

INTEGRYS ENERGY GROUP, INC.

Form 10-K

February 26, 2010

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2009

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 (312) 228-5400	39-1775292

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

Title of each class	Name of each exchange on which registered
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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  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 [ ]

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). (Registrant is not yet required to provide financial disclosure in an Interactive Data File format.)

Yes  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

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

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

\$2,291,910,925 as of June 30, 2009

Number of shares outstanding of each class of common stock, as of February 24, 2010

Common Stock, \$1 par value, 76,522,377 shares

DOCUMENT INCORPORATED BY REFERENCE

Definitive proxy statement for the Integrys Energy Group, Inc. Annual Meeting of Shareholders to be held on May 13, 2010 is incorporated by reference into Part III.

INTEGRYS ENERGY GROUP, INC.

ANNUAL REPORT ON FORM 10-K  
For the Year Ended December 31, 2009

TABLE OF CONTENTS

	Page
<u>Forward-Looking Statements</u>	1
<u>PART I</u>	3
ITEM 1. BUSINESS	3
A. GENERAL	3
B. REGULATED NATURAL GAS UTILITY OPERATIONS	4
C. REGULATED ELECTRIC UTILITY OPERATIONS	7
D. INTEGRYS ENERGY SERVICES	10
E. ENVIRONMENTAL MATTERS	13
F. CAPITAL REQUIREMENTS	13
G. EMPLOYEES	13
H. AVAILABLE INFORMATION	14
<u>ITEM 1A.</u> RISK FACTORS	15
<u>ITEM 1B</u> UNRESOLVED STAFF COMMENTS	21
<u>ITEM 2.</u> PROPERTIES	22
A. REGULATED	22
B. INTEGRYS ENERGY SERVICES	23
	4

<u>ITEM 3.</u>	LEGAL PROCEEDINGS	24
<u>ITEM 4.</u>	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	24
<u>ITEM 4A.</u>	EXECUTIVE OFFICERS OF INTEGRYS ENERGY GROUP	25
PART II		26
<u>ITEM 5.</u>	MARKET FOR INTEGRYS ENERGY GROUP'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	26
<u>ITEM 6.</u>	SELECTED FINANCIAL DATA	28
<u>ITEM 7.</u>	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	29
<u>ITEM 7A.</u>	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	73

<u>ITEM</u>	FINANCIAL STATEMENTS AND SUPPLEMENTARY	
<u>8.</u>	DATA	76
A.	Management Report on Internal Control over Financial Reporting	76
B.	Report of Independent Registered Public Accounting Firm	77
C.	<u>Consolidated Statements of Income</u>	79
D.	<u>Consolidated Balance Sheets</u>	80
E.	<u>Consolidated Statements of Equity</u>	81
F.	<u>Consolidated Statements of Cash Flows</u>	82
G.	<u>Notes to Consolidated Financial Statements</u>	83
	Note 1 Summary of Significant Accounting Policies	83
	Note 2 Risk Management Activities	90
	Note 3 Restructuring Expense	94
	Note 4 Dispositions	95
	Note 5 PEC Merger	101
	Note 6 Property, Plant, and Equipment	102
	Note 7 Jointly Owned Utility Facilities	103
	Note 8 Regulatory Assets and Liabilities	104
	Note 9 Investments in Affiliates, at Equity Method	105
	Note 10 Goodwill and Other Intangible Assets	107
	Note 11 Leases	109
	Note 12 Short-Term Debt and Lines of Credit	110
	Note 13 Long-Term Debt	112
	Note 14 Asset Retirement Obligations	114
	Note 15 Income Taxes	116
	Note 16 Commitments and Contingencies	119
	Note 17 Guarantees	126
	Note 18 Employee Benefit Plans	127
	Note 19 Preferred Stock of Subsidiary	133
	Note 20 Common Equity	134
	Note 21 Stock-Based Compensation	135
	Note 22 Fair Value	138
	Note 23 Miscellaneous Income	140
	Note 24 Regulatory Environment	141
	Note 25 Segments of Business	144
	Note 26	147

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Quarterly Financial Information  
(Unaudited)

H.	Report of Independent Registered Public Accounting Firm on Financial Statements	148
<u>ITEM 9.</u>	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	149
ITEM 9A.	CONTROLS AND PROCEDURES	149
ITEM 9B.	OTHER INFORMATION	149
PART III		150
<u>ITEM 10.</u>	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	150
<u>ITEM 11.</u>	EXECUTIVE COMPENSATION	150
<u>ITEM 12.</u>	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	150
<u>ITEM 13.</u>	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	151
<u>ITEM 14.</u>	PRINCIPAL ACCOUNTING FEES AND SERVICES	151

PART IV		152
<u>ITEM 15.</u>	EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	152
<u>SIGNATURES</u>		153
<u>SCHEDULE I</u> - CONDENSED PARENT COMPANY FINANCIAL STATEMENTS INTEGRYS ENERGY GROUP, INC. (PARENT COMPANY ONLY)		154
A.	Statements of Income and Retained Earnings	154
B.	Balance Sheets	155
C.	Statements of Cash Flows	156
D.	<u>Notes to Parent Company Financial Statements</u>	157
<u>SCHEDULE II</u> - VALUATION AND QUALIFYING ACCOUNTS		160
<u>EXHIBIT INDEX</u>		161



Acronyms Used in this Annual Report on Form 10-K

AFUDC	Allowance for Funds Used During Construction
ASC	Accounting Standards Codification
ATC	American Transmission Company LLC
EEP	Enhanced Efficiency Program
EPA	United States Environmental Protection Agency
ESOP	Employee Stock Ownership Plan
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
GAAP	United States Generally Accepted Accounting Principles
IBS	IntegrYS Business Support, LLC
ICC	Illinois Commerce Commission
IRS	United States Internal Revenue Service
LIFO	Last-in, First-out
MERC	Minnesota Energy Resources Corporation
MGU	Michigan Gas Utilities Corporation
MISO	Midwest Independent Transmission System Operator, Inc.
MPSC	Michigan Public Service Commission
MPUC	Minnesota Public Utility Commission
N/A	Not Applicable
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
WPS	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. 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. Although Integrys Energy Group and its subsidiaries believe that these forward-looking statements and the underlying assumptions are reasonable, they cannot provide assurance that such statements will prove correct.

Forward-looking statements include, among other things, statements concerning management's expectations and projections regarding earnings, regulatory matters, fuel costs, sources of electric energy supply, coal and natural gas deliveries, remediation costs, environmental and other capital expenditures, liquidity and capital resources, trends, estimates, completion of construction projects, and other matters.

Forward-looking statements involve a number of risks and uncertainties. Some risks that could cause results to differ 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, 2009. Other factors include:

- 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, changes in environmental and other regulations, including but not limited to, greenhouse gas emissions, energy efficiency mandates, renewable energy standards, and reliability standards, and changes in tax and other laws and regulations to which Integrys Energy Group and its subsidiaries are subject;

- Current and future litigation and regulatory investigations, enforcement actions or inquiries, including but not limited to, manufactured gas plant site cleanup, third-party intervention in permitting and licensing projects, compliance with Clean Air Act requirements at generation plants, and prudence and reconciliation of costs recovered in revenues through an automatic gas cost recovery mechanism;

- The impacts of changing financial market conditions, credit ratings, and interest rates on the liquidity and financing efforts of Integrys Energy Group and its subsidiaries;

- The risks related to executing the strategy change associated with Integrys Energy Group's nonregulated energy services business, including the restructuring of its retail natural gas and retail electric marketing business;

- The risks associated with changing commodity prices (particularly natural gas and electricity) and the available sources of fuel and purchased power, including their impact on margins;

- 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 Integrys Energy Group's subsidiaries operate;

- The retention of market-based rate authority;

The risk associated with the value of goodwill or other intangibles and their possible impairment;  
Investment performance of employee benefit plan assets and the related impact on future funding requirements;  
Changes in technology, particularly with respect to new, developing, or alternative sources of generation;  
Effects of and changes in political and legal developments, as well as economic conditions and the related impact on customer demand;  
Potential business strategies, including mergers, acquisitions, and 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 effectiveness of risk management strategies, the use of financial and derivative instruments, and the ability to recover costs from customers in rates associated with the use of those strategies and financial instruments;

The risk of financial loss, including increases in bad debt expense, associated with the inability of Integrys Energy Group's and its subsidiaries' counterparties, affiliates, and customers to meet their obligations;

Customer usage, weather, and other natural phenomena;

The utilization of tax credit and loss carryforwards;

Contributions to earnings by non-consolidated equity method and other investments, which may vary from projections;

The effect of accounting pronouncements issued periodically by standard-setting bodies; and

Other factors discussed elsewhere herein and in other reports filed by Integrys Energy Group from time to time with the SEC.

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.

## PART I

### ITEM 1. BUSINESS

#### A. GENERAL

References to "Notes" are to the Notes to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

For financial information on Integrys Energy Group's foreign and domestic revenues, foreign and domestic long-lived assets, revenues from external customers, net income (loss) attributed to common shareholders and total assets by reportable segment, see Note 25, "Segments of Business." For financial information about Integrys Energy Group's reportable segments, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations."

#### Integrys Energy Group, Inc.

Integrys Energy Group was incorporated in Wisconsin in 1993. Integrys Energy Group is a holding company for its regulated utility and nonregulated business units.

#### Natural Gas Utility Segment

The natural gas utility segment includes the regulated natural gas utility operations of WPS, MGU, MERC, PGL, and NSG. WPS, a Wisconsin corporation, began operations in 1883. MGU and MERC, both Delaware corporations, began operations upon the 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, began operations in 1855 and 1900, respectively. Integrys Energy Group acquired PGL and NSG in February 2007 in the PEC merger. For the last three years, all of the natural gas utility segment's revenues were earned within the United States and all assets were located within the United States.

#### Electric Utility Segment

The electric utility segment includes the regulated electric utility operations of WPS and UPPCO. UPPCO, a Michigan corporation, 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.

#### Integrys Energy Services

Integrys Energy Services, a Wisconsin corporation, was established in 1994. Integrys Energy Services is a diversified nonregulated energy supply and services company serving retail customers (residential, commercial, and industrial). Integrys Energy Services provides energy supply solutions, products, and strategies that enable customers to manage energy needs while capitalizing on opportunities resulting from deregulated markets.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Introduction," for a discussion of the revised strategy for Integrys Energy Services going forward.

#### Electric Transmission Investment

The electric transmission investment segment consists of WPS Investments, LLC's approximate 34% ownership interest in ATC. As of December 31, 2009, WPS Investments was owned 84.5% by Integrys Energy Group, 12.8% by WPS, and 2.7% by UPPCO. ATC is a federally regulated electric transmission

-3-

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company with operations in Wisconsin, Michigan, Minnesota, and Illinois. ATC began operations in 2001. See Note 9, "Investments in Affiliates, at Equity Method," for more information about ATC.

