Quarter	.565	51.60	47.39
3rd Quarter	.575	52.88	47.67
4th Quarter	.575	54.83	49.18
Total	$2.280		

Integrys Energy Group common stock is traded on the New York Stock Exchange under the ticker symbol "TEG." The transfer agent and registrar for Integrys Energy Group's common stock is American Stock Transfer & Trust Company, 59 Maiden Lane, New York, NY 10038.

As of February 21, 2008, there were 35,100 common stock shareholders of record.

Dividend Restrictions

For information on dividend restrictions related to Integrys Energy Group and any of its subsidiaries, see Note 21, "Common Equity."

See Item 11 - Executive Compensation of this Annual Report on Form 10-K for information regarding our equity compensation plans.

ITEM 6. SELECTED FINANCIAL DATA

INTEGRYS ENERGY GROUP, INC.
COMPARATIVE FINANCIAL STATEMENTS AND
FINANCIAL AND OTHER STATISTICS (2003 TO 2007)

As of or for Year Ended December 31 (Millions, except per share amounts, stock price, return on average equity and number of shareholders and employees)	2007 (1)	2006 (2)	2005	2004	2003
Total revenues	$ 10,292.4	$ 6,890.7	$ 6,825.5	$ 4,876.1	$ 4,309.8
Income from continuing operations	181.1	151.6	150.6	156.6	110.7
Income available for common shareholders	251.3	155.8	157.4	139.7	94.7
Total assets	11,234.4	6,861.7	5,462.5	4,376.8	4,292.3
Preferred stock of subsidiaries	51.1	51.1	51.1	51.1	51.1
Long-term debt (excluding current portion)	2,265.1	1,287.2	867.1	865.7	871.9
Shares of common stock (less treasury stock and shares in deferred compensation trust)					
Outstanding	76.0	43.1	39.8	37.3	36.6
Average	71.6	42.3	38.3	37.4	33.0
Earnings per common share (basic)					
Income from continuing operations	$ 2.49	$ 3.51	$ 3.85	$ 4.10	$ 3.26
Earnings per common share	$ 3.51	$ 3.68	$ 4.11	$ 3.74	$ 2.87
Earnings per common share (diluted)					
Income from continuing operations	2.48	3.50	3.81	4.08	3.24
Earnings per common share	3.50	3.67	4.07	3.72	2.85
Dividend per share of common stock	2.56	2.28	2.24	2.20	2.16
Stock price at year-end	$ 51.69	$ 54.03	$ 55.31	$ 49.96	$ 46.23
Book value per share	$ 42.58	$ 35.61	$ 32.76	$ 29.30	$ 27.40
Return on average equity	8.5%	10.6%	13.6%	13.5%	11.5%
Number of common stock shareholders	35,212	19,837	20,701	21,358	22,172
Number of employees	5,231	3,326	2,945	3,048	3,080

(1)Includes the impact of the PEC merger on February 21, 2007.
(2)Includes the impact of the acquisition of natural gas distribution operations from Aquila by MGUC on April 1, 2006 and MERC on July 1, 2006.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

INTRODUCTION

Integrys Energy Group is a diversified holding company with regulated utility operations operating through six wholly owned subsidiaries, WPSC, PGL, NSG, UPPCO, MGUC, and MERC; nonregulated energy operations through its wholly owned nonregulated subsidiary, Integrys Energy Services; and also a 34.5% equity ownership interest in ATC (an electric transmission company operating in Wisconsin, Michigan, Minnesota, and Illinois).

Strategic Overview

Integrys Energy Group's goal is the creation of long-term value for shareholders and customers through growth in its regulated and nonregulated portfolio (while placing an emphasis on regulated growth). In order to create value, Integrys Energy Group is focused on:

Maintaining and Growing a Strong Regulated Utility Base– A strong regulated utility base is necessary to maintain a strong balance sheet, predictable cash flows, a desired risk profile, attractive dividends, and quality credit ratings, which are critical to our success. Integrys Energy Group believes the following recent developments have helped, or will help, maintain and grow its regulated utility base:

- The February 2007 merger with PEC, which added the regulated natural gas distribution operations of PGL and NSG to the regulated utility base of Integrys Energy Group.

- Our investment in ATC was at 34.5% at December 31, 2007. ATC owned approximately $2.2 billion in net transmission and general plant assets at December 31, 2007 and anticipates additional capital investment of approximately $865 million over the next 3 years.

- Construction of the 500-megawatt coal-fired Weston 4 base-load power plant located near Wausau, Wisconsin, which is scheduled to be placed in service in the first quarter of 2008. This power plant is jointly-owned with DPC. WPSC holds a 70% ownership interest in the Weston 4 power plant, with DPC owning the remaining 30% interest in the facility.

- The proposed acceleration of investment in the natural gas distribution system at PGL. The replacement of cast iron mains and investment in underground natural gas storage facilities is expected to total approximately $100 million through 2010.

- Investment of approximately $75 million in lateral infrastructure related to the connection of the WPSC distribution system to the Guardian II natural gas pipeline to Green Bay.

- WPSC's negotiations to purchase a 99-megawatt wind generation facility to be constructed in Howard County, Iowa.

- WPSC's continued investment in environmental projects to improve air quality and meet the requirements set by environmental regulators. Capital projects to construct and upgrade equipment to meet or exceed required environmental standards are planned each year.

- For more detailed information on Integrys Energy Group's capital expenditure program see "Liquidity and Capital Resources, Capital Requirements," below.

Strategically Growing Nonregulated Business– Integrys Energy Services is focused on growth in the competitive energy services and supply business through growing its customer base. Integrys Energy Group expects its nonregulated operations to provide between 20% and 30% of Integrys Energy Group's earnings, on average, in the future. Integrys Energy Group believes the following recent developments have helped, or will help, maintain and grow its nonregulated business:

- The merger with PEC combined the nonregulated energy marketing businesses of both companies. The combination provided Integrys Energy Services with a strong market position in the Illinois retail electric market and expanded its originated wholesale natural gas business, creating a stronger, more competitive, and better balanced growth platform for the nonregulated business.

- The 2007 opening of nonregulated operations in Denver, Colorado, has allowed Integrys Energy Services to expand its operations into the Western Systems Coordinating Council markets.

- The 2007 completion of a 6.5 megawatt landfill gas project, the Winnebago Energy Center Development in Rockford, Illinois, which consists of gas cleanup equipment and engines to collect and burn landfill gas at the site to generate electricity.

- The on-going development of renewable energy products, such as land fill gas and solar projects.

Integrating Resources to Provide Operational Excellence– Integrys Energy Group is committed to integrating resources of its regulated businesses and also its nonregulated businesses, while meeting any and all applicable regulatory and legal requirements. This will provide the best value to customers and shareholders by leveraging the individual capabilities and expertise of each business and assist in lowering costs for certain activities. Integrys Energy Group believes the following recent developments have helped, or will help, integrate resources and provide operational excellence:

- The PEC merger is helping to align the best practices and expertise of both companies, which will continue to result in efficiencies by eliminating redundant and overlapping functions and systems. Integrys Energy Group expects the merger to generate annual pre-tax synergy savings of approximately $106 million for the combined company by the end of the fifth full year of operations following completion of the merger. One-time costs to achieve the synergies are expected to be approximately $155 million.

- Integrys Business Support, LLC, a wholly owned service company, was formed to achieve a significant portion of the cost synergies anticipated from the merger with PEC through the consolidation and efficient delivery of various support services and to provide more consistent and transparent allocation of costs throughout Integrys Energy Group and its subsidiaries.

- "Competitive Excellence" and project management initiatives are being implemented at Integrys Energy Group and its subsidiaries to improve processes, reduce costs, and manage projects within budget and timeline constraints to provide more value to customers.

Placing Strong Emphasis on Asset and Risk Management– Our asset management strategy calls for the continuous assessment of our existing assets, the acquisition of assets, and contractual commitments to obtain resources that complement our existing business and strategy, thereby providing the most efficient use of and best return on our resources while maintaining an acceptable risk profile. This strategy calls for a focus on the disposition of assets, including plants and entire business units, which are either no longer strategic to ongoing operations, are not performing as needed, or have an unacceptable risk profile. We maintain a portfolio approach to risk and earnings. Integrys Energy Group believes the following recent developments have helped, or will help, manage assets and risk:

- The combination of Integrys Energy Group and PEC created a larger, stronger, and more competitive regional energy company. This merger, along with the 2006 acquisition of the Michigan and Minnesota natural gas distribution operations, diversified the company's regulatory and geographic risk due to the expansion of utility operations to multiple jurisdictions.

- The September 2007 sale of PEP, Integrys Energy Group's oil and natural gas production subsidiary acquired in the merger with PEC. The divesture of the oil and natural gas production business reduced Integrys Energy Group's business risk profile and provided funds to reduce debt.

- The January 2007 sale of WPS Niagara Generation, LLC for approximately $31 million. WPS Niagara Generation, LLC owned a 50-megawatt generation facility located in the Niagara Mohawk Frontier region in Niagara Falls, New York.

Our risk management strategy, in addition to asset risk management, includes the management of market, credit, and operational risk through the normal course of business. Forward purchases and sales of electric capacity, energy, natural gas, and other commodities allow for opportunities to secure prices in a volatile energy market. Oversight of the risk profile related to these financial instruments is monitored daily in each business unit consistent with the company's financial risk management policy. Corporate oversight is provided through the Corporate Risk Management group which reports through the Chief Financial Officer.

RESULTS OF OPERATIONS

	Year Ended December 31,				
(Millions except per share amounts)	2007	2006	2005	Change in 2007 over 2006	Change in 2006 over 2005
Electric utility operations	$ 87.4	$ 85.5	$ 64.2	2.2%	33.2%
Natural gas utility operations	28.7	(2.3)	13.2	-	-
Nonregulated energy operations	98.0	72.3	74.1	35.5%	(2.4)%
Holding company and other operations	(18.8)	0.3	5.9	-	(94.9)%
Oil and natural gas operations	56.0	-	-	-	-
Income available for common shareholders	$ 251.3	$ 155.8	$ 157.4	61.3%	(1.0)%
Average basic shares of common stock	71.6	42.3	38.3	69.3%	10.4%
Average diluted shares of common stock	71.8	42.4	38.7	69.3%	9.6%
Basic earnings per share	$ 3.51	$ 3.68	$ 4.11	(4.6)%	(10.5)%
Diluted earnings per share	$ 3.50	$ 3.67	$ 4.07	(4.6)%	(9.8)%

2007 income available for common shareholders increased $95.5 million and 2007 diluted earnings per share decreased $0.17, both compared to 2006. 2006 income available for common shareholders decreased $1.6 million and 2006 diluted earnings per share decreased $0.40, both compared to 2005. Significant factors impacting the change in earnings and diluted earnings per share were as follows (and are discussed in more detail thereafter):

Electric Utility Operations:
Earnings increased $1.9 million in 2007 over 2006, resulting primarily from the following:

Retail electric rate increases at both WPSC and UPPCO had a positive year-over-year impact on operating income.

Favorable weather conditions at WPSC contributed an approximate $6.0 million ($3.6 million after-tax) year-over-year increase in operating income; however, this increase was partially offset by a decrease in weather normalized residential and commercial and industrial customer usage.

Fuel and purchased power costs were higher than what was recovered in rates during the year ended December 31, 2007, compared with fuel and purchased power costs that were less than what was recovered in rates during the same period in 2006, driving a $14.4 million ($8.6 million after-tax) negative variance in operating income.

Maintenance expense related to WPSC's power plants was higher in 2007 compared to 2006, driven by an increase in unplanned outages in 2007 as well as the extension of some 2007 planned outages.

Earnings increased $21.3 million from 2005 to 2006, primarily due to the following:

Fuel and purchased power costs that were less than what was recovered in rates during the year ended December 31, 2006, compared with fuel and purchased power costs that were more than what was recovered in rates during the same period in 2005 (the under collection in 2005 was primarily due to the impact 2005 hurricanes had on natural gas prices), contributed an estimated $14 million after-tax, year-over-year increase in earnings.

A PSCW ruling, which disallowed recovery of costs that were deferred related to the 2004 Kewaunee nuclear plant outage as well as a portion of the loss on the Kewaunee sale, resulted in the write-off of $13.7 million of regulatory assets in 2005, which resulted in an after-tax reduction in earnings in 2005 of approximately $8 million (positive variance compared with 2006 earnings).

Retail electric rate increases at both WPSC and UPPCO also had a positive year-over-year impact on earnings.

Unfavorable weather conditions in 2006, compared with 2005, had an estimated $9 million year-over-year negative after-tax impact on electric utility earnings.

Natural Gas Utility Operations:
Financial results improved $31.0 million in 2007 over 2006, primarily due to the following:

Financial results for MGUC and MERC increased $18.1 million, from a combined net loss of $11.3 million in 2006, to earnings of $6.8 million in 2007. The positive change in earnings at MGUC and MERC was driven by the fact that these natural gas utilities operated during the first quarter heating season in 2007, but were not acquired by Integrys Energy Group until after the first quarter 2006 heating season. In addition, MGUC and MERC incurred a combined $11.8 million ($7.1 million after-tax) of transition costs in 2006 for the start-up of outsourcing activities and other legal and consulting fees. In 2007, MGUC and MERC were allocated $1.7 million ($1.0 million after-tax) of external costs to achieve merger synergies related to the PEC merger.

Regulated natural gas utility earnings at WPSC increased $13.5 million, from earnings of $9.6 million in 2006, to earnings of $23.1 million in 2007. Higher earnings were driven by increased volumes due to colder weather conditions during the heating season. A natural gas rate increase effective January 12, 2007 also contributed to the increase.

The PEC natural gas utilities (PGL and NSG), which were acquired effective February 21, 2007, recognized a combined net loss of approximately $1 million, primarily related to the seasonal nature of natural gas utilities, which derive earnings during the heating season (first and fourth quarters). Because of the late February acquisition date, results for the majority of the two coldest months of the year were not included in natural gas utility earnings in 2007. The 2007 net income for PGL was less than the level we would normally expect, primarily due to increased costs of providing service. It is important to note, however, that we received a rate increase at PGL in February 2008, which will help offset rising costs. Please see Note 23, "Regulatory Environment," for more information on the rate increase.

Earnings decreased $15.5 million from 2005 to 2006, primarily due to the following:

MGUC and MERC (acquired on April 1 and July 1, 2006, respectively) had a combined net loss of approximately $11 million. Included in the net loss incurred by MGUC and MERC, was $7.1 million of after-tax external transition costs incurred by these regulated natural gas utilities. The net loss recognized at MGUC and MERC in excess of transition costs incurred can be attributed to not owning these operations during the January through March 2006 heating season and warmer than normal weather conditions during the last few months of 2006. From the acquisition dates through December 31, 2006, actual heating degree days were 13.9% and 7.3% below normal for MGUC and MERC, respectively.

Earnings at WPSC's natural gas utility also decreased approximately $4 million, driven by unfavorable weather conditions and customer conservation efforts.

Nonregulated Energy Operations:
Earnings increased $25.7 million in 2007 over 2006, primarily due to the following:

Operating income at Integrys Energy Services increased $40.2 million ($24.1 million after-tax).

After-tax income from discontinued operations at Integrys Energy Services increased $7.5 million, driven by the sale of Niagara Generation, LLC in the first quarter of 2007.

Miscellaneous expense at Integrys Energy Services decreased $11.1 million ($6.7 million after-tax), driven by a decrease in pre-tax losses recognized for the period related to Integrys Energy Services' investment in a synthetic fuel facility.

Minority interest income decreased $3.7 million ($2.2 million after-tax) as Integrys Energy Services' partner elected to stop receiving production from the synthetic fuel facility and, therefore, did not share in losses from this facility in 2007.

Section 29/45K federal tax credits recognized from Integrys Energy Services' investment in a synthetic fuel facility decreased $15.9 million, from $29.5 million in 2006, to $13.6 million in 2007.

Earnings decreased $1.8 million from 2005 to 2006, primarily due to the following:

An $11.0 million ($6.6 million after-tax) increase in interest expense due to higher working capital requirements, primarily related to growth in Integrys Energy Services' natural gas operations.

A $10.6 million ($6.4 million after-tax) increase in miscellaneous expenses, primarily related to increased tons procured from Integrys Energy Services' investment in a synthetic fuel facility and the fact that Integrys Energy Services received no royalty payments from this investment in 2006.

A $4.2 million after-tax decrease in income from discontinued operations.

The items negatively impacting earnings (discussed above) were partially offset by a $14.4 million ($8.6 million after-tax) increase in margin (including an $11.1 million pre-tax decrease in gains on derivative instruments used to protect the value of Section 29/45K tax credits).

A $6.7 million ($4.0 million after-tax) decrease in operating expenses, primarily related to the recognition of a $9.0 million pre-tax gain on the sale of WPS ESI Gas Storage, LLC in the second quarter of 2006.

A $3.4 million increase in Section 29/45K federal tax credits recognized from Integrys Energy Services' investment in a synthetic fuel facility.

Holding Company and Other Operations:
In 2007, financial results decreased $19.1 million, from earnings of $0.3 million in 2006, to a net loss of $18.8 million in 2007. See "Overview of Holding Company and Other Segment Operations," for more information.

In 2006, earnings decreased $5.6 million from earnings of $5.9 million in 2005, to earnings of $0.3 million in 2006. See "Holding Company and Other Segment Operations," for more information.

Oil and Natural Gas Operations:
In connection with the PEC merger, Integrys Energy Group announced its intent to divest of PEC's oil and natural gas production operations, PEP. PEP was sold in the third quarter of 2007. In 2007, PEP recognized earnings of $56.0 million, including $58.5 million of earnings reported as discontinued operations. The $2.5 million loss reported in continuing operations related primarily to intercompany expense allocations to PEP (salaries, interest expense, etc.) related to employees and debt that remained at Integrys Energy Group after the sale. The sale of PEP resulted in a $7.6 million after-tax gain.

Earnings per share:
Diluted earnings per share was impacted by the items discussed above as well as an increase of 29.4 million shares (69.3%) in the weighted average number of outstanding shares of Integrys Energy Group's common stock from 2006 to 2007 and an increase of 3.7 million shares (9.6%) in the weighted average number of outstanding shares of Integrys Energy Group's common stock from 2005 to 2006. Integrys Energy Group issued 31.9 million shares of common stock on February 21, 2007, in conjunction with the merger with PEC, issued 2.7 million shares of common stock in May 2006 in order to settle its forward equity agreement with an affiliate of J.P. Morgan Securities, and issued 1.9 million shares of common stock through a public offering in November 2005. Additional shares were also issued under the Stock Investment Plan and certain stock-based employee benefit plans in 2007, 2006, and 2005.