#### 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 WPS, MGU, MERC, UPPCO, PGL, NSG, and IBS. Equity earnings from Integrys Energy Group's investment in WRPC are included in the Holding Company and Other segment.

#### B. REGULATED NATURAL GAS UTILITY OPERATIONS

Integrys Energy Group provides regulated natural gas utility service to approximately 1,669,000 residential, commercial and industrial, transportation, and other customers located in Chicago and northern suburbs of Chicago, northeastern Wisconsin, adjacent portions of Michigan's Upper Peninsula, various cities and communities throughout Minnesota, and in the southern portion of lower Michigan.

#### Facilities

For information regarding the regulated natural gas facilities, see Item 2, "Properties." For Integrys Energy Group's utility plant asset book value, see Note 6, "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 customer usage patterns 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 (in the United States and Canada) 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 price purchases. To supplement natural gas supplies and minimize risk, Integrys Energy Group purchases additional natural gas supplies on the monthly spot market through fixed-term firm contracts rather than on the daily spot market. During periods of colder than normal weather or when the opportunity arises, natural gas may be purchased in the daily spot market.

Integrys Energy Group's natural gas utilities contract with local distribution companies, interstate pipelines, and storage operators that own underground storage fields to purchase underground storage capacity and have two company-owned storage fields. Integrys Energy Group's natural gas utilities contract with local distribution companies and interstate pipelines to purchase firm transportation. Besides providing the ability to manage significant changes in daily natural gas demand, storage also provides Integrys Energy Group with the ability to purchase steady levels of natural gas on a year-round basis, thus lowering supply cost volatility.

For further information on Integrys Energy Group's regulated natural gas utility supply and transportation contracts, see Note 16, "Commitments and Contingencies."

Integrys Energy Group's natural gas utilities had adequate capacity to meet all firm natural gas load obligations during 2009 and expect to have adequate capacity to meet all firm obligations during 2010. Integrys Energy Group's natural gas utilities forecast design peak-day throughput of 3,897 thousands of dekatherms (MDth) for the 2009 through 2010 heating season.





The deliveries to customers (including transportation customers) in MDth for Integrys Energy Group's regulated natural gas utility operations were as follows:

(MDth)	2009	2008	2007
Natural gas purchases	225,719	250,967	202,803
Customer-owned natural gas received	164,676	182,919	160,581
Underground storage, net	1,080	(3,469)	(18,486)
Hub fuel in kind	141	135	134
Liquefied petroleum gas	12	5	4
Owned storage cushion injection	(1,272)	(1,280)	(1,278)
Contracted pipeline and storage compressor fuel, franchise requirements, and unaccounted-for natural gas	(9,692)	(11,042)	(13,451)
Total	380,664	418,235	330,307

## Regulatory Matters

### Legislation and Regulation at State Level

The natural gas retail rates of Integrys Energy Group's regulated natural gas utilities are regulated by the ICC, PSCW, MPSC, and MPUC. These commissions have general supervisory and regulatory powers over public utilities in their respective jurisdictions.

Sales are made and services rendered by the regulated natural gas utilities pursuant to rate schedules on file with the respective commissions containing various service classifications largely reflecting customers' different uses and levels of consumption. In addition to the rates for distribution of natural gas, Integrys Energy Group's regulated natural gas utilities bill customers on a one-for-one basis through a purchased gas adjustment clause representing prudently incurred costs of delivered natural gas, transportation, and storage services purchased, as well as gains, losses, and costs incurred under hedging programs, the amount of which is also subject to applicable commission authority. Changes in the cost of natural gas are reflected in both natural gas revenues and natural gas purchases.

All of Integrys Energy Group's utility subsidiaries are required to provide service and grant credit (with applicable deposit requirements) to customers within their service territories. The utilities are generally precluded from discontinuing service to residential customers who do not pay their bills during winter moratorium months. Both federal and certain state governments have legislation that provides for a limited amount of additional funding for assistance to low-income energy users, including customers of the utilities.

See Note 24, "Regulatory Environment," for recent Illinois legislation affecting PGL and NSG regarding bad debt expense and new customer assistance programs, discussion of MGU's 2010 rate order which includes a new bad debt tracking mechanism, and decoupling mechanisms in place for certain natural gas utilities.

### Legislation and Regulation at Federal Level

Most of the natural gas distributed by Integrys Energy Group is transported to its distribution systems by interstate pipelines. The pipelines' services (transportation and storage) are regulated by the FERC under the Natural Gas Act and the Natural Gas Policy Act of 1978.

Under United States Department of Transportation regulations, the state commissions are responsible for monitoring the regulated natural gas utilities' safety compliance programs for their pipelines under 49 Code of Federal Regulations (CFR) Part 192 (Transportation of Natural and Other Gas by Pipeline: Minimum Federal Safety Standards) and 49 CFR Part 195 (Transportation of Hazardous Liquids by Pipeline).



PGL utilizes its storage and transmission 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.

#### Other Matters

##### Seasonality

The natural gas throughput of Integrys Energy Group's regulated natural gas utilities follows a seasonal pattern because the heating requirements of customers are temperature driven. Specifically, customers typically use more natural gas during the winter months. During 2009, the regulated natural gas utility segment recorded approximately 70% of its revenues in January, February, March, November, and December.

##### Competition

Integrys Energy Group's regulated natural gas utility operations face competition from 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 energy commodity 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.

Natural gas transportation service and interruptible natural gas sales are offered to enable customers to better manage their energy costs. Transportation customers purchase natural gas directly from third-party natural gas suppliers and contract with one of Integrys Energy Group's natural gas utility entities to transport the natural gas from pipelines to their facilities. Additionally, some customers have elected to purchase their natural gas commodity directly from one of Integrys Energy Group's natural gas utility entities 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

The working capital needs of Integrys Energy Group's regulated natural gas utility operations vary significantly over time due to volatility in levels of natural gas inventories and the price of natural gas. Integrys Energy Group's regulated natural gas utilities' working capital needs are met by cash generated from operations and debt (both long-term and short-term). The seasonality of natural gas revenues causes the timing of cash collections to be concentrated from January through June. A portion of the winter natural gas supply needs is typically purchased and stored from April through November. Also, planned capital spending on the natural gas distribution facilities is concentrated in April through November. Because of these timing differences, the cash flow from customers is typically supplemented with temporary increases in short-term borrowings during the late summer and fall. Short-term debt is typically reduced over the January through June period.

### C. REGULATED ELECTRIC UTILITY OPERATIONS

Integrys Energy Group's regulated electric utility operations are provided through WPS and UPPCO to approximately 489,000 residential, commercial and industrial, wholesale, and other customers. WPS'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.

In 2009, WPS reached a firm net design peak of 2,264 megawatts (MW) on June 24. At the time of this summer peak, WPS's total firm resources (i.e., generation plus firm purchases) totaled 3,196 MW. 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 WPS's regulated electric utility capacity. The PSCW requires WPS to maintain a planning reserve margin above its projected annual peak demand forecast to help ensure reliability of electric service to its customers. WPS expects future supply reserves to meet the minimum planning reserve margin criteria through 2010. The PSCW established a 14.5% reserve margin requirement for long-term planning (planning years two through ten), and the short-term (planning year one) reserve margin for Wisconsin utilities follows the planning reserve margin established by MISO under Module E of its Open Access Transmission and Energy Markets Tariff. In 2009, UPPCO reached a firm net design peak of 139 MW on July 27. At the time of this peak, UPPCO's total firm resources totaled 150 MW. The MPSC has not established minimum guidelines for future supply reserves.

WPS and UPPCO had adequate capacity through company-owned generation units and purchased power contracts to meet all firm electric load obligations during 2009 and expect to have adequate capacity to meet all obligations during 2010.

#### Facilities

For a complete listing of Integrys Energy Group's regulated electric utility facilities, see Item 2, "Properties." For Integrys Energy Group's utility plant asset book value, see Note 6, "Property, Plant, and Equipment."

#### Electric Supply

Both WPS and UPPCO are members of MISO, a FERC-approved, independent, non-profit organization, which operates a financial and physical electric wholesale market in the Midwest. WPS and UPPCO offer their generation and bid their customer load into the MISO market. MISO evaluates WPS's, UPPCO's, and other market participants' energy injections into, and withdrawals from, the system to economically dispatch electricity within the system. MISO settles the participants' offers and bids based on locational marginal prices, which are market-driven values based on the specific time and location of the purchase and/or sale of energy.

## Electric Generation and Supply Mix

The sources of Integrys Energy Group's regulated electric utility supply were as follows:

(Millions)

Energy Source (kilowatt-hours)	2009	2008
Company-owned generation units		
Coal	8,974.3	9,570.9
Natural gas, fuel oil, and tire derived	71.4	201.7
Hydroelectric	225.9	261.2
Wind	46.4	17.8
Total company-owned generation units	9,318.0	10,051.6
Purchased power contracts		
Nuclear (Kewaunee Power Station)	2,663.9	2,656.8
Natural gas (Fox Energy Center, LLC and Combined Locks Energy Center, LLC)	673.7	699.5
Hydroelectric	569.5	369.4
Wind	136.9	109.0
Other	571.1	167.8
Total purchased power contracts	4,615.1	4,002.5
Purchased power from MISO	1,898.9	1,934.0
Purchased power from other	54.4	78.9
Total purchased power	6,568.4	6,015.4
Opportunity sales		
Sales to MISO	(462.5)	(539.8)
Net sales to other	(450.5)	(303.2)
Total opportunity sales	(913.0)	(843.0)
Total Integrys Energy Group electric utility supply	14,973.4	15,224.0

## Fuel Costs

The cost of fuel per generation of one million British thermal units (Btus) was as follows:

Fuel Type	2009	2008
Coal	\$ 1.94	\$ 1.78
Natural gas	6.73	9.74
Fuel oil	17.09	19.07

## Coal Supply

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

Historically, WPS 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 WPS for its share of the coal costs. At December 31, 2009, WPS had coal transportation contracts in place for 90% of its 2010 coal transportation requirements. For more information on coal purchases and coal deliveries under contract, see Note 16, "Commitments and Contingencies."



## Power Purchase Agreements

Integrys Energy Group's regulated electric facilities enter into short-term and long-term power purchase agreements to meet a portion of electric energy supply needs. The most significant of these is an agreement through 2013 with Dominion Energy Kewaunee, LLC to purchase energy and capacity from the Kewaunee Power Station consistent with volumes available when WPS owned the facility. For more information on power purchase obligations, see Note 16, "Commitments and Contingencies."

## Regulatory Matters

Integrys Energy Group's electric utility operations are regulated by the PSCW, MPSC, and FERC. WPS's retail electric rates are regulated by the PSCW and MPSC, and UPPCO's retail electric rates are regulated by the MPSC. The FERC regulates wholesale electric rates for WPS and UPPCO. In 2009, retail electric revenues accounted for 78.7% of total electric revenues, while wholesale electric revenues accounted for 21.3% of total electric revenues.