Utility Operations

In 2007, utility operations included the regulated electric segment, consisting of the regulated electric operations of WPSC and UPPCO, and the regulated natural gas utility segment, consisting of the natural gas operations of WPSC, PGL, NSG, MGUC, and MERC. The natural gas operations of WPSC, MGUC, and MERC were included for all of 2007, while the natural gas operations of PGL and NSG were included from February 22, 2007 through December 31, 2007. The natural gas operations of WPSC were included for all of 2006, while the natural gas operations of MGUC and MERC were included from April 1, 2006 through December 31, 2006, and July 1, 2006 through December 31, 2006, respectively. For the year ended December 31, 2005, utility operations included the regulated electric segment, including the electric operations of WPSC and UPPCO, and the regulated natural gas utility segment, including the natural gas operations of WPSC.

Regulated Electric Segment Operations

	Year Ended December 31,				
	2007	2006	2005	Change in 2007 over 2006	Change in 2006 over 2005
Revenues	$ 1,246.1	$ 1,099.4	$ 1,037.1	13.3%	6.0%
Fuel and purchased power costs	636.5	551.0	444.2	15.5%	24.0%
Margins	609.6	548.4	592.9	11.2%	(7.5)%
Operating and maintenance expense	321.1	265.3	355.7	21.0%	(25.4)%
Depreciation, amortization and decommissioning expense	80.1	78.5	120.4	2.0%	(34.8)%
Taxes other than income	43.2	41.6	38.5	3.8%	8.1%
Operating income	$ 165.2	$ 163.0	$ 78.3	1.3%	108.2%
Sales in kilowatt-hours					
Residential	3,173.6	3,144.8	3,127.4	0.9%	0.6%
Commercial and industrial	8,750.9	8,645.2	8,641.8	1.2%	-%
Wholesale	4,024.9	4,093.1	3,849.2	(1.7)%	6.3%
Other	42.4	42.2	41.7	0.5%	1.2%
Total sales in kilowatt-hours	15,991.8	15,925.3	15,660.1	0.4%	1.7%
Weather – WPSC					
Heating degree days	7,102	6,785	7,401	4.7%	(8.3)%
Cooling degree days	634	521	649	21.7%	(19.7)%

Revenue

2007 Compared with 2006:

Regulated electric revenue increased $146.7 million, driven by the following:

- On January 11, 2007, the Public Service Commission of Wisconsin issued a final written order to WPSC authorizing a retail electric rate increase of $56.7 million (6.6%), effective January 12, 2007, for Wisconsin electric customers.

- In June 2006, the MPSC issued a final written order to UPPCO authorizing an annual retail electric rate increase for UPPCO of $3.8 million (4.8%), effective June 28, 2006. See Note 23, "Regulatory Environment," for more information related to the retail electric rate increases at WPSC and UPPCO.

- On a per-unit basis, fuel and purchased power costs were approximately 17% higher during the year ended December 31, 2007, compared with the same period in 2006. In addition, sales volumes increased 0.4%, primarily related to an increase in sales volumes to residential and commercial and industrial customers, driven by warmer weather during the cooling season and colder weather during the heating season (a portion of heating load is electric) in 2007, compared with 2006. The increase in sales volumes related to weather was partially offset by an approximate 2% decrease in weather normalized residential and commercial and industrial customer usage, driven by customer conservation resulting from higher energy costs and weaker general economic conditions.

2006 Compared with 2005:

Regulated electric revenue increased $62.3 million, driven by the following:

- Approved 2006 electric rate increases for WPSC and UPPCO retail electric customers and rate increases for WPSC's wholesale customers resulting from the formula rate mechanism in place for these customers. See Note 23, "Regulatory Environment," for more information related to these rate increases.

- Electric sales volumes increased 1.7%, primarily related to a 6.3% increase in sales volumes to wholesale customers due to higher demand and new wholesale contracts.

- Unfavorable weather conditions during both the heating and cooling seasons for the year ended December 31, 2006, compared with 2005, partially offset the increases discussed above.

Margin

2007 Compared with 2006:

The regulated electric margin increased $61.2 million, driven by the following:

- A $57.0 million (11.5%) increase in the electric utility margin at WPSC.

  - WPSC's margin was positively impacted by the retail electric rate increases discussed above and by higher electric sales volumes to residential and commercial and industrial customers related to weather. Favorable weather conditions during both the heating and cooling seasons positively impacted margin by an estimated $6.0 million.

  - The year-over-year change in WPSC's margin was also positively impacted by a $16.2 million decrease in the 2006 margin related to the accrual of the refund to wholesale customers in 2006 of their portion of the Kewaunee nonqualified decommissioning trust fund. Pursuant to regulatory accounting, the decrease in the 2006 margin related to this refund was offset by a corresponding decrease in operating and maintenance expenses in 2006 and, therefore, did not have an impact on earnings. No such accrual to wholesale customers occurred in 2007; however, the payment of the refund was made in 2007.

  - Partially offsetting the increase in WPSC's margin, fuel, and purchased power costs were 3.7% higher than what was recovered in rates during the year ended December 31, 2007, compared with fuel and purchased power costs that were 10.5% less than what was recovered in rates during the same period in 2006, driving a $14.4 million negative variance in WPSC's electric margin. In 2007, fuel and purchased power prices were above what was projected in the rate case primarily due to higher than anticipated commodity costs and the market effects of unplanned plant outages. On October 6, 2007, a lightning strike hit Weston 3. The unit returned to full service on January 14, 2008. The unscheduled outage did not have a significant impact on the electric utility margin as the PSCW approved deferral of unanticipated fuel and purchased power costs directly related to the outage. The outage did, however, cause the price of purchased power from other sources to increase. Excluding the additional purchased power which resulted from the Weston 3 outage, fuel and purchased power costs at WPSC increased 17% in 2007, compared with the same period in 2006, primarily related to the higher per-unit cost of fuel and purchased power required from the market to serve WPSC's customers.

- UPPCO's margin increased approximately $4 million, primarily due to its retail electric rate increase, effective June 2006, and higher retail sales volumes.

2006 Compared with 2005:

The regulated electric margin decreased $44.5 million, driven by the following:

- A $48.7 million decrease in WPSC's electric margin, primarily related to the sale of the Kewaunee nuclear generation plant to Dominion Energy Kewaunee on July 5, 2005, and the related power purchase agreement. Excluding the $54.2 million increase in fixed payments made to Dominion Energy Kewaunee during the year ended December 31, 2006, WPSC's electric utility margin increased $5.5 million.

    - The retail and wholesale electric rate increases discussed above had a favorable impact on WPSC's regulated electric margin.

    - WPSC's fuel and purchased power costs were less than were recovered in rates during the year ended December 31, 2006, compared with fuel and purchased power costs that were more than were recovered in rates during the same period in 2005 (the under collection in 2005 was primarily due to the impact 2005 hurricanes had on natural gas prices), which had an estimated $23 million positive year-over-year impact on margin.

    - WPSC's margin was also positively impacted by higher wholesale electric sales volumes, driven by higher demand from existing customers and new wholesale customer contracts.

    - The increase in WPSC's margin was partially offset by a $70.8 million decrease in 2006 margin related to the refund to retail customers and the accrual for the refund to wholesale customers of a portion of the Kewaunee nonqualified decommissioning trust fund.

    - Also, unfavorable weather conditions during the 2006 heating and cooling seasons negatively impacted margin by an estimated $14 million

- UPPCO's margin increased approximately $4 million primarily due to its first retail electric base rate increase since 2002.

Operating Income

2007 Compared with 2006:

Operating income increased $2.2 million, driven by the $61.2 million increase in regulated electric margin discussed above, partially offset by a $54.3 million (23.7%) increase in operating and maintenance expenses at WPSC and a combined $3.2 million increase in depreciation and taxes other than income taxes at the regulated electric utility.

- The change in operating and maintenance expense at WPSC was primarily related to the following:

    - Regulated electric maintenance expenses increased $15.3 million, driven by longer than anticipated planned outages and a higher number of unplanned outages year-over-year (which included major overhauls planned at the Weston 2 and Weston 3 generation stations and the De Pere Energy Center, planned major turbine and generator work performed at the Pulliam electric generation station, and several unplanned outages at the Weston 3 generation station).

- Regulated electric transmission expenses increased $14.2 million, primarily related to higher rates charged by MISO and ATC due to additional transmission investment.

- The regulated electric segment of WPSC was allocated external costs to achieve merger synergies of $11.4 million for the year ended December 31, 2007.

- Amortization in 2006 of the regulatory liability recorded for WPSC's obligation to refund proceeds received from the liquidation of the Kewaunee nonqualified decommissioning trust fund to wholesale electric ratepayers contributed $16.2 million to the increase in WPSC's operating and maintenance expense. Pursuant to regulatory accounting, the 2006 increase in operating and maintenance expense related to this refund was offset by a corresponding increase in 2006 margin and, therefore, did not have an impact on earnings.

- Lower pension, post-retirement, and other employee benefit costs partially offset the increase in regulated electric operating and maintenance expense at WPSC.

- An increase in depreciation expense related to continued capital investment at the electric utility, while the increase in taxes other than income reflected an increase in sales year-over-year.

2006 Compared with 2005:

Operating income increased $85.1 million, driven by a $90.8 million decrease in operating and maintenance expense, and a $41.9 million decrease in depreciation and amortization expense, partially offset by the $44.5 million decrease in the regulated electric margin.

- The change in operating and maintenance expense was primarily related to the following:

  - Partial amortization of the regulatory liability recorded for WPSC's obligation to refund proceeds received from the liquidation of the Kewaunee nonqualified decommissioning trust fund to retail and wholesale electric ratepayers contributed $70.8 million to the decrease in operating expenses in 2006, compared with 2005. Pursuant to regulatory accounting, the decrease in operating expense related to this refund was offset by a corresponding decrease in margin.

  - Operating and maintenance expense related to the Kewaunee nuclear plant decreased approximately $17 million, driven by the sale of this facility in July 2005. The decrease in operating and maintenance expense related to Kewaunee did not have a significant impact on income available for common shareholders as WPSC is still purchasing the same amount of power from this facility as it obtained from it when WPSC owned a 59% interest in the plant. The cost of the power is included as a component of utility cost of fuel, natural gas, and purchased power.

  - As a result of the PSCW's disallowance of certain costs, WPSC incurred a $6.1 million charge in 2005 related to one-half the loss on the sale of Kewaunee, creating a corresponding year-over-year decrease in operating expenses.

  - Also, as disallowed by the PSCW, WPSC wrote-off $2.1 million in 2005 of previously deferred operating and maintenance expenses related to the 2004 extended outage at Kewaunee, creating a corresponding year-over-year decrease in operating expenses.

- Salaries and employee benefits also decreased in part due to the sale of Kewaunee in 2005.

- Partially offsetting the decrease in operating and maintenance expense, software amortization increased $5.4 million, driven by the late 2005 implementation of a new customer billing system.

- Excluding Kewaunee, maintenance expenses at the electric utility segment were up $4.9 million. Planned maintenance was required on certain combustion turbines, and maintenance expense related to electric distribution assets also increased.

- Electric transmission expense increased $4.1 million.

- The change in depreciation, amortization and decommissioning expense was primarily related to the following:

· Approximately $41 million of decommissioning expense was recorded during 2005, compared with no decommissioning expense recorded in 2006. In 2005, realized gains on decommissioning trust assets were substantially offset by decommissioning expense pursuant to regulatory practice (see analysis of "Miscellaneous Income" below).

· A $10.2 million decrease in depreciation expense resulting from the sale of Kewaunee in July 2005. Subsequent to the sale of Kewaunee, decommissioning expense is no longer recorded.

· An increase in depreciation expense related to continued capital investment at the electric utility partially offset the overall decrease in depreciation and decommissioning expense.

Regulated Natural Gas Utility Segment Operations

	Year Ended December 31,				
	2007	2006	2005	Change in 2007 over 2006	Change in 2006 over 2005
Revenues	$ 2,103.7	$ 676.9	$ 522.0	210.8%	29.7%
Purchased natural gas costs	1,453.5	493.8	397.4	194.4%	24.3%
Margins	650.2	183.1	124.6	255.1%	47.0%
Operating and maintenance expense	427.4	121.3	69.4	252.4%	74.8%
Depreciation and amortization expense	97.7	32.7	19.5	198.8%	67.7%
Taxes other than income	33.1	11.8	6.1	180.5%	93.4%
Operating income	$ 92.0	$ 17.3	$ 29.6	431.8%	(41.6)%
Throughput in therms					
Residential	1,251.8	351.5	241.6	256.1%	45.5%
Commercial and industrial	439.2	190.6	134.7	130.4%	41.5%
Interruptible	59.4	40.1	36.1	48.1%	11.1%
Interdepartmental	47.1	27.6	70.8	70.7%	(61.0)%
Transport	1,505.6	657.5	344.0	129.0%	91.1%
Total sales in therms	3,303.1	1,267.3	827.2	160.6%	53.2%
Weather (*)					
WPSC heating degree days	7,102	6,785	7,401	4.7%	(8.3)%

* Weather information for MGUC, MERC, PGL, and NSG is not shown as the information is not comparable to the prior year since the companies were not part of Integrys Energy Group prior to April 1, 2006 (MGUC), July 1, 2006 (MERC), and February 21, 2007 (PGL and NSG).

Revenue

2007 Compared with 2006:

Regulated natural gas utility segment revenue increased $1,426.8 million, driven by the following:

- PGL and NSG (acquired February 21, 2007) generated $1,118.5 million of natural gas utility revenue and contributed approximately 1.5 billion therms of natural gas throughput volumes in 2007.

- MERC (which acquired natural gas distribution operations in Minnesota on July 1, 2006) generated $294.0 million of natural gas utility revenue and approximately 705 million therms of natural gas throughput volumes in 2007, compared with $123.0 million of natural gas utility revenue and approximately 348 million therms of natural gas throughput volumes in 2006.

- MGUC (which acquired natural gas distribution operations in Michigan on April 1, 2006) generated $220.2 million of natural gas utility revenue and approximately 311 million therms of natural gas throughput volumes in 2007, compared with $110.1 million of natural gas revenue and approximately 193 million therms of natural gas throughput volumes during 2006.

- WPSC's natural gas utility revenue increased $27.2 million, from $443.8 million in 2006, to $471.0 million in 2007, driven by the following:

  - On January 11, 2007, the PSCW issued a final written order to WPSC authorizing a retail natural gas rate increase of $18.9 million (3.8%), effective January 12, 2007. See Note 23, "Regulatory Environment," for more information related to the retail natural gas rate increase at WPSC.

  - An 8.6% increase in natural gas throughput volumes. The increase in natural gas throughput volumes was driven by a 10.3% increase in residential volumes and a 70.7% increase in natural gas volumes sold to the electric utility. The increase in sales volumes to residential customers was driven in part by colder year-over-year weather conditions during the 2007 heating season. The increase in natural gas volumes sold to the electric utility was driven by an increase in the need for the electric utility to run its peaking generation units.

  - Natural gas prices were 10.1% lower on a per-unit basis, compared with 2006, resulting in a decrease in natural gas utility revenue, which partially offset the overall increase in natural gas utility revenue at WPSC.

2006 Compared with 2005:

Regulated natural gas utility segment revenue increased $154.9 million, driven by the following:

- The acquisition of natural gas distribution operations in Michigan by MGUC on April 1, 2006, and the acquisition of natural gas distribution operations in Minnesota by MERC on July 1, 2006. These acquisitions contributed approximately $233 million to natural gas utility revenue and approximately 541 million therms to natural gas throughput volumes in 2006.

- WPSC's natural gas utility revenue was $443.8 million in 2006, compared with $522.0 million in 2005. Lower natural gas revenues at WPSC were primarily related to:

  - A 12.2% decrease in natural gas throughput volumes, primarily related to a 61.0% decrease in natural gas throughput volumes sold to the electric utility for electric generation and a 9.2% decrease in throughput volumes to residential and commercial and industrial customers. The decrease in throughput volumes to the electric utility resulted from a decrease in the need for the electric utility to run its natural gas-fired peaking generation units during the year ended December 31, 2006, compared with 2005, and from higher dispatch of these peaking generation units by MISO in 2005 for reliability purposes. The decrease in throughput volumes to residential and commercial and industrial customers was also driven by unfavorable weather conditions in 2006 compared with 2005, as well as customer conservation efforts. Particularly at the beginning of 2006, customers were taking measures to conserve energy as a result of the high natural gas prices in the first half of 2006.

- In 2006, natural gas prices were 1.4% lower on a per-unit basis, compared with 2005, resulting from a large decline in the price of natural gas in the second half of 2006, also contributing to the decrease in natural gas revenue.

- Partially offsetting the decrease in WPSC's natural gas utility revenue was the 2006 natural gas rate increase at WPSC (see Note 23, "Regulatory Environment," for more information related to this rate increase).

Margin

2007 Compared with 2006:

The regulated natural gas utility segment margin increased $467.1 million, driven by the following:

- The combined margin provided by PGL and NSG in 2007 was $387.2 million.

- The combined margin at MGUC and MERC increased $55.1 million, from $59.1 million in 2006, to $114.2 million in 2007. The increase in natural gas margin at MGUC and MERC was driven primarily by the fact that MGUC and MERC operated during the first quarter heating season in 2007, but were not acquired by Integrys Energy Group until after the first quarter heating season in 2006.

- WPSC's natural gas margin increased $24.8 million, from $124.0 million in 2006, to $148.8 million in 2007. As discussed in more detail above, the increase in WPSC's margin was driven by the retail natural gas rate increase and an increase in throughput volumes to higher margin residential customers due in part to colder year-over-year weather conditions during the heating season. The increase in throughput volumes sold to the electric utility did not have a significant impact on WPSC's natural gas utility margin.

2006 Compared with 2005:

The regulated natural gas utility segment margin increased $58.5 million, driven by the following:

- The combined margin provided by MGUC and MERC was approximately $59 million.

- WPSC's natural gas utility margin decreased $0.6 million. As discussed in more detail above, a decrease in throughput volumes to higher margin residential and commercial and industrial customers was partially offset by the natural gas rate increase.