The PSCW sets rates through its ratemaking process, which is based upon recovery of operating costs and a return on invested capital. One of the cost recovery components is fuel and purchased power, which is governed by a fuel window mechanism, as described in Note 1(e), "Summary of Significant Accounting Policies – Revenue and Customer Receivables." The MPSC and FERC ratemaking processes are similar to those of the PSCW, with the exception of fuel and purchased power, which are recovered on a one-for-one basis.

See Note 24, "Regulatory Environment," for information regarding the rate cases and decoupling mechanisms of Integrys Energy Group's electric utilities.

## Hydroelectric Licenses

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

## Other Matters

### 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 do not follow a 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 generation 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 regulated electric utility segment, the impact on utility production costs is partially managed through the WPS Electric 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 and industrial customers into their service territories. 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 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

-9-

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markets are regulated, utilities still face competition from other energy sources, such as self-generation by large industrial customers and alternative 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.

#### D. INTEGRYS ENERGY SERVICES

Integrys Energy Services and its subsidiaries market energy and related products in the retail market serving commercial, industrial, direct, and "aggregated" small commercial and residential customers. Aggregated customers are municipalities, associations, or groups of customers that have joined together to negotiate purchases of electric or natural gas energy as a larger group.

Integrys Energy Services is investing in and promoting renewable energy, which it believes is important to the future of the energy industry. Clean, renewable, and efficient energy sources are developed, acquired, owned, and operated by Integrys Energy Services. Integrys Energy Services assists customers with selecting an energy solution that meets their needs and collaborates with energy developers of wholesale energy projects to overcome challenges with integrating the technical, regulatory, and financial aspects of their projects.

Integrys Energy Services utilizes derivative instruments, including forwards, futures, options, and swaps, to manage its exposure to market risks from its generation and energy supply portfolios in accordance with limits and approvals established in its risk management and credit 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 Operations – Market Price Risk Management Activities."

#### Recent Developments

Since the beginning of 2009, Integrys Energy Services has been in the process of reevaluating its strategy with a focus on reducing its scale and risk profile. The result of this evaluation was the decision to exit its wholesale natural gas and wholesale electric businesses, its Canadian energy marketing business, its energy management consulting business, certain retail markets, and a portion of its electric generation fleet. The remaining business lines will continue to invest in growing a portfolio of retail natural gas and electric customers as well as energy assets with renewable attributes.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Introduction," and Note 4, "Dispositions," for a discussion of the current strategy for Integrys Energy Services.

#### Facilities

##### Generation

For information regarding the energy asset facilities owned by Integrys Energy Services, see Item 2, "Properties." For Integrys Energy Group's nonregulated plant asset book value, see Note 6, "Property, Plant, and Equipment."

##### Renewable Energy

In response to customers' growing interest in sustainability and Integrys Energy Group's own concern for the environment, Integrys Energy Services is now focusing on delivering value-added energy services and renewable

commodities to its retail customers. Product offerings include renewable natural gas and

-10-

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electric products and development of green power generation projects. See Item 2, "Properties," for more information on renewable energy projects.

#### Fuel Supply for Generation Facilities

Integrys Energy Services' fuel inventory policy varies for each generation facility depending on the type of fuel used and available natural gas storage facilities. The cost of the majority of the fuel used by the generation facilities is subject to market price volatility, and the facilities are run to produce energy when economical at current fuel prices. Integrys Energy Services' only coal-fired merchant generation facility is its Westwood facility located in Pennsylvania. Actual fuel needs in 2010 will depend on market conditions and operational capability of the Westwood facility. However, Integrys Energy Services' Westwood facility burns waste coal left behind by mining operations and has several years' supply on site. All fuel is located within a seven-mile radius of the plant.

#### Energy Supply

Physical supply obligations are created when Integrys Energy Services executes forward customer sales contracts. Integrys Energy Services' electricity and natural gas supply requirements are primarily met through the procurement of natural gas and electricity in the wholesale markets. Integrys Energy Services does not own any reserves, so all natural gas supply is procured from producers and other suppliers in the wholesale markets.

#### Retail Electricity

The majority of Integrys Energy Services' obligations to provide physical electricity result from forward retail sales to commercial and industrial customers, many of which are through full-requirements contracts. Integrys Energy Services uses a combination of bilateral electricity purchase agreements from generation companies and other marketers as well as regional power pools to meet those obligations.

#### Retail Natural Gas

Physical natural gas supply obligations are created by the execution of forward retail sales contracts by Integrys Energy Services' retail marketing operation. Commercial and industrial customers, as well as some residential customers, make up the majority of its sales commitments. Natural gas is sourced in the wholesale markets at the customer load regions, or in some cases is transported to the customer load regions using natural gas transportation contracts.

#### Regulatory Matters

Integrys Energy Services is a FERC-authorized power marketer and has all of the licenses required to conduct business in the states in which it operates.

## Other Matters

### Customer Segmentation

As of December 31, 2009, Integrys Energy Services was delivering electricity and natural gas supply to customers in 20 states. Integrys Energy Services periodically reviews and evaluates the profitability of its operations in each of these markets. Integrys Energy Services continues to concentrate on adding customers in existing markets and emphasizing business that provides the appropriate rate of return, but currently has no plans to expand into new geographic regions. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Introduction," for a discussion of the current strategy for Integrys Energy Services.

As of December 31, 2009, Integrys Energy Services was serving electric customers within 18 states, including its largest markets in Illinois, New York, Mid-Atlantic and New England regions. Integrys Energy Services was also serving natural gas customers within eight states, including its largest markets in Wisconsin, Illinois, Michigan, and Ohio.

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.

### 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 electricity generally peak in the summer months. Generally in the summer months, the demand for electricity is high, which increases the price at which electricity can be sold. In periods of high residential natural gas and oil 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 retail energy marketer that competes against regulated utilities and other retail energy marketers. Integrys Energy Services competes with other energy providers on the basis of price, reliability, customer service, product offerings, financial strength, consumer convenience, performance, and reputation.

The competitive landscape differs in each regional area and within each targeted customer segment. For residential and small commercial customers, the primary competitive challenges come from the incumbent utility and affiliated utility marketing companies. The large commercial, institutional, and industrial segments are very competitive in most markets with nearly all natural gas customers having already switched away from utilities to an alternative provider. National affiliated marketers, energy producers, and other independent retail energy companies compete for customers in this segment.

The incumbent regulated utilities and the nationally-branded utility affiliates typically benefit from the economies of scale derived from the strength of substantial asset-based balance sheets and vertically integrated business models that combine production, transmission, and distribution assets. These advantages are offset by the lack of flexibility to offer multiple product choices to their customers, and the nationally-branded utility affiliates struggle with long-term focus and cultural adaptation to a nonregulated market environment.

The local utilities have the advantage of long-standing relationships with their customers, and they have longer operating histories, greater financial and other resources, and greater name recognition in their

-12-

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markets than Integrys Energy Services does. In addition, local utilities have been subject to many years of regulatory oversight and thus have a significant amount of experience regarding the policy preferences of their regulators. Local utilities may seek to decrease their tariff retail rates to limit or preclude the opportunities for competitive energy suppliers and may seek to establish rates, terms, and conditions to the disadvantage of competitive energy suppliers.

#### Working Capital

The working capital needs of Integrys Energy Services vary significantly over time due to volatility in commodity prices and related margin calls, and levels of natural gas storage inventories. Integrys Energy Services' working capital needs are met by cash generated from operations, equity infusions, and debt (both long-term and short-term). Integrys Energy Services has the ability to borrow up to \$400 million through an intercompany loan agreement with Integrys Energy Group. Integrys Energy Group has provided total parental guarantees of \$958.4 million on behalf of Integrys Energy Services.

#### E. ENVIRONMENTAL MATTERS

For information on environmental matters related to Integrys Energy Group and its subsidiaries, see Note 16, "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 Operations – Liquidity and Capital Resources."

#### G. EMPLOYEES

At December 31, 2009, Integrys Energy Group's consolidated subsidiaries had the following employees:

	Total Number of Employees	Percentage of Employees Covered by Collective Bargaining Agreements
WPS	1,462	65%
IBS	1,318	-
PGL	1,109	83%
Integrys Energy Services	436	1%
MERC	223	19%
NSG	166	81%
MGU	165	68%
UPPCO	146	78%
Total	5,025	45%

Integrys Energy Group's subsidiaries have collective bargaining agreements with various unions which are summarized in the table below.

Union	Subsidiary	Contract Expiration Date
Local 310 of the International Union of Operating Electricians	WPS	October 13, 2012
Local 18007 of the Utility Workers Union of America	PGL	April 30, 2013
Local 31 of the International Brotherhood of Electrical Workers, AFL CIO	MERC	May 31, 2011
	NSG	June 30, 2013

Local 2285 of the International Brotherhood of Electrical  
Workers

Local 12295 of the United Steelworkers of America, AFL CIO MGU January 15, 2015  
CLC

Local 417 of the Utility Workers Union of America, AFL CIO MGU February 15, 2012

Local 510 of the International Brotherhood of Electrical Workers, AFL CIO UPPCO April 12, 2014

#### H. AVAILABLE INFORMATION

Integrys Energy Group files the following reports with the SEC:

- Annual Report on Form 10-K;
- Quarterly Reports on Form 10-Q;
- Proxy statements;
- 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 its Internet website, [www.integrysgroup.com](http://www.integrysgroup.com), as soon as reasonably practicable after they are filed with the SEC. Integrys Energy Group's Code of Conduct may also be accessed on Integrys Energy Group's website, and any amendments to or waivers from the Code of Conduct will be timely disclosed on Integrys Energy Group's website. Reports, statements, and amendments posted on Integrys Energy Group's website do not include access to exhibits and supplemental schedules electronically filed with the reports, statements, or amendments. Integrys Energy Group is not including the information contained on or available through its website as a part of, or incorporating such information by reference into, this Annual Report on Form 10-K.

You may obtain materials filed with the SEC by Integrys Energy Group at the SEC Public Reference Room at 100 F Street, NE, Washington, DC 20549. To obtain information on the operation of the Public Reference Room, you may call the SEC at 1-800-SEC-0330. You may also view Integrys Energy Group's reports, proxy statements, and other information (including exhibits) filed electronically with the SEC, at the SEC's website at [www.sec.gov](http://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 Integrys Energy Group faces. Additional risks and uncertainties not presently known or that Integrys Energy Group currently believes to be immaterial may also adversely affect Integrys Energy Group.

Integrys Energy Group is subject to changes in government regulation, which may have a negative impact on its businesses, financial position, and results of operations.