Operating Income

2007 Compared with 2006:

Operating income increased $74.7 million, driven by the $467.1 million increase in the regulated natural gas utility margin, partially offset by a $306.1 million increase in operating and maintenance expense, a $65.0 million increase in depreciation and amortization expense, and a $21.3 million increase in taxes other than income taxes.

- The increase in operating and maintenance expense was primarily related to the following:

    - Combined operating and maintenance expenses of $292.9 million were incurred by PGL and NSG in 2007.

    - Combined operating and maintenance expense at MGUC and MERC increased approximately $9 million, primarily due to the fact that both of these businesses incurred operating expenses for only a partial year in 2006, compared to incurring a full year of operating and maintenance expenses in 2007. For the year ended December 31, 2006, $11.8 million of combined operating and maintenance expense related to external transition costs, primarily for the start-up of outsourcing activities and other legal and consulting fees. For the year ended December 31, 2007, MGUC and MERC were allocated $1.7 million of external costs to achieve merger synergies related to the PEC merger.

- Operating expenses related to WPSC's natural gas operations increased $3.7 million year-over-year, due primarily to the allocation of $2.8 million of external costs to achieve merger synergies related to the PEC merger.

- The increase in depreciation and amortization expense was primarily related to the merger with PEC (a combined $59.0 million of depreciation and amortization expense was recognized at PGL and NSG in 2007) and an increase in depreciation expense at MERC and MGUC (these businesses were not included in results of operations for the full year in 2006). Depreciation and amortization expense at WPSC's natural gas utility was relatively flat year-over-year.

- The increase in taxes other than income taxes from 2006 to 2007 was primarily related to the merger with PEC ($16.8 million of taxes other than income taxes were recognized at PGL and NSG in 2007), and the acquisition of the Michigan and Minnesota natural gas distribution operations, which were not included in results of operations for the full year in 2006. Taxes other than income taxes are primarily related to property taxes, real estate taxes, gross receipts taxes, and payroll taxes paid by these companies.

2006 Compared with 2005:

Operating income decreased $12.5 million, driven by a $71.0 million increase in total operating and maintenance expense, partially offset by the $58.5 million increase in regulated natural gas utility margin as discussed above. The increase in operating expenses is explained below.

- Operating and maintenance expenses increased $52.1 million. The increase in operating and maintenance expense at the regulated natural gas utility segment was driven by $56.6 million of combined operating and maintenance expense incurred by MGUC and MERC. Of the $56.6 million of operating and maintenance expense incurred by MGUC and MERC during the year ended December 31, 2006, $11.8 million related to external transition expenses, primarily for the start-up of outsourcing activities and other legal and consulting fees. Partially offsetting the increase in operating and maintenance expenses related to MGUC and MERC, operating expenses related to WPSC's natural gas operations decreased, driven by decreases in various employee benefit related expenses.

- The $13.2 million year-over-year increase in depreciation expense recorded at the regulated natural gas utility segment was driven by a combined $10.4 million of depreciation expense recorded by MGUC and MERC for the year ended December 31, 2006. Continued capital investment at WPSC's natural gas utility also contributed to the increase in depreciation expense.

- The $5.7 million increase in taxes other than income taxes was driven by $4.8 million of taxes other than income taxes recorded by MGUC and MERC, primarily related to property taxes.

Integrys Energy Services' Operations

Integrys Energy Services is a diversified nonregulated energy supply and services company serving residential, commercial, industrial and wholesale customers in developed competitive markets in the United States and Canada.

Integrys Energy Services' Segment Results of Operations

(Millions, except natural gas sales volumes)	Year Ended December 31, 2007	2006	2005	Change in 2007 Over 2006	Change in 2006 Over 2005
Revenues	$ 6,979.7	$ 5,159.1	$ 5,314.9	35.3%	(2.9)%
Cost of fuel, natural gas, and purchased power	6,675.6	4,978.0	5,148.6	34.1%	(3.3)%
Margins	$ 304.1	$ 181.1	$ 166.3	67.9%	8.9%
Margin Detail					
Electric and other margins	$ 164.9	$ 60.5	$ 105.3	172.6%	(42.5)%
Natural gas margins	$ 139.2	$ 120.6	$ 61.0	15.4%	97.7%
Operating and maintenance expense	$ 159.4	$ 81.5	$ 88.9	95.6%	(8.3)%
Depreciation and amortization	14.4	9.4	9.5	53.2%	(1.1)%
Taxes other than income taxes	7.1	7.2	5.4	(1.4)%	33.3%
Operating Income	$ 123.2	$ 83.0	$ 62.5	48.4%	32.8%
Gross volumes (includes volumes both physically delivered and net settled)					
Wholesale electric sales volumes in kilowatt-hours	132,623.6	58,794.9	44,778.3	125.6%	31.3%
Retail electric sales volumes in kilowatt-hours	14,849.7	6,554.1	8,021.0	126.6%	(18.3)%
Wholesale natural gas sales volumes in billion cubic feet	483.1	402.2	338.1	20.1%	19.0%
Retail natural gas sales volumes in billion cubic feet	368.8	314.5	276.6	17.3%	13.7%
Physical volumes (includes only transactions settled physically for the periods shown)					
Wholesale electric sales volumes in kilowatt-hours *	3,599.7	968.2	1,515.6	271.8%	(36.2)%
Retail electric sales volumes in kilowatt-hours *	14,584.4	4,565.6	6,594.5	219.4%	(30.8)%
Wholesale natural gas sales volumes in billion cubic feet *	445.6	373.5	327.8	19.3%	13.9%
Retail natural gas sales volumes in billion cubic feet *	319.4	264.0	227.7	21.0%	15.9%

* Represents gross physical volumes.

Revenue

2007 Compared with 2006

Year-over-year, revenues increased approximately $1.8 billion. The increase was primarily due to increased volumes as a result of the addition of the nonregulated energy operations of PEC and an average increase in 2007 electric prices of over 10%. In addition to revenue and volume contributions from the merger with PEC, retail electric sales volumes and related revenue increased as a result of Integrys Energy Services' new retail electric product offerings to existing markets and expansion into new retail electric markets. Wholesale electric sales volumes and revenue increased as a result of the additional wholesale origination structured transactions. Wholesale natural gas volumes increased as a result of an increase in the profitability of wholesale origination structured natural gas transactions throughout 2006 and into 2007. Some of these transactions were entered into in prior periods for future delivery; therefore, Integrys Energy Services is seeing an increase in volumes in the periods in which these transactions settle. Retail natural gas volumes also increased, driven by favorable pricing compared with 2006, which encouraged new and existing customers to enter into or extend supply contracts with Integrys Energy Services.

2006 Compared with 2005

Year-over-year, revenues decreased $155.8 million, primarily related to a decrease in both physical retail and wholesale electric sales volumes and a decrease in energy prices during the latter half of 2006. The decrease in physical retail electric sales volumes was driven by a decrease in retail electric sales volumes in Ohio as aggregation sales in Ohio ended on December 31, 2005, with the expiration of Integrys Energy Services' contracts with Ohio aggregation customers. Michigan retail electric sales volumes also decreased as many customers returned to their utility supplier beginning in 2005 and continuing into 2006 as a result of high wholesale energy prices and utility tariff changes, which significantly lowered the savings that customers could obtain from contracting with non-utility suppliers. In other areas, lower wholesale energy prices in the latter half of 2006 allowed Integrys Energy Services to sign up a significant number of new retail customers. The decrease in physically settled wholesale electric sales volumes was driven by a trend toward more financially settled transactions in 2006, compared to 2005.

Margins

Integrys Energy Services' margin increased $123.0 million from 2006 to 2007 and increased $14.8 million from 2005 to 2006. The table below provides a summary of the significant items contributing to the change in margin. "Other significant items" in the table below are generally related to the timing of gain and loss recognition on certain transactions and the settlement of the derivative instruments used to protect the value of Section 29/45K tax credits.

(Millions except natural gas sales volumes)	Increase (Decrease) in Margin in 2007	Increase (Decrease) in Margin in 2006
Electric and other margins		
Realized gains on structured origination contracts	$ 11.8	$ 6.3
Realized retail electric margin	15.9	(2.9)
All other wholesale electric operations	3.9	4.8
Other significant items:		
Oil option activity	22.0	(11.1)
Retail mark-to-market activity	45.3	(27.3)
2005 liquidation of electric supply contract	5.5	(14.6)
Net increase (decrease) in electric and other margins	104.4	(44.8)
Natural gas margins		
Realized natural gas margins	8.0	32.2
Other significant items:		
Mass market supply options	6.6	(8.4)
Spot to forward differential	(0.2)	5.4
Other mark-to-market activity	4.2	30.4
Net increase in natural gas margins	18.6	59.6
Net increase in Integrys Energy Services' margin	$ 123.0	$ 14.8

Electric and Other Margins

Integrys Energy Services' electric and other margins increased $104.4 million from 2006 to 2007 and decreased $44.8 million from 2005 to 2006. The 2007 electric and other margin included the negative impact of $15.2 million of amortization related to purchase accounting adjustments required as a result of the merger with PEC. The following items were the most significant contributors to the change in Integrys Energy Services' electric and other margins.

Realized gains on structured origination contracts

Realized gains on structured origination contracts increased $11.8 million, from $6.3 million in 2006 to $18.1 million in 2007. Origination contracts are physical, customer-based agreements with municipalities, merchant generators, cooperatives, municipalities, and regulated utilities. The increase was primarily due to continued growth in existing markets in the Midwest and Northeastern United States, as well as expansion into the markets in the western United States.

Realized gains on structured origination contracts increased $6.3 million from 2005 to 2006. The increase was primarily due to realized gains from origination contracts involving the sale of energy through structured transactions to wholesale customers in the Midwest and northeastern United States. These origination contracts were not in place in 2005. Integrys Energy Services provided products to large origination customers desiring to take advantage of falling energy prices.

Realized retail electric margin

The realized retail electric margin increased $15.9 million from $18.3 million in 2006 to $34.2 million in 2007. The change was primarily due to the following:

A $13.9 million increase related to operations in Illinois, driven by the merger with PEC's nonregulated business and the addition of new customers due to the expiration of certain regulatory provisions in the state in 2007 that effectively opened the market to nonregulated energy suppliers.

A $6.0 million increase related to operations in Texas, as a result of further penetration into this market resulting from continued marketing efforts. Retail offerings in Texas first began in the third quarter of 2006.

A $3.6 million increase related to operations in New England as new customers were added due to an increased sales focus in this region.

Partially offsetting the increases discussed above were:

A $4.4 million decrease related to Michigan operations as many customers continued to return to utility suppliers as a result of high wholesale energy prices and changes in utility tariffs which have continued to make the Michigan energy market less competitive.

A $3.3 million decrease related to operations in the state of New York, related to a change in the product mix offered to customers in response to utility rate structure changes.

The realized retail electric margin decreased $2.9 million from 2005 to 2006. The decrease was primarily driven by an $8.2 million decrease in margin in Ohio and a $3.7 million decrease in margin in northern Maine. These decreases were partially offset by a $4.4 million increase in margin in Michigan, a $2.8 million increase in margin in New York, and positive margin contributions from retail electric operations in Texas and

Illinois. Integrys Energy Services' retail electric aggregation sales in Ohio ended on December 31, 2005, with the expiration of Integrys Energy Services' contracts with Ohio aggregation customers. The decrease in margin from operations in northern Maine was driven by higher supply costs in part tied to diesel fuel prices. A portion of the electricity purchased by Integrys Energy Services to supply customers in northern Maine is derived from burning wood chips. The cost to transport wood chips, as well as the operating costs of the machine utilized to make the wood chips, were negatively impacted by higher diesel fuel prices. In 2006, Integrys Energy Services shared in this diesel fuel exposure with the generation supplier. The increase in margin from retail electric operations in Michigan was driven by the elimination of the Seams Elimination Charge Adjustment (SECA) effective March 31, 2006. See Note 23, "Regulatory Environment," for more information related to SECA. Integrys Energy Services began developing a product offering in the Texas retail electric market in 2005 and started to deliver power to these customers in July 2006. In 2006, Integrys Energy Services began offering retail electric products to large commercial and industrial customers in Illinois. In 2005, Integrys Energy Services was only offering natural gas products and energy management services to customers in Illinois.

All other wholesale electric operations

As part of its trading activities, Integrys Energy Services seeks to generate profits from the volatility of the price of electricity by purchasing or selling various financial and physical instruments (such as forward contracts, options, financial transmission rights, and capacity contracts) in established wholesale markets where Integrys Energy Services has market expertise, under risk management policies set by management and approved by Integrys Energy Group's Board of Directors. Integrys Energy Services also seeks to reduce market price risk and extract additional value from its generation and customer supply portfolios through the use of various financial and physical instruments (such as forward contracts, options, financial transmission rights, and capacity contracts). Period-by-period variability in the margin contributed by Integrys Energy Services' optimization strategies and trading activities is expected due to changing market conditions and differences in the timing of gains and losses recognized on derivative and non-derivative contracts, as required by generally accepted accounting principles. A diverse mix of products and markets, combined with disciplined execution and exit strategies, has allowed Integrys Energy Services to generate economic value and earnings from these activities while staying within the value-at-risk (VaR) limits authorized by Integrys Energy Group's Board of Directors. For more information on VaR, see "Item 7A, Quantitative and Qualitative Disclosures about Market Risk."

Integrys Energy Services' margin from all other wholesale electric operations increased $3.9 million from 2006 to 2007, driven by an increase in net realized and unrealized gains (primarily unrealized gains) related to trading activities utilized to optimize the value of Integrys Energy Services' merchant generation fleet and energy contract portfolios. Partially offsetting the increase resulting from realized and unrealized gains, the overall level of proprietary trading was less in 2007, due primarily to a decrease in electric price volatility during the first three quarters of 2007, increased emphasis on structured electric transactions in 2007, and the departure of several key traders in the third quarter of 2006. Proprietary trading started picking up again in the fourth quarter of 2007 as electric price volatility increased. Integrys Energy Services used the 2006 departure of several of its traders as an opportunity to restructure trading operations into two groups. Its East trading group was relocated from Washington D.C. to Chicago and the West trading group is located in Denver. The restructured trading operations allow Integrys Energy Services to more effectively service customers in the West by providing better diversification of trading talent, market expertise, and product offerings.

Integrys Energy Services' margin from all other wholesale electric operations increased $4.8 million from 2005 to 2006, driven by an increase in net realized and unrealized gains related to trading activities utilized to optimize the value of Integrys Energy Services' merchant generation fleet and energy contract portfolios.

Oil option activity

Oil option activity drove a $22.0 million increase in electric and other margins from 2006 to 2007. The oil options were utilized to protect the value of a portion of Integrys Energy Services' Section 29/45K federal tax credits from 2005 to 2007. However, companies are no longer allowed to generate tax credits from the production of synthetic fuel as this program ended effective December 31, 2007. Therefore, Integrys Energy Services exercised substantially all of its remaining oil options in 2007. Net mark-to-market and realized losses on oil options of $2.4 million were recognized in 2006, compared with net mark-to-market and realized gains on oil options of $19.6 million in 2007. These derivative instruments were not designated as hedging instruments and, as a result, changes in the fair value were recorded in earnings. The increase in the fair value of these instruments in 2007 over 2006 reflects increased oil prices.

Oil option activity drove an $11.1 million decrease in electric and other margins from 2005 to 2006. The decrease was driven by a decrease in the fair value of derivative instruments utilized to protect the value of a portion of Integrys Energy Services' Section 29/45K federal tax credits from 2005 to 2006. This decrease is a result of net mark-to market and realized losses on oil options of $2.4 million in 2006, compared with net mark-to-market and realized gains on oil options of $8.7 million in 2005.

Retail mark-to-market activity

Earnings volatility from this activity results from the application of derivative accounting rules to customer supply contracts (requiring that these derivative instruments be marked-to-market), without a corresponding mark-to-market offset related to the customer sales contracts, which are not considered derivative instruments. These mark-to-market gains and losses will vary each period, and ultimately reverse as the related customer sales contracts settle. As a result, Integrys Energy Services generally experiences mark-to-market losses on supply contracts in periods of declining wholesale prices and mark-to-market gains in periods of increasing wholesale prices.

Results from retail mark-to-market activity increased $45.3 million from $18.5 million of unrealized losses in 2006 to $26.8 million of unrealized gains in 2007.

Results from retail mark-to-market activity decreased $27.3 million from 2005 to 2006.

2005 liquidation of electric supply contract

In the fourth quarter of 2005, an electricity supplier exiting the wholesale market in Maine requested that Integrys Energy Services liquidate a firm contract to buy power in 2006 and 2007. At that time, Integrys Energy Services recognized an $8.2 million gain related to the liquidation of the contract and entered into a new contract with another supplier for firm power in 2006 and 2007 to supply its customers in Maine. The cost to purchase power under the new contract was more than the cost under the liquidated contract. The liquidation and subsequent replacement of this contract resulted in the following:

A $5.5 million increase in margins from 2006 to 2007. The replacement contract increased the cost of purchased power needed to serve customers in Maine by $6.4 million in 2006, compared with $0.9 million in 2007.

A $14.6 million negative impact on the 2006 electric and other margin, as a result of higher purchased power costs recorded under the new contract of $6.4 million compared with an $8.2 million gain recognized on the liquidation of the original contract in 2005.

Natural Gas Margins

Integrys Energy Services' natural gas margins increased $18.6 million from 2006 to 2007 and increased $59.6 million from 2005 to 2006. The 2007 natural gas margins included the negative impact of $6.1 million of amortization related to purchase accounting adjustments required as a result of the merger with PEC. The following items were the most significant contributors to the change in Integrys Energy Services' natural gas margins.

Realized natural gas margins

Realized natural gas margins increased $8.0 million, from $92.6 million in 2006, to $100.6 million in 2007. The majority of this increase, $5.7 million, was driven by margin contributed by the nonregulated retail natural gas marketing operations of PEC and improved supply optimization, as Integrys Energy Services was able to secure lower supply costs for firm sales commitments to retail natural gas customers in Ohio and Illinois. The remaining increase in realized natural gas margins was driven by the nonregulated wholesale natural gas marketing operations added with the PEC merger.