The rates that Integrys Energy Group's regulated utilities are allowed to charge for their retail and wholesale services are some of the most important items influencing its business, financial position, results of operations, and liquidity. While rate regulation is premised on providing an opportunity to earn a reasonable rate of return on invested capital, there is no assurance that the applicable regulatory commissions will judge all the costs of the regulated utilities to have been prudently incurred or that the regulatory process in which rates are determined will always result in rates that will produce full recovery of such costs or provide for a reasonable return on equity. Certain items that would otherwise be immediately recognized as revenues and expenses are deferred as regulatory assets and regulatory liabilities for future recovery or refund to customers, as authorized by regulators. Future recovery of regulatory assets is not assured, and is generally subject to review by regulators in rate proceedings for matters such as prudence and reasonableness. If recovery of costs is not approved or is no longer deemed probable, regulatory assets would be recognized in current period expense and could have a material impact on Integrys Energy Group's financial results.

Integrys Energy Group is subject to comprehensive regulation by several federal and state regulatory agencies and local governmental bodies, which significantly influences its operating environment and may affect Integrys Energy Group's ability to recover costs from utility customers. In particular, the PSCW, ICC, MPSC, MPUC, FERC, SEC, EPA, Minnesota Office of Pipeline Safety, United States Department of Transportation, WDNR, Michigan Department of Natural Resources and Environment, the city of Chicago, and Illinois Environmental Protection Agency regulate many aspects of Integrys Energy Group's utility operations, including, but not limited to, construction and operation of facilities, conditions of service, the issuance of securities, and the rates that it can charge customers. Integrys Energy Group is required to have numerous permits, approvals, and certificates from these agencies to operate its business. Failure to comply with any applicable rules or regulations may lead to penalties, customer refunds, or other amounts, which could have a material impact on the financial results of Integrys Energy Group.

Existing statutes and regulations may be revised or reinterpreted by these agencies, or these agencies may adopt new laws and regulations that apply to Integrys Energy Group. Integrys Energy Group is unable to predict the impact on its businesses and operating results of any such actions by these agencies. However, changes in regulations or the imposition of additional regulations may require Integrys Energy Group to incur additional expenses or change business operations, which may have an adverse impact on results of operations. In addition, federal regulatory reforms may produce unexpected changes and costs in the public utility industry.

Integrys Energy Group may face significant costs to comply with the regulation of greenhouse gas emissions.

Climate change and the effect of greenhouse gas emissions, most notably carbon dioxide, are increasingly becoming a concern for the energy industry. While there is currently no federal legislation in the United States that mandates the reduction of greenhouse gas emissions, it is possible that such legislation may be enacted in the future. In addition, the EPA may adopt regulations under the Clean Air Act. To that end, federal and state legislative proposals have been introduced to regulate the emission of greenhouse gases, including bills pending in the United States Congress that

would regulate greenhouse gas emissions through a cap-and-trade system under which emitters would be required to buy allowances

-15-

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to offset greenhouse gas emissions. However, until legislation is passed at the federal or state level, it remains unclear as to (1) which industry sectors will be impacted, (2) when compliance will be required, (3) the magnitude of the greenhouse gas emissions reductions that will be required, and (4) the costs and opportunities associated with compliance. Integrys Energy Group is evaluating both the technical and cost implications which may result from future state, regional, or federal greenhouse gas regulatory programs, but at this time, it is uncertain as to the effect climate change regulation may have on Integrys Energy Group's future operations, capital expenditures, and financial results.

Based on the complexity and uncertainty of these issues, it is possible that future carbon regulation will increase the cost of electricity produced at coal-fired generation units and may affect the capital expenditures Integrys Energy Group would make at its generation units. At this time, there is no commercially available technology for removing carbon dioxide from a pulverized coal-fired plant. In addition, future legislation designed to reduce greenhouse gas emissions could make some of the generating units uneconomical to maintain or operate and could impact future results of operations, cash flows, and financial condition if such costs are not recoverable through regulated rates.

Integrys Energy Group's natural gas delivery systems may generate fugitive gas as a result of normal operations and as a result of excavation, construction, and repair of natural gas delivery systems. Fugitive gas typically vents to the atmosphere and consists primarily of methane, a greenhouse gas. Carbon dioxide is also a byproduct of natural gas consumption. As a result, future legislation to regulate the emission of greenhouse gases could increase the price of natural gas, restrict the use of natural gas, adversely affect the ability to operate our natural gas facilities, and/or reduce natural gas demand.

Costs of environmental compliance, liabilities, fines, penalties, and litigation could exceed Integrys Energy Group's 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 cleanup and compliance costs and the possibility that changes will be made to the current environmental laws and regulations.

Integrys Energy Group's natural gas utility subsidiaries are accruing liabilities and deferring costs (recorded as regulatory assets) incurred in connection with their former manufactured gas plant sites, including related legal expenses, pending recovery through rates or from other entities. Regulatory assets reflect the net amount of (1) costs incurred to date, (2) carrying costs (excluding those for WPS, which are not recoverable), (3) amounts recovered from insurance companies, other entities and customers, and (4) management's best estimates of the costs Integrys Energy Group will spend in the future for investigating and remediating the manufactured gas plant sites. Integrys Energy Group believes that any of these costs that are not recoverable from other entities or from insurance carriers are recoverable through rates for utility services under approved mechanisms for the recovery of prudently incurred costs. A change in these rate recovery mechanisms, however, or a decision by the applicable state commission that some or all of these costs were not prudently incurred, could result in the present recognition as expense of some or all of these costs. For more information, see Note 16, "Commitments and Contingencies."

WPS owns coal-fired electric generating facilities at which it has performed maintenance activities that the EPA could determine were subject to Clean Air Act New Source Review permitting requirements. Depending on potential settlement terms or a court decision, WPS could be required to install environmental controls, change operations, shut down certain plants, undertake supplemental environmental projects, and/or pay fines.

In addition, impacts resulting from future federal or state regulation regarding mercury, sulfur dioxide, and nitrogen oxide emissions, as well as the management of coal combustion byproducts, are uncertain.

-16-

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There is also uncertainty in quantifying liabilities under environmental laws that impose joint and several liability 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 Integrys Energy Group. Such actions could seek penalties, injunctive relief, and costs of litigation. Private citizens can also bring lawsuits to recover environmental damages they believe they have incurred.

Integrys Energy Group's operations are subject to risks beyond its control, including but not limited to customer usage, weather, terrorist attacks, or acts of war.

Integrys Energy Group's revenues are affected by the demand for electricity and natural gas. That demand can vary greatly based upon:

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

General economic conditions and customers focusing on energy efficiency in Integrys Energy Group's service areas may result in a decrease in demand for electricity or natural gas, which could have an adverse impact on Integrys Energy Group's results of operations, financial condition, and cash flows.

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 Integrys Energy Group's facilities due to storms, natural disasters, wars, terrorist acts, and other catastrophic events, in excess of insurance limits established for such repairs or excluded by insurance policies, may adversely impact Integrys Energy Group's 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 Integrys Energy Group's results of operations and financial condition in unpredictable ways. These actions could also result in disruptions of power and fuel markets. In addition, Integrys Energy Group's natural gas distribution system and pipelines and electric generation units and distribution system could be directly or indirectly harmed by future terrorist activity.

Adverse capital and credit market conditions could negatively affect Integrys Energy Group's ability to meet liquidity needs, access capital, and/or grow or sustain its current businesses. Cost of capital and disruptions, uncertainty, and/or volatility in the financial markets could also adversely impact the results of operations and financial condition of Integrys Energy Group, as well as exert downward pressure on its stock price.

Having access to the credit and capital markets, at a reasonable cost, is necessary for Integrys Energy Group to fund its operations, including capital requirements. The capital and credit markets provide Integrys Energy Group with liquidity to operate and grow its businesses that is not otherwise provided from operating cash flows. The credit and capital markets also support the ability of Integrys Energy Group to provide credit support for the nonregulated operations of Integrys Energy Services. Disruptions, uncertainty, and/or volatility in those markets could increase Integrys Energy Group's cost of capital. If Integrys Energy Group or its subsidiaries are unable to access the credit and capital markets on terms that are reasonable, they may have to delay raising capital, issue shorter-term securities, and/or bear an increased cost of capital. This, in turn, could impact Integrys Energy Group's ability to grow or sustain its current businesses, cause a reduction in earnings, and/or limit Integrys Energy Group's ability to sustain its current common stock dividend level.



A reduction in Integrys Energy Group's or its subsidiaries' credit ratings could materially and adversely affect their business, financial position, results of operations, and liquidity.

Integrys Energy Group cannot be sure that any of Integrys Energy Group's or its subsidiaries' 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 the rating agency's judgment, circumstances in the future so warrant. Any downgrade could:

- Require the payment of higher interest rates in future financings and possibly reduce the potential pool of creditors;
- Increase borrowing costs under certain existing credit facilities;
- Limit 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, including cash margin calls, to contract counterparties.

The failure to effectively operate Integrys Energy Services' scaled back nonregulated energy services business and/or the failure to execute the remaining transactions that are part of the process to significantly reduce the scope and size of Integrys Energy Services, could negatively impact the future results of operations and financial condition of Integrys Energy Group.

Integrys Energy Services' change in focus from significant growth in nonregulated wholesale and retail energy markets across the United States and Canada, to a focus on selected nonregulated retail energy markets, could result in increased risks, including but not limited to:

- Lower earnings capacity from this business segment going forward, which Integrys Energy Group may not be able to replace;
- A reduction in the value of the nonregulated business segment, including a potential corresponding negative impact on Integrys Energy Group;
- A reduction in operating efficiencies, as operating margins may decline at a faster rate than the associated operating expenses; and
  - Potential loss of key employees during periods of increased employment uncertainty.

Integrys Energy Group cannot be certain that it will be able to successfully execute the remaining transactions to complete the strategic initiative to reduce the scope and scale of the nonregulated business segment. Pending transactions and plans to sell assets and components of this business segment may not be completed, or these transactions could result in obtaining less economic benefit than projected.

Refer to Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Introduction," for a further discussion of the current strategy for Integrys Energy Services.

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

Integrys Energy Group uses derivative instruments, including futures, forwards, options, and swaps, to manage its commodity and financial market risks. Significant volatility in energy prices could adversely impact Integrys Energy Group's cash collateral requirements due to counterparty margin calls related to these instruments.

In the absence of actively quoted market prices and pricing information from external sources, the valuation of derivative 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. Furthermore, realized values could differ from values determined by management.

-18-

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For additional information concerning derivatives and commodity-based trading contracts, see Note 2, "Risk Management Activities."

Poor investment performance of retirement plan investments and other factors impacting retirement plan costs could unfavorably impact Integrys Energy Group's liquidity and results of operations.

Integrys Energy Group has employee benefit plans that cover substantially all of its employees and retirees. Integrys Energy Group's cost of providing these benefit plans is dependent upon actual plan experience and assumptions concerning the future, such as earnings on and/or valuations of plan assets, discount rates, the level of interest rates used to measure the required minimum funding levels of the plans, future government regulation, and required or voluntary contributions to the plans. Depending upon the investment performance over time and other factors impacting its costs (as listed above), Integrys Energy Group could be required to make larger contributions in the future to fund these plans. These additional funding obligations could have a material adverse impact on Integrys Energy Group's cash flows, financial condition, and/or results of operations. Changes made to the plans may also impact current and future pension and other postretirement benefit costs.