Realized natural gas margins increased $32.2 million, from $60.4 million in 2005, to $92.6 million in 2006. The majority of this increase, $26.6 million, related to an increase in retail natural gas margin, driven by continued expansion of Integrys Energy Services' Canadian retail operations (including higher sales volumes to existing customers as well as new customer additions). Margins from retail natural gas operations in Wisconsin, Michigan, and Illinois also increased, as Integrys Energy Services was able to better manage supply to these customers, aided by favorable market conditions. The remaining $5.6 million increase in realized natural gas margins related to wholesale operations, driven by an increase in structured wholesale natural gas transactions attributed to an increase in the volatility of the price of natural gas as well as high natural gas storage spreads during most of 2006.

Mass market supply options

Options utilized to manage supply costs for mass market customers are used to reduce the risk of price movements, customer migration, and changes in consumer consumption patterns. Earnings volatility results from the application of derivative accounting rules to the options (requiring that these derivative instruments be marked-to-market), without a corresponding mark-to-market offset related to the customer contracts. Full requirements natural gas contracts with Integrys Energy Services' customers are not considered derivatives and, therefore, no gain or loss is recognized on these contracts until settlement. The option mark-to-market gains and losses will reverse as the related customer sales contracts settle.

In 2007, options utilized to manage supply costs for mass market customers drove a $6.6 million increase in Integrys Energy Services' natural gas margin. These options had a $1.1 million positive impact on margin in 2007 (commensurate with higher natural gas prices), compared with a negative $5.5 million impact on margin in 2006 (commensurate with declining natural gas prices).

In 2006, options utilized to manage supply costs for mass market customers drove an $8.4 million decrease in Integrys Energy Services' natural gas margin. These options had a $5.5 million negative impact on Integrys Energy Services' natural gas margin in 2006 (commensurate with declining natural gas prices), compared with a $2.9 million positive impact on margin in 2005 (commensurate with higher natural gas prices in the latter half of 2005).

Spot to forward differential

Integrys Energy Services experiences earnings volatility associated with the natural gas storage cycle, which runs annually from April through March of the next year. Generally, injections of natural gas into storage inventory take place in the summer months and natural gas is withdrawn from storage in the winter months. Integrys Energy Services' policy is to hedge the value of natural gas storage with contracts in the over-the-counter and futures markets, effectively locking in a margin on the natural gas in storage. However, fair market value hedge accounting rules require the natural gas in storage to be marked-to-market using spot prices, while the future sales contracts are marked-to-market using forward prices. When the spot price of natural gas changes disproportionately to the forward price of natural gas, Integrys Energy Services experiences volatility in its earnings. Consequently, earnings volatility may occur within the contract period for natural gas in storage. The accounting treatment does not impact the underlying cash flows or economics of these transactions.

The natural gas storage cycle had a negative $0.2 million impact on natural gas margins from 2006 to 2007. There was no material impact on margin as a result of the natural gas storage cycle in 2007 compared with a $0.2 million positive impact in 2006. At December 31, 2007, the market value of natural gas in storage was $5.6 million less than the market value of future sales contracts (net unrealized loss), related to the 2007/2008 natural gas storage cycle. This $5.6 million difference is expected to vary with market conditions, and will reverse entirely and have a positive impact on earnings when all of the natural gas is withdrawn from storage.

The natural gas storage cycle had a positive $5.4 million impact on natural gas margins from 2005 to 2006. In 2006, the natural gas storage cycle had a positive $0.2 million impact on margin, compared with a $5.2 million negative impact on margin in 2005.

Other mark-to-market activity

Other mark-to-market activity primarily relates to changes in the fair market value of basis swaps utilized to mitigate market price risk associated with natural gas transportation contracts and certain natural gas sales contracts as well as contracts utilized to mitigate market price risk related to certain natural gas storage contracts. Earnings volatility results from the application of derivative accounting rules to the basis and other swaps (requiring that these derivative instruments be marked-to-market), without a corresponding mark-to-market offset related to the physical natural gas transportation contracts, the natural gas sales contracts, or the natural gas storage contracts (as these contracts are not considered derivative instruments). Therefore, no gain or loss is recognized on the transportation contracts, customer sales contracts, or natural gas storage contracts until physical settlement of these contracts occurs.

Derivative instruments not previously discussed drove a $4.2 million increase in the natural gas margins as mark-to-market gains on these instruments increased to $37.5 million in 2007.

Derivative instruments not previously discussed drove a $30.4 increase in the natural gas margins as mark-to-market gains on these instruments increased in 2006, compared with 2005.

Operating Income

2007 Compared with 2006:

Operating income at Integrys Energy Services increased $40.2 million, driven by the $123.0 million increase in margin discussed above, partially offset by a $77.9 million increase in operating and maintenance expense and a $5.0 million increase in depreciation and amortization expense.

The increase in operating and maintenance expense was driven by higher payroll and benefit costs related to additional employees required as a result of continued business expansion activities at Integrys Energy Services (the most significant of which related to the merger of PEC's nonregulated operation into Integrys Energy Services). A $9.0 million pre-tax gain on the 2006 sale of WPS ESI Gas Storage, LLC, $7.7 million of costs to achieve merger synergies and additional costs related to plant outages of $2.6 million in 2007 also contributed to the increase in operating and maintenance expense.

2006 compared with 2005:

Operating income at Integrys Energy Services increased $20.5 million, driven by the $14.8 million increase in margin discussed above and a $7.4 million decrease in operating and maintenance expense. The decrease in operating and maintenance expense was primarily related to a $9.0 million pre-tax gain recognized on the sale of WPS ESI Gas Storage, LLC in the second quarter of 2006. This gain was partially offset by higher payroll and benefit costs related to an increase in the number of employees as a result of business expansion activities.

Holding Company and Other Segment Operations

2007 Compared with 2006:

Financial results at the Holding Company and Other segment decreased $19.1 million, from net income of $0.3 million for the year ended December 31, 2006, to a net loss of $18.8 million for the year ended December 31, 2007. The change was driven by the following:

- A $42.0 million ($25.2 million after-tax) increase in interest expense, driven by additional borrowings assumed in the merger with PEC, as well as an increase in short-term and long-term borrowings required to fund the acquisitions of the natural gas distribution operations in Michigan and Minnesota, higher working capital requirements at Integrys Energy Services, and transaction and transition costs related to the merger with PEC.

- A $6.2 million ($3.7 million after-tax) gain on the sale of Integrys Energy Group's one-third interest in Guardian Pipeline, LLC in April 2006 also contributed to the decrease in year-over year earnings.

- An $11.5 million increase in pre-tax earnings ($6.9 million after-tax) from Integrys Energy Group's 34.5% ownership interest in ATC. Integrys Energy Group recorded $50.5 million of pre-tax equity earnings from ATC during the year ended December 31, 2007, compared with $39.0 million for the same period in 2006.

- A $1.7 million ($1.0 million after-tax) decrease in operating and maintenance expenses, primarily related to the reallocation of external costs to achieve merger synergies associated with the PEC merger, incurred from July 2006 through March 2007. In March 2007, all external costs to achieve were reallocated from the Holding Company and Other segment (where they were initially recorded) to other reportable segments, which will ultimately be the beneficiaries of the synergy savings resulting from the costs to achieve.

2006 Compared with 2005:

Earnings at the Holding Company and Other segment decreased $5.6 million, from net income of $5.9 million for the year ended December 31, 2005, to a net income of $0.3 million for the year ended December 31, 2006. The changes were driven by the following:

- A $12.9 million increase in interest expense, net of intercompany interest income ($7.7 million after taxes) Higher interest expense was driven by an increase in short-term and long-term borrowings required to fund the acquisition of natural gas distribution operations in Michigan and Minnesota and working capital requirements at

Integrys Energy Services.

- A $9.2 million increase in operating and maintenance expense ($5.5 million after taxes). The increase in operating and maintenance expense was driven by legal and consulting expenses related to business expansion activities, primarily attributed to the merger with PEC.

- A $4.8 million year-over year decrease in after-tax gains from land sales.

- A $13.9 million increase in pre-tax earnings ($8.3 million after-tax) from ATC (pre-tax equity earnings from ATC increased to $39.0 million in 2006, from $25.1 million in 2005).

- A $6.2 million ($3.7 million after-tax) gain recognized from the 2006 sale of Integrys Energy Group's one-third interest in Guardian Pipeline, LLC.

Summary of External Costs to Achieve

Below is a table depicting the pre-tax impact that external costs to achieve had on each reportable segment of Integrys Energy Group during the year ended December 31, 2007. Note that external costs to achieve incurred at the holding company in 2006 and the first quarter of 2007 were reallocated down to the segment level in the first quarter of 2007.

Reportable Segment (millions)	2007 Pre-tax Impact (Income)/Expense
Electric utility	$ 12.3
Natural gas utility	4.5
Integrys Energy Services	7.7
Holding company and other	(6.8)
Total	$ 17.7

Other Income (Expense)

	Year Ended December 31, 2007	2006	2005	Change 2007 over 2006	Change 2006 over 2005
Miscellaneous income	$ 64.1	$ 42.8	$ 88.8	49.8%	(51.8%)
Interest expense	(164.5)	(99.2)	(62.0)	65.8%	60.0%
Minority interest	0.1	3.8	4.5	(97.4%)	(15.6%)
Other (expense) income	$ (100.3)	$ (52.6)	$ 31.3	90.7%	-

Miscellaneous Income

2007 Compared with 2006:

The $21.3 million increase in miscellaneous income was primarily driven by:

- An $11.5 million increase in pre-tax equity earnings from Integrys Energy Group's 34.5% ownership interest in ATC.

- A $5.7 million decrease in pre-tax losses recognized for the year related to Integrys Energy Services' investment in a synthetic fuel facility. Integrys Energy Services took less production from this facility in 2007 compared with 2006.

- A $3.8 million increase in foreign currency gains at Integrys Energy Services' Canadian subsidiaries, which was offset by related losses in gross margin. These transactions are substantially hedged from an economic perspective, resulting in no significant impact on income (loss) available for common shareholders.

- An increase of $2.9 million, partially due to an increase in interest income recognized related to the transmission facilities WPSC is funding on ATC's behalf pending the start-up of Weston 4.

- A decrease due to the $6.2 million pre-tax gain recognized from the sale of Integrys Energy Group's one-third interest in Guardian Pipeline, LLC in the second quarter of 2006.

2006 Compared with 2005:

Miscellaneous income decreased $46.0 million driven primarily by:

- Approximately $41 million of realized gains on nuclear decommissioning trust assets recorded during the year ended December 31, 2005. Pursuant to regulatory practice, the increase in miscellaneous income related to these realized gains was offset by a corresponding increase in decommissioning expense in 2005.

- Integrys Energy Services' equity investment in a synthetic fuel facility contributed an additional $11.3 million decrease in miscellaneous income, driven in part by additional synthetic fuel production procured in 2006 from our partners in this facility.

- Pre-tax gains recognized on land sales decreased $8.0 million, from $10.3 million in 2005 to $2.3 million in 2006.

- These decreases were partially offset by a $13.9 million increase in pre-tax equity earnings from ATC and a $6.2 million pre-tax gain recognized from the sale of Integrys Energy Group's one-third interest in Guardian Pipeline, LLC.

Interest Expense

2007 Compared with 2006:

Interest expense increased $65.3 million as a result of:

- Interest expense of $30.3 million recorded at PGL and NSG from February 22, 2007 through December 31, 2007.

- The remaining increase in interest expense was driven by an increase in short-term and long-term borrowings required to fund the acquisitions of the natural gas distribution operations in Michigan and Minnesota, higher working capital requirements at Integrys Energy Services, and transaction and transition costs related to the merger with PEC.

2006 Compared with 2005:

Interest expense increased $37.2 million due primarily to:

- An increase in the average amount of both short-term and long-term debt outstanding and higher average short-term interest rates. During 2006, borrowings were primarily utilized to fund the purchase of natural gas distribution operations in Michigan and Minnesota, the construction of Weston 4, and for working capital requirements at Integrys Energy Services.

Minority Interest

2007 Compared with 2006:

A decrease of $3.7 million in minority interest related to Integrys Energy Services' synthetic fuel operations. In 2007, Integrys Energy Services' partner elected to stop receiving production from the synthetic fuel facility and, therefore, did not share in losses from this facility.

2006 Compared with 2005:

Minority interest related to Integrys Energy Services' synthetic fuel operation did not significantly change for the year ended December 31, 2006 compared to the same period in 2005.

Provision for Income Taxes

	Year Ended December 31,		
	2007	2006	2005
Effective Tax Rate	32.2%	22.9%	20.8%

The 2007 increase in the effective tax rate was driven by a decrease in Section 29/45K federal tax credits recognized in 2007 compared with 2006. The decrease in Section 29/45K federal tax credits recognized was driven by the impact of high oil prices on our ability to realize the benefit of Section 29/45K federal tax credits. Section 29/45K federal tax credits recognized from the production and sale of synthetic fuel were $13.6 million in 2007, compared with $29.5 million in 2006.

The 2006 increase in the effective tax rate was driven by a higher effective state tax rate, primarily related to the acquisition of regulated natural gas operations in Minnesota and also due to a loss in value of various state net operating loss carryforwards. Section 29/45K federal tax credits from the production and sale of synthetic fuel increased $3.4 million to $29.5 million in 2006, to partially offset the increase in effective tax rate.

Discontinued Operations, Net of Tax

2007 Compared with 2006:

Income from discontinued operations, net of tax, increased $66.0 million, from after-tax income of $7.3 million in 2006 to after-tax income of $73.3 million in 2007.

> In September 2007, Integrys Energy Group completed the sale of PEP for approximately $879.1 million. Post-closing adjustments in the amount of $9.9 million were settled in February 2008 related to this sale, which reduced the sale price to $869.2 million. These post-closing adjustments were funded through other current liabilities at December 31, 2007. During the year ended December 31, 2007, $58.5 million of income from discontinued operations was recognized related to PEP, which included an after-tax gain of $7.6 million on the sale.
>
> Discontinued operations, net of tax, related to WPS Niagara Generation, LLC (Niagara), which was sold in January 2007, increased $14.4 million, from income of $0.4 million in 2006 to income of $14.8 million in 2007. The increase in income generated from Niagara was mostly due to a $14.7 million after-tax gain on the sale of the facility.
>
> Partially offsetting these increases were discontinued operations related to Sunbury Generation, LLC (Sunbury). Income from discontinued operations related to Sunbury was $6.9 million for the period January 1, 2006, through the date of sale in July 2006, including a $12.5 million after-tax gain on the sale of this facility.

2006 Compared with 2005:

Income from discontinued operations, net of tax, decreased $4.2 million, from after-tax income of $11.5 million in 2005 to after tax income of $7.3 million in 2006.

Discontinued operations, net of tax, related to Sunbury decreased $2.2 million, from income of $9.1 million in 2005, to income of $6.9 million in 2006. The $6.9 million of income recorded in 2006 included a $12.5 million after-tax gain on the sale of Sunbury, which was sold in July 2006.

Discontinued operations, net of tax, related to WPS Niagara Generation, LLC decreased $2.0 million, from income of $2.4 million in 2005 to income of $0.4 million in 2006. The decrease in income generated from WPS Niagara Generation was mostly due to a decrease in the average price per megawatt sold from this facility in 2006 compared to 2005.

Cumulative Effect of Change in Accounting Principles

2006 compared with 2005:

In March 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations." This Interpretation clarifies when companies are required to recognize conditional legal asset retirement obligations that result from the acquisition, construction, and normal operation of a long-lived asset. Because the accounting for conditional asset retirement obligations had been interpreted differently between companies, SFAS No. 143, "Accounting for Asset Retirement Obligations," had been inconsistently applied in practice.

The adoption of Interpretation No. 47 at Integrys Energy Services on December 31, 2005, resulted in a negative $1.6 million after-tax cumulative effect of change in accounting principle, related to recording a liability for asbestos remediation at certain of Integrys Energy Services' generation plants. For the utility segments of Integrys Energy Group, we concluded it was probable that any differences between expenses under Interpretation No. 47 and expenses currently recovered through customer rates will be recoverable in future customer rates. Accordingly, the adoption of this statement had no impact on the utility segment's income.

BALANCE SHEET

Net accounts receivable increased $368.0 million (35.5%), from $1,037.3 million at December 31, 2006, to $1,405.3 million at December 31, 2007, primarily due to the following:

At December 31, 2007, PGL and NSG had a net accounts receivable balance of $196.0 million.

Net accounts receivable at Integrys Energy Services increased $83.5 million, driven primarily by the integration of PEC's nonregulated business into Integrys Energy Services, as well as continued growth in Integrys Energy Services' business in 2007.

Net accounts receivable at WPSC increased $84.7 million (49.8%), primarily due to an $82.3 million receivable from ATC pertaining to transmission facilities required to support Weston 4 that WPSC is funding on their behalf pending completion of Weston 4. At December 31, 2006, the amount owed to WPSC by ATC was $20.8 million and was included as a component of other long-term assets. At December 31, 2007, the $20.8 million was reflected as a receivable from ATC as was the $61.5 million of incremental funding that was incurred in 2007.

Accrued unbilled revenues increased $279.9 million (151.5%), from $184.8 million at December 31, 2006, to $464.7 million at December 31, 2007, primarily driven by combined accrued unbilled revenues of $155.1 million at PGL and NSG at December 31, 2007. Accrued unbilled revenues at Integrys Energy Services also increased $108.9 million, driven by the integration of PEC's nonregulated business into Integrys Energy Services, as well as continued growth in Integrys Energy Services' business in 2007.

Inventories increased $207.1 million (45.4%), from $456.3 million at December 31, 2006, to $663.4 million at December 31, 2007. The inventory balance at Integrys Energy Services increased $139.9 million (48.6%), due to the addition of PEC's nonregulated business as well as an increase in storage volumes related to continued growth of Integrys Energy Services' natural gas business in new and existing markets. The inventory balance at PGL and NSG was $93.8 million at December 31, 2007.

At December 31, 2007, compared to December 31, 2006, total assets from risk management activities decreased $76.8 million (5.6%) and total liabilities from risk management activities decreased $80.9 million (6.4%). The decrease in assets and liabilities from risk management activities was driven by timing of mark-to-market gain and loss recognition on the underlying contracts. Although total risk management assets and liabilities decreased, long-term risk management assets and liabilities increased at December 31, 2007, compared to December 31, 2006. This increase related to more emphasis on structured origination contracts, which are physical, customer based agreements with municipalities, merchant generators, and regulated utilities, and are generally longer term in nature.

Total regulatory assets increased $805.2 million (183.5%), from $438.8 million at December 31, 2006, to $1,244.0 million at December 31, 2007, primarily attributed to a $656.1 million increase in the regulatory asset related to environ