Fluctuating commodity prices may reduce energy margins.

Integrys Energy Group's regulated natural gas margins are sensitive to changes in natural gas commodity prices. Any changes could affect the prices the regulated natural gas utilities charge, their operating costs, and the competitive position of their products and services. Prudently incurred costs for purchased natural gas and pipeline transportation and storage services are fully recoverable through the annual reconciliation of revenues from the natural gas charge. However, increases in natural gas costs affect total retail prices and, therefore, the competitive position of Integrys Energy Group's natural gas businesses relative to other forms of energy. In addition, the timing and extent of higher natural gas prices can adversely affect accounts receivable, bad debts, fuel cost, and interest expense. Integrys Energy Group is also subject to margin requirements in connection with its use of forward contracts, and these requirements could escalate if prices move adversely relative to these positions.

Integrys Energy Group's regulated electric utility margins are directly affected by commodity costs related to coal, natural gas, and other fuels used in the electric generation process. Integrys Energy Group may experience increased expenses, including interest costs and bad debts, higher working capital requirements, and possibly reduction in demand as a result of any increase in the cost of fuel or purchased power.

Higher commodity prices result in increased energy prices that may impact customer demand for energy in the nonregulated market and increase counterparty and bad debt risk. This may stress margins at Integrys Energy Group's nonregulated subsidiaries. If market prices for electric energy decline below the cost of production at Integrys Energy Group's nonregulated generation facilities, these units may be temporarily shut down.

Counterparties and customers may not meet their obligations.

Integrys Energy Group is exposed to the risk that counterparties to various arrangements who owe Integrys Energy Group money, energy, natural gas, coal, or other commodities or services will not be able to perform their obligations. Should the counterparties to these arrangements fail to perform, Integrys Energy Group might be forced to replace or to sell the underlying commitment at then-current market prices. In such event, Integrys Energy Group might incur losses, or its results of operations, financial position, or liquidity could otherwise be adversely affected.

Some of Integrys Energy Group's customers are experiencing, or may experience, financial problems that could have a significant impact on their creditworthiness. Integrys Energy Group cannot provide assurance that its financially distressed customers will not default on their obligations to Integrys Energy Group and that such a default will not have a material adverse impact on Integrys Energy Group's



business, financial position, results of operations, or cash flows. Furthermore, the bankruptcy of one or more of its customers, or some other similar proceeding or liquidity constraint, might make it unlikely that Integrys Energy Group would be able to collect all or a significant portion of amounts owed by distressed entities or residential customers. Such events could adversely impact Integrys Energy Group's receivable collections and additional allowances may be required, which could adversely affect its operating results. In addition, such events might force customers to reduce or curtail their future use of Integrys Energy Group's products and services, which could have a material adverse impact on Integrys Energy Group's results of operations and financial condition.

Any change in Integrys Energy Group's ability to sell electricity generated from its facilities at market-based rates may impact earnings.

The FERC has authorized certain of Integrys Energy Group's subsidiaries to sell generation from certain of its facilities at market prices. The FERC retains the authority to modify or withdraw this market-based rate authority. If the FERC determines that the market is not workably competitive, that Integrys Energy Group or its subsidiaries possess market power, or that they are not charging just and reasonable rates, the FERC may require Integrys Energy Group's subsidiaries to sell power at a price based upon the costs incurred in producing the power. Integrys Energy Group's revenues and profit margins may be negatively affected by any reduction by the FERC of the rates it may receive.

Integrys Energy Group has recorded goodwill that could become impaired and adversely affect financial results.

The PEC merger and the acquisition of natural gas distribution operations in Minnesota and Michigan were accounted for as purchases by Integrys Energy Group in accordance with GAAP. Under the purchase method of accounting, the assets and liabilities acquired were recorded at their respective fair values at the date of acquisition and added to those of Integrys Energy Group. 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 noncash charges relating to such impairments. Such impairment charges could have a material impact on the financial results of Integrys Energy Group.

Actual results could differ from estimates used to prepare Integrys Energy Group's financial statements.

In preparing the financial statements in accordance with GAAP, 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 significant estimates and assumptions, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies."

Integrys Energy Group may not be able to utilize tax credit and/or net operating loss carryforwards.

Integrys Energy Group has significantly reduced its consolidated federal and state income tax liability in the past through tax credits and tax net operating losses available under the applicable tax codes. Integrys Energy Group has not fully utilized these tax credits and tax net operating losses in its previous tax filings, but expects to prior to their expiration in future filings. However, Integrys Energy Group may not be able to fully utilize the tax credits and tax net operating losses available as carryforwards if its future federal and state taxable income and related income tax liability is insufficient to permit the use of such credits and losses.

In addition, any future disallowance of some or all of those tax credits or tax net operating losses as a result of legislative change or adverse determination by one of the applicable taxing jurisdictions could materially affect Integrys Energy Group's tax obligations.



Integrys Energy Group is subject to provisions that can limit merger and acquisition opportunities for its 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 Integrys Energy Group's 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 Integrys Energy Group that is not approved by its board of directors, even if the shareholders believe that such events may be beneficial to Integrys Energy Group's 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 Integrys Energy Group without the approval of its 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 and jointly owned facilities as of December 31, 2009:

Type	Name	Location	Fuel	Rated Capacity (MW) (1)
Steam	Columbia Units 1 and 2	Portage, WI	Coal	354.5 (2)
	Edgewater Unit 4	Sheboygan, WI	Coal	92.6 (2)
	Pulliam (4 units)	Green Bay, WI	Coal	320.3
	Weston Units 1, 2, and 3	Marathon County, WI	Coal	471.1
	Weston Unit 4	Marathon County, WI	Coal	373.4 (2)
Total Steam				1,611.9
Combustion	De Pere Energy Center	De Pere, WI	Natural Gas	166.6
Turbine and	Eagle River	Eagle River, WI	Distillate Fuel Oil	4.2
Diesel	Gladstone	Gladstone, MI	Oil	19.1
	Juneau #31	Adams County, WI	Distillate Fuel Oil	7.1 (2)
	Oneida Casino	Green Bay, WI	Distillate Fuel Oil	3.5
	Portage	Houghton, MI	Oil	18.1
	Pulliam #31	Green Bay, WI	Natural Gas	84.7
	West Marinette #31	Marinette, WI	Natural Gas	38.3
	West Marinette #32	Marinette, WI	Natural Gas	35.4
	West Marinette #33	Marinette, WI	Natural Gas	51.6 (2)
	Weston #31	Marathon County, WI	Natural Gas	15.3
	Weston #32	Marathon County, WI	Natural Gas	48.4
Total Combustion Turbine and Diesel				492.3
Hydroelectric	Various	Michigan	Hydro	20.3
	Various	Wisconsin	Hydro	67.9 (3)
Total Hydroelectric				88.2
Wind	Kewaunee County	Wisconsin	Wind	1.0
	Crane Creek	Iowa	Wind	21.7

Total Wind	22.7
Total System	2,215.1

- (1) Based on capacity ratings for July 2010, which can differ from nameplate capacity, especially on wind projects. 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 at Integrys Energy Group's electric segment.
- (2) These facilities are jointly owned by WPS and various other utilities. The capacity indicated for each of these units is equal to WPS's portion of total plant capacity based on its percent of ownership.
- Wisconsin Power and Light Company operates the Columbia and Edgewater units, and WPS holds a 31.8% ownership interest in these facilities.
  - WPS operates the Weston 4 facility and holds a 70% ownership in this facility, while Dairyland Power Cooperative holds the remaining 30%.
  - WRPC owns and operates the Juneau unit. WPS holds a 50% ownership interest in WRPC.
  - WPS operates the West Marinette 33 unit and holds a 68% ownership interest in the facility, while Marshfield Electric and Water Department holds the remaining 32% ownership.
- (3) WRPC owns and operates the Castle Rock and Petenwell units. WPS holds a 50% ownership interest in WRPC; however, WPS is entitled to 66.7% of total capacity at Petenwell and Castle Rock.

As of December 31, 2009, Integrys Energy Group's electric utilities owned approximately 24,900 miles of electric distribution lines located in Michigan and Wisconsin and approximately 170 distribution substations.

## Natural Gas Facilities

At December 31, 2009, Integrys Energy Group's natural gas properties were located in Illinois, Wisconsin, Minnesota, and Michigan, and consisted of the following:

Approximately 22,000 miles of natural gas distribution mains,  
 Approximately 1,010 miles of natural gas transmission mains,  
 Approximately 291 natural gas distribution and transmission gate stations,  
 Approximately 1.3 million natural gas lateral services,  
 A 3.6 billion-cubic-foot natural gas storage field located in Michigan, and  
 A 36.5 billion-cubic-foot underground natural gas storage reservoir and a liquefied natural gas plant at Manlove Field located in central Illinois.

## General

Substantially all of Integrys Energy Group's utility plant at WPS, UPPCO, PGL, and NSG is subject to first mortgage liens.

## B. INTEGRYS ENERGY SERVICES

The following table summarizes information on the energy asset facilities owned by Integrys Energy Services as of December 31, 2009:

Type	Name	Location	Fuel	Rated Capacity (MW) (1)
Combined Cycle	Beaver Falls	Beaver Falls, NY	Gas/Oil	78.9
	Combined Locks	Combined Locks, WI	Gas	46.8 (2)
	Syracuse	Syracuse, NY	Gas/Oil	85.0
Total Combined Cycle				210.7
Steam	Westwood	Tremont, PA	Culm	30.0
	Caribou	Caribou, ME	Oil	21.7 (3)
Total Steam				51.7
Hydroelectric	Caribou	Caribou ME	Hydro	0.9 (3)
	Squa Pan	Ashland, ME	Hydro	1.4 (3)
	Tinker	New Brunswick, Canada	Hydro	(3) 34.5
Total Hydroelectric				36.8
Combustion Turbine and Diesel	Caribou	Caribou ME	Diesel	(3) 7.0
	Flo's Inn	Presque Isle, ME	Diesel	4.2 (3)
	Loring	Limestone, ME	Diesel	5.2 (3)
	Tinker	New Brunswick, Canada	Diesel	(3) 1.0
Total Combustion Turbine and Diesel				17.4



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Reciprocating Engine	Winnebago	Rockford, IL	Landfill Gas	6.4
Solar	Various	California		1.7
	Various	Connecticut		0.3
	Various	New Jersey		5.8
Total Solar				7.8
Total Energy Assets				330.8
			Length of Pipeline (Miles)	
Landfill Gas Transportation	LGS	Brazoria County, TX	Landfill Gas	33 miles(4)

(1) Based on summer rated capacity.

(2) Combined Locks has an additional five MW of capacity available at this facility through the lease of a steam turbine.

(3) At December 31, 2009, these properties were classified as assets held for sale. For more information see Note 4, "Dispositions."

(4) LGS Renewables 1, LC, owns and operates the LGS facility. PDI, a wholly owned subsidiary of Integrys Energy Services, holds a 50% ownership interest in LGS.

ITEM 3. LEGAL PROCEEDINGS

For information on material legal proceedings and matters related to Integrys Energy Group and its subsidiaries, see Note 16, "Commitments and Contingencies."

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

None

-24-

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## ITEM 4A. EXECUTIVE OFFICERS OF INTEGRYS ENERGY GROUP

Name and Age (1)		Position and Business Experience During Past Five Years	Effective Date
Larry L. Weyers	64	Executive Chairman Chairman, President and Chief Executive Officer President and Chief Executive Officer Chairman, President and Chief Executive Officer	01-01-09 05-15-08 02-21-07 02-12-98
Charles A. Schrock	56	President and Chief Executive Officer President and Chief Executive Officer of WPS President of WPS President and Chief Operating Officer – Generation – WPS	01-01-09 05-31-08 02-21-07 08-15-04
Thomas P. Meinz	63	Executive Vice President and Chief External Affairs Officer Executive Vice President – External Affairs Executive Vice President – Public Affairs	05-15-08 02-21-07 09-12-04
Phillip M. Mikulsky	61	Executive Vice President – Corporate Development and Shared Services Executive Vice President and Chief Development Officer Executive Vice President – Development	09-21-08 02-21-07 09-12-04
Joseph P. O'Leary	55	Senior Vice President and Chief Financial Officer	06-04-01
Diane L. Ford	56	Vice President and Corporate Controller Vice President – Controller and Chief Accounting Officer	02-21-07 07-11-99
Bradley A. Johnson	55	Vice President and Treasurer	07-18-04
Barth J. Wolf	52	Vice President, Chief Legal Officer and Secretary Vice President – Legal Services and Chief Compliance Officer – IBS Secretary and Manager – Legal Services	07-31-07 02-21-07 09-19-99
Lawrence T. Borgard	48	President and Chief Operating Officer – Utilities of Integrys Energy Group and President and Chief Executive Officer of WPS President and Chief Operating Officer – Integrys Gas Group (2) President and Chief Operating Officer – Energy Delivery – WPS	04-05-09 02-21-07 08-15-04

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William D. Laakso (3)	47	Vice President – Human Resources	09-21-08
		Interim Vice President – Human Resources – IBS	05-15-08
		Director – Workforce Planning and Organizational Design – WPS	08-12-07
		Director Organizational Development – WPS	07-11-06
		Director of Organizational Development – WPS	12-12-05
		Vice President – Operations/Clinical Director – Employee Resource Center, Inc.	02-04-02
Mark A Radtke	48	President and Chief Executive Officer – Integrys Energy Services	06-01-08
		President – Integrys Energy Services (previously named WPS Energy Services, Inc.)	10-17-99

- (1) All ages are as of January 1, 2010. 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 Integrys Energy Group. 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.
- (2) The Integrys Gas Group includes PGL, NSG, MERC, and MGU.
- (3) Prior to joining Integrys Energy Group, William D. Laakso’s responsibilities at Employee Resource Center, Inc. (ERC) included leadership of ERC’s management team and duties of Clinical Director. ERC provides employee assistance programs to over 200 corporate customers in Northeast Wisconsin and covers 75,000 employees and their dependents.

## PART II

ITEM MARKET FOR INTEGRYS ENERGY GROUP'S COMMON EQUITY, RELATED  
5. 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
2009			
1st Quarter	\$ .680	\$45.10	\$19.44
2nd Quarter	.680	30.40	24.95
3rd Quarter	.680	36.75	28.31
4th Quarter	.680	42.99	34.20
Total	\$2.720		
2008			
1st Quarter	\$ .670	\$53.26	\$44.04
2nd Quarter	.670	52.74	46.89
3rd Quarter	.670	53.92	48.88
4th Quarter	.670	51.47	36.91
Total	\$2.680		

Integrys Energy Group's 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, LLC, 59 Maiden Lane, New York, NY 10038.

As of February 22, 2010, there were 32,608 common stock shareholders of record.

## Dividend Restrictions

Integrys Energy Group is a holding company and its ability to pay dividends is largely dependant upon the ability of its subsidiaries to pay dividends.

The PSCW has restricted WPS to paying normal dividends on its common stock of no more than 103% of the previous year's common stock dividend. Integrys Energy Group's right to receive dividends on the common stock of WPS is also subject to the prior rights of WPS's preferred shareholders and to provisions in WPS's restated articles of incorporation, which limit the amount of common stock dividends that WPS may pay if its common stock and common stock surplus accounts constitute less than 25% of its total capitalization. These limitations are not expected to limit any dividend payments in the foreseeable future. At December 31, 2009, these limitations amounted to \$1.4 million out of WPS's total retained earnings of \$392.2 million. Consequently, at December 31, 2009, WPS had \$390.8 million of retained earnings available for the payment of dividends.

The PSCW also requires WPS to maintain a financial capital structure (i.e., the percentages by which each of common stock equity, preferred stock equity and debt constitute the total capital invested in a utility), that has a common equity range of 49% to 54%. The PSCW also established a targeted financial common equity ratio at 51% that results in a regulatory common equity ratio of 53.41%. The primary difference between the financial and the regulatory common equity ratio relates to certain off-balance sheet obligations, primarily purchased power obligations, considered by the PSCW in establishing the financial common equity target. These limitations may be modified by the PSCW.



UPPCO's indentures relating to its first mortgage bonds contain certain limitations on the payment of cash dividends on its common stock, which is held solely by Integrys Energy Group. At December 31, 2009, these restrictions amounted to \$10.7 million out of UPPCO's total retained earnings of \$50.1 million. Consequently, at December 31, 2009, UPPCO had \$39.4 million of retained earnings available for the payment of common stock cash dividends.

NSG's long-term debt obligations contain provisions and covenants restricting the payment of cash dividends and the purchase or redemption of capital stock. At December 31, 2009, these restrictions amounted to \$6.9 million out of NSG's total retained earnings of \$70.2 million. Consequently, at December 31, 2009, NSG had \$63.3 million of retained earnings available for the payment of dividends.

At December 31, 2009, Integrys Energy Group had \$326.6 million of retained earnings available for the payment of dividends. Except for the subsidiary restrictions described above, Integrys Energy Group does not have any dividend restrictions.

#### Equity Compensation Plans

See Item 11, "Executive Compensation," for information regarding Integrys Energy Group's equity compensation plans.

ITEM 6. SELECTED FINANCIAL  
DATAINTEGRYS ENERGY GROUP, INC.  
COMPARATIVE FINANCIAL DATA AND  
OTHER STATISTICS (2005 TO 2009)

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)

	2009	2008	2007 (1)	2006 (2)	2005
Total revenues	\$ 7,499.8	\$ 14,047.8	\$ 10,292.4	\$ 6,890.7	\$ 6,825.5
Net income (loss) from continuing operations	(71.6)	124.7	181.0	147.8	146.1
Net income (loss) attributed to common shareholders	(70.9)	126.4	251.3	155.8	157.4
Total assets	11,847.9	14,272.5	11,234.4	6,861.7	5,462.5
Preferred stock of subsidiary	51.1	51.1	51.1	51.1	51.1
Long-term debt (excluding current portion)	2,394.7	2,285.7	2,265.1	1,287.2	867.1
Shares of common stock (less treasury stock and shares in deferred compensation trust)					
Outstanding	76.0	76.0	76.0	43.1	39.8
Average	76.8	76.7	71.6	42.3	38.3
Earnings (loss) per common share (basic)					
Net income (loss) from continuing operations	\$ (0.96)	\$ 1.59	\$ 2.49	\$ 3.51	\$ 3.85
Earnings (loss) per common share	(0.92)	1.65	3.51	3.68	4.11
Earnings (loss) per common share (diluted)					
Net income (loss) from continuing operations	(0.96)	1.58	2.48	3.50	3.81
Earnings (loss) per common share	(0.92)	1.64	3.50	3.67	4.07
Dividends per common share declared	2.72	2.68	2.56	2.28	2.24
Stock price at year-end	\$ 41.99	\$ 42.98	\$ 51.69	\$ 54.03	\$ 55.31
Book value per share	\$ 37.62	\$ 40.78	\$ 42.58	\$ 35.61	\$ 32.76
Return on average equity	(2.5)%	3.7%	8.5%	10.6%	13.6%
Number of common stock shareholders	32,755	34,016	35,212	19,837	20,701
Number of employees	5,025	5,191	5,231	3,326	2,945



(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 MGU 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 energy holding company with regulated electric and natural gas utility operations (serving customers in Illinois, Michigan, Minnesota, and Wisconsin), nonregulated energy operations, and an approximate 34% equity ownership interest in ATC (a federally regulated electric transmission company operating in Wisconsin, Michigan, Minnesota, and Illinois).

#### Strategic Overview

IntegrYS Energy Group's goal is to create long-term value for shareholders and customers through growth in its core regulated businesses. IntegrYS Energy Group has substantially completed its previously announced strategy to divest of or significantly reduce the size of its nonregulated energy services business segment to a smaller segment with significantly reduced credit and collateral support requirements.

The essential components of IntegrYS Energy Group's business strategy are:

**Maintaining and Growing a Strong Regulated Utility Base** – A strong regulated utility base is essential to maintain a strong balance sheet, predictable cash flows, a desired risk profile, attractive dividends, and quality credit ratings. This is critical to IntegrYS Energy Group's success as a strategically focused regulated business. IntegrYS Energy Group believes the following projects have helped, or will help, maintain and grow its regulated utility base and meet its customers' needs:

- WPS's continued investment in environmental projects to improve air quality and meet the requirements set by environmental regulators. Capital projects to construct and/or upgrade equipment to meet or exceed required environmental standards are planned each year.
- IntegrYS Energy Group's approximate 34% ownership interest in ATC, a transmission company that had over \$2.8 billion of transmission assets at December 31, 2009. ATC plans to invest approximately \$2.5 billion during the next ten years. Although ATC's equity requirements to fund its capital investments will primarily be met by earnings reinvestment, IntegrYS Energy Group plans to continue to fund its share of the equity portion of future ATC growth, as necessary.
- An accelerated annual investment in natural gas distribution facilities (replacement of cast iron mains) at PGL.
- WPS's purchase of the 99-megawatt Crane Creek wind generation project constructed in Howard County, Iowa, which became operational in 2009.

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

**Operating a Nonregulated Energy Services Business Segment with a Controlled Risk and Capital Profile** – Through its nonregulated IntegrYS Energy Services subsidiary, IntegrYS Energy Group provides retail natural gas and electric

products to end-use customers in the upper Midwest and Northeastern regions of the United States. Integrys Energy Group has repositioned this subsidiary from a focus on significant growth in wholesale and retail markets across the United States and Canada, to a focus on selected retail markets with the expectation that recurring customer based business will result in dependable cash and earnings contributions with a reduced risk and capital profile. In addition, Integrys Energy Services will continue to invest in energy assets with renewable attributes.

-29-

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

- IBS, a wholly owned service company of Integrys Energy Group, was formed to achieve 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.
- "Operational Excellence" initiatives were implemented to provide top performance in the areas of project management, process improvement, contract administration, and compliance in order to reduce costs and manage projects and activities within appropriate budgets, schedules, and regulations.

**Placing Strong Emphasis on Asset and Risk Management** – Integrys Energy Group's asset management strategy calls for the continuous assessment of existing assets, the acquisition of assets, and contractual commitments to obtain resources that complement its existing business and strategy. The goal is to provide the most efficient use of resources while maximizing return and maintaining an acceptable risk profile. This strategy focuses on the disposition of assets, including property, plant, and equipment and entire business units, which are no longer strategic to ongoing operations, are not performing as needed, or have an unacceptable risk profile. Integrys Energy Group maintains a portfolio approach to risk and earnings. Integrys Energy Group's decision regarding the future of Integrys Energy Services illustrates its asset management strategy.

Integrys Energy Group's risk management strategy includes the management of market, credit, and operational risks through the normal course of business. Forward purchases and sales of electric capacity, energy, natural gas, and other commodities and the use of derivative financial instruments, including commodity swaps and options, allow for opportunities to reduce the risk associated with price movement in a volatile energy market. Each business unit manages the risk profile related to these instruments consistent with Integrys Energy Group's risk management policies, which are approved by the Board of Directors. The Corporate Risk Management Group, which reports through the Chief Financial Officer, provides corporate oversight.

**Continuing Emphasis on Safe, Reliable, Competitively Priced, and Environmentally Sound Energy and Energy Related Services** – Integrys Energy Group's mission is to provide customers with the best value in energy and energy related services. By effectively operating a mixed portfolio of generation assets and investing in new generation and natural gas distribution assets, while maintaining or exceeding environmental standards, Integrys Energy Group is able to provide a safe, reliable, value-priced service to its customers. Integrys Energy Group concentrates its efforts on improving and operating efficiently in order to reduce costs and maintain a low risk profile. Integrys Energy Group actively evaluates opportunities for increasing its focus on energy efficiency and for adding more renewable generation to provide additional environmentally sound energy to its portfolio. Integrys Energy Group believes the following activities have helped, and will continue to help, to provide safe, reliable, competitively priced, and environmentally sound energy and energy related services:

- Managing operations to minimize the impact on the environment. WPS's Weston 4 facility, completed in 2008, is one of the most efficient pulverized coal-fired electric generation units in the country with state-of-the-art environmental controls, which allows reductions in the amount of emissions produced. Integrys Energy Group also expects to maintain or decrease the amount of greenhouse gases released over time and supports research and development initiatives that will enable further progress toward

decreasing its carbon footprint.

- Effectively operating a mixed portfolio of generation assets and investing in new generation and distribution assets, such as Weston 4, wind projects, and its natural gas connection to the Guardian II pipeline, ensures continued reliability for Integrys Energy Group's customers.

-30-

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## RESULTS OF OPERATIONS

Year Ended December 31

(Millions, except per share amounts)	2009	2008	2007	Change in 2009 Over 2008	Change in 2008 Over 2007
Natural gas utility operations	\$ (172.1)	\$ 84.5	\$ 28.7	N/A	194.4%
Electric utility operations	88.9	92.6	87.4	(4.0)%	5.9%
IntegrYS Energy Services operations	2.5	(61.5)	98.0	N/A	N/A
Electric transmission investment	45.5	39.7	30.3	14.6%	31.0%
Holding company and other operations	(35.7)	(28.9)	(49.1)	23.5%	(41.1)%
Oil and natural gas operations	-	-	56.0	N/A	(100.0)%
Net income (loss) attributed to common shareholders	\$ (70.9)	\$ 126.4	\$ 251.3	N/A	(49.7)%
Basic earnings (loss) per share	\$ (0.92)	\$ 1.65	\$ 3.51	N/A	(53.0)%
Diluted earnings (loss) per share	\$ (0.92)	\$ 1.64	\$ 3.50	N/A	(53.1)%
Average shares of common stock					
Basic	76.8	76.7	71.6	0.1%	7.1%
Diluted	76.8	77.0	71.8	(0.3)%	7.2%

## Financial Results – 2009 Compared with 2008

IntegrYS Energy Group recognized a net loss attributed to common shareholders of \$70.9 million (\$0.92 net loss per share) in 2009 compared with net income attributed to common shareholders of \$126.4 million (\$1.64 diluted earnings per share) in 2008. Significant factors impacting the \$197.3 million decrease in earnings were as follows (and are discussed in more detail thereafter).

- Earnings at the regulated natural gas utility segment decreased \$256.6 million, driven by a \$242.3 million increase in after-tax non-cash goodwill impairment losses period-over-period. A \$16.2 million after-tax decrease in margin from lower period-over-period volumes, net of decoupling, also negatively impacted earnings. An \$8.0 million after-tax increase in employee benefit costs, a \$9.6 million after-tax increase in other operating and maintenance expenses related primarily to natural gas maintenance costs and workers compensation claims, and \$4.1 million after-tax of restructuring costs related to workforce reductions also contributed to the decrease in earnings. These negative impacts were partially offset by a \$17.4 million after-tax net positive impact that increased rates at certain natural gas utilities had on margin and a \$10.6 million after-tax decrease in bad debt expense.
- Earnings at the regulated electric utility segment decreased \$3.7 million, driven by a \$20.2 million after-tax increase in operating expenses, including restructuring costs, a \$3.7 million after-tax increase in other expense primarily related to an increase in interest expense at WPS, and a \$3.3 million increase in income taxes. Partially offsetting these increases in expenses was a \$23.8 million after-tax increase in margin.

Earnings at Integrys Energy Services increased \$64.0 million, driven by a \$127.3 million after-tax increase in Integrys Energy Services' margin year-over-year, primarily related to the positive year-over-year impact of inventory valuation adjustments recorded in prior periods, partially offset by non-cash accounting losses due to derivative fair value adjustments. Partially offsetting the increase in Integrys Energy Services' margin were an increase in the provision for income taxes, primarily due to an \$18.4 million year-over-year decrease in income tax credits recognized, after-tax restructuring expenses of \$17.4 million, after-tax losses of \$17.3 million related to dispositions completed in connection with the strategy change primarily driven by timing differences caused by the accounting treatment for derivative and non-derivative contracts, and an after-tax increase in operating and maintenance expenses of \$5.5 million.

- Earnings at the electric transmission investment segment increased \$5.8 million year-over-year, due to an increase in income from Integrys Energy Group's approximate 34% ownership interest in ATC.
- Net loss at the holding company and other segment increased \$6.8 million, driven by an increase in interest expense.

#### Financial Results – 2008 Compared with 2007

Integrys Energy Group recognized net income attributed to common shareholders of \$126.4 million (\$1.64 diluted earnings per share) in 2008 compared with \$251.3 million (\$3.50 diluted earnings per share) in 2007. Significant factors impacting the \$124.9 million decrease in earnings were as follows (and are discussed in more detail thereafter).

- Earnings at the regulated natural gas utility segment increased \$55.8 million, driven by the inclusion of PGL and NSG for all of 2008 compared with only a partial year of operations in 2007 and by the positive impact of PGL's 2008 rate increase. From 2007 to 2008, earnings related to PGL and NSG increased \$43.3 million. Also positively impacting earnings was an increase in natural gas sales volumes at WPS, MERC, and MGU, which drove a \$6.6 million after-tax increase in margin.
- Earnings at the regulated electric utility segment increased \$5.2 million, driven by a \$7.0 million after-tax decrease in electric maintenance expenses, an approximate \$6 million after-tax positive impact related to retail electric rate increases, and an approximate \$6 million after-tax increase in wholesale margins, partially offset by an \$8.3 million after-tax increase in electric transmission expenses and an approximate \$7 million after-tax decrease in margin due to lower residential and commercial and industrial sales volumes as a result of cooler weather during the cooling season and customer conservation efforts.
- Earnings at Integrys Energy Services decreased \$159.5 million, driven by a \$131.0 million after-tax decrease in Integrys Energy Services' margin year-over-year, primarily related to non-cash accounting losses due to derivative fair value and inventory valuation adjustments, partially offset by an increase in retail electric margin. Also contributing to the decrease in Integrys Energy Services' earnings was a \$13.4 million after-tax increase in operating and maintenance expenses, the year-over-year impact of the recognition of \$17.1 million of after-tax earnings from Integrys Energy Services' investment in a synthetic fuel production facility in 2007, and a \$10.9 million decrease in after-tax income from discontinued operations as a result of the sale of Niagara Generation, LLC in 2007. Partially offsetting the decrease in earnings was the recognition of \$10.0 million of investment tax credits related to solar projects completed in the fourth quarter of 2008.
- Earnings at the oil and natural gas operations segment decreased \$56.0 million. 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 sale of PEP resulted in a \$7.6 million after-tax gain in 2007.



- Earnings at the electric transmission investment segment increased \$9.4 million year-over-year, due to an increase in income from Integrys Energy Group's ownership interest in ATC.
- Net loss at the holding company and other segment decreased \$20.2 million, driven by lower operating expenses at the holding company, partially offset by the negative year-over-year impact on operating income of the reallocation of external costs to achieve merger synergies in 2007.

- Diluted earnings per share was impacted by a 5.2 million share (7.2%) increase in the weighted average number of outstanding shares of Integrys Energy Group common stock from 2007 to 2008. Integrys Energy Group issued 31.9 million shares of common stock on February 21, 2007, in conjunction with the PEC merger. Additional shares were also issued under the Stock Investment Plan and certain stock-based employee benefit plans in 2007.

### Utility Operations

For 2009 and 2008, utility operations included the regulated natural gas utility segment, consisting of the natural gas operations of PGL, WPS, MERC, MGU, and NSG, and the regulated electric segment, consisting of the regulated electric operations of WPS and UPPCO. The regulated natural gas operations of WPS, MERC, and MGU were included in results of operations for all of 2007, while the regulated natural gas operations of PGL and NSG were included in results of operations beginning on February 22, 2007.

### Regulated Natural Gas Utility Segment Operations

	Year Ended December 31			Change in 2009 Over 2008	Change in 2008 Over 2007
	2009	2008	2007		
Revenues	\$ 2,237.5	\$ 3,025.9	\$ 2,103.7	(26.1)%	43.8%
Purchased natural gas costs	1,382.0	2,147.7	1,453.5	(35.7)%	47.8%
Margins	855.5	878.2	650.2	(2.6)%	35.1%
Operating and maintenance expense	532.6	539.1	427.4	(1.2)%	26.1%
Goodwill impairment loss (1)	291.1	6.5	-	4,378.5%	N/A
Restructuring expense (2)	6.9	-	-	N/A	N/A
Depreciation and amortization expense	106.1	108.3	97.7	(2.0)%	10.8%
Taxes other than income taxes	33.4	32.1	33.1	4.0%	(3.0)%
Operating income (loss)	(114.6)	192.2	92.0	N/A	108.9%
Miscellaneous income	3.1	7.0	5.5	(55.7)%	27.3%
Interest expense	(52.2)	(56.6)	(53.4)	(7.8)%	6.0%
Other expense	(49.1)	(49.6)	(47.9)	(1.0)%	3.5%
Income (loss) before taxes	\$ (163.7)	\$ 142.6	\$ 44.1	N/A	223.4%
Throughput in therms					
Residential	1,602.8	1,708.9	1,251.8	(6.2)%	36.5%
Commercial and industrial	501.4	550.8	439.2	(9.0)%	25.4%
Interruptible	51.3	60.1	59.4	(14.6)%	1.2%
Interdepartmental	9.5	28.6	47.1	(66.8)%	(39.3)%
Transport	1,641.6	1,834.0	1,505.6	(10.5)%	21.8%
Total sales in therms	3,806.6	4,182.4	3,303.1	(9.0)%	26.6%

### Weather

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Average heating degree days	7,061	7,257	N/M(3)	(2.7)%	N/A
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(1) See Note 10, "Goodwill and Other Intangible Assets," for more information.

(2) See Note 3, "Restructuring Expense," for more information.

(3) Not meaningful as the PEC merger was completed on February 21, 2007.

-33-

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2009 Compared with 2008

Revenues

Regulated natural gas utility segment revenue decreased \$788.4 million, driven by:

- An approximate \$648 million decrease in revenue as a result of an approximate 30% decrease in the average per-unit cost of natural gas sold by the regulated natural gas utilities during 2009 compared with 2008. For all of Integrys Energy Group's regulated natural gas utilities, prudently incurred natural gas commodity costs are passed directly through to customers in current rates.
- An approximate \$166 million decrease in revenue as a result of lower year-over-year natural gas throughput volumes, driven by:
  - An approximate \$83 million decrease related to lower overall volumes, including residential customer volumes, resulting from customer conservation and efficiency efforts. Lower volumes were also driven by decreased commercial and industrial customer volumes resulting from reduced demand related to changes in customers' plant operations and a decline in customer base at PGL and MGU, both of which Integrys Energy Group attributed to the general economic slowdown.
  - An approximate \$70 million decrease as a result of warmer year-over-year weather during the heating season as indicated by the 2.7% decrease in average heating degree days.
  - An approximate \$19 million decrease related to a reduction in volumes sold to the electric utility segment driven by the availability of lower cost power from MISO, resulting in a decrease in the need for the electric utility to run its natural gas-fired peaking generation units.
  - This decrease in revenue was partially offset by the \$6 million positive impact of decoupling mechanisms that were first effective for PGL and NSG on March 1, 2008, and for WPS on January 1, 2009. Under decoupling, these utilities are allowed to defer the difference between the actual and rate case authorized delivery charge components of margin from certain customers and adjust future rates in accordance with rules applicable to each jurisdiction.
- An approximate \$20 million year-over-year net decrease in revenue from lower recovery of environmental cleanup expenditures at PGL and NSG related to former manufactured gas plant sites, partially offset by higher recovery of EEP expenses. The EEP program was established in the 2008 PGL and NSG rate cases and is designed to encourage energy efficiency initiatives.
- The decrease in revenue was partially offset by the approximate \$29 million year-over-year net positive impact of natural gas distribution rate cases and changes in rate design at the regulated natural gas utilities. See Note 24, "Regulatory Environment," for more information on these rate cases.
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Effective January 14, 2009, MGU received a final rate order from the MPSC for a natural gas distribution rate increase. On June 29, 2009, MERC received a final rate order granting a natural gas distribution rate increase. Prior to this final order, MERC had been granted interim rate relief effective October 1, 2008. Together, these rate increases had an approximate \$19 million positive impact on revenue.

- In 2009, PGL and NSG received the full impact of their 2008 natural gas distribution rate orders, which were effective February 14, 2008, and drove an approximate \$5 million increase in revenue year-over-year.

- Effective January 1, 2009, the PSCW required WPS to change its retail natural gas distribution rate design which incorporates higher volumetric rates and lower fixed customer charges. In 2009, revenue increased approximately \$5 million related to this change in rate design.

## Margins

Regulated natural gas utility segment margin decreased \$22.7 million, driven by:

- An approximate \$27 million year-over-year decrease in margin resulting from the 9.0% decrease in natural gas throughput volumes attributed to the negative impact of the general economic slowdown, customer conservation and efficiency efforts, and warmer year-over-year weather. This decrease in margin includes the impact of decoupling mechanisms that were first effective for PGL and NSG on March 1, 2008, and for WPS on January 1, 2009. The decoupling mechanism for WPS's natural gas utility includes an annual \$8.0 million cap for the deferral of any excess or shortfall from the rate case authorized margin. Approximately \$7 million of additional margin was recognized at WPS due to a shortfall from the rate case authorized margin during 2009.
- An approximate \$20 million year-over-year net decrease in margin due to lower recovery of environmental cleanup expenditures at PGL and NSG related to former manufactured gas plant sites, partially offset by an increase in recovery of EEP expenses. This decrease in margin was offset by a net decrease in operating expense from both the amortization of the related regulatory asset and EEP expenses and, therefore, had no impact on earnings.
- An approximate \$2 million year-over-year decrease in margin at MGU related to an adjustment in the third quarter of 2008 for recovery of prior natural gas costs in a MPSC proceeding.
- The decrease in margin was partially offset by the approximate \$29 million net positive year-over-year impact of rate orders and impacts of rate design changes at the regulated natural gas utilities.

## Operating Income (Loss)

Operating results at the regulated natural gas utility segment decreased \$306.8 million, from operating income of \$192.2 million in 2008, to an operating loss of \$114.6 million in 2009. This decrease was primarily driven by a year-over-year increase in non-cash goodwill impairment losses of \$284.6 million and the \$22.7 million decrease in natural gas margin, partially offset by a \$0.5 million decrease in other operating expenses. See Note 10, "Goodwill and Other Intangible Assets," for information related to the goodwill impairment losses recorded in 2009 and 2008.

The year-over-year decrease in other operating expenses primarily related to:

- An approximate \$20 million net decrease in amortization of the regulatory asset related to environmental cleanup expenditures of manufactured gas plant sites, partially offset by an increase in EEP expenses. Both of these costs were recovered from customers in rates.
- A \$17.7 million decrease in bad debt expense driven by the impact lower energy prices had on overall accounts receivable balances and the implementation of bad debt expense tracking mechanisms at PGL, NSG, and MGU. PGL and NSG elected during the third quarter of 2009, under a new Illinois state law, to file for recovery from or refund to customers the difference between actual bad debt expense reported as a component of earnings and the bad debt expense included in utility rates retroactive to January 1, 2008. Bad debt expense also decreased as a result of MGU's rate order effective January 1, 2010, which established a bad debt expense tracking mechanism that allows for the deferral and subsequent recovery or refund of 80% of the difference between actual bad debt write-offs (net of recoveries) and bad debt expense included in utility rates. The bad debt mechanism allowed

recovery of a portion of the December 31, 2009 accounts receivable reserve representing future bad debt write-offs. The decrease in bad debt expense attributed to the implementation of bad debt expense tracking mechanisms at the natural gas utilities was \$9.3 million.

· These decreases were partially offset by:

-35-

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- A \$13.4 million increase in employee benefit costs, partially related to an increase in pension expense resulting from negative pension investment returns in 2008, as well as higher health care related expenses in 2009.
- Restructuring expenses of \$6.9 million related to a reduction in workforce. See Note 3, "Restructuring Expense," for more information.
- A \$5.5 million increase in natural gas maintenance costs, primarily related to increased system inspection and maintenance requirements.
- A \$5.0 million increase in expenses related to workers compensation claims.
- A \$3.0 million charge related to an expected settlement at PGL and NSG.
- A \$2.5 million increase in amortization of a regulatory asset related to conservation program initiatives.

#### 2008 Compared with 2007

##### Revenues

Regulated natural gas utility segment revenue increased \$922.2 million, driven by:

- A combined increase in PGL and NSG natural gas utility revenue of \$780.5 million, from \$1,118.5 million during 2007, to \$1,899.0 million during 2008. The increase in revenue at both of these natural gas utilities was driven primarily by the fact that they were not included in regulated natural gas utility results until after the PEC merger on February 21, 2007. Other factors that contributed to this combined increase include:
  - PGL's annualized rate increase effective February 14, 2008, which increased revenue year-over-year by approximately \$61 million. See Note 24, "Regulatory Environment," for more information on the PGL and NSG rate cases.
  - Higher year-over-year natural gas prices. Increases in natural gas commodity costs are passed directly through to customers in rates.
  - Colder weather during the 2008 heating season, partially offset by energy conservation efforts by natural gas utility customers and a larger number of customer disconnections, which Integrys Energy Group believes resulted from high energy prices and a general slowdown in the economy.
- An increase in natural gas revenue of \$141.7 million at the remaining natural gas utilities (WPS, MERC, and MGU) from \$985.1 million during 2007, to \$1,126.8 million during 2008, which resulted primarily from:
  - A combined \$112.2 million increase in revenue driven by the approximate 13% increase in the per-unit cost of natural gas in 2008 compared with 2007.



- A \$43.4 million increase in revenue from colder weather during the 2008 heating season compared with 2007, evidenced by an approximate 11% year-over-year increase in heating degree days across these three utilities.
- An increase in revenue from MERC's interim rate increase, effective October 1, 2008, for retail natural gas customers.

- The combined increase in revenue at WPS, MGU, and MERC, was partially offset by a \$17.9 million decrease in revenue driven by a decrease in year-over-year volumes normalized for the impact of weather, \$15.6 million of which was driven by a 39.3% decrease in natural gas throughput volumes sold by WPS to its electric utility segment. The decrease in volumes sold to the electric utility segment was a result of a decrease in the need for the electric utility to run its peaking generation units during the 2008 summer cooling season because of cooler year-over-year weather. Additional electricity was also available within the electric utility segment from Weston 4, a coal-fired generating facility that became commercially operational in June 2008. The remaining decrease in weather normalized volumes was driven by energy conservation efforts of residential customers and a larger number of customer disconnections year-over-year, which Integrys Energy Group believes resulted from high energy prices and a general slowdown in the economy.

### Margins

Regulated natural gas utility segment margin increased \$228.0 million, primarily due to:

- An increase in the combined margin at PGL and NSG of \$208.6 million, from \$387.2 million in 2007 to \$595.8 million in 2008. The increase in combined margin was driven by:
  - The acquisition of PGL and NSG on February 21, 2007. The combined operations for the entire heating season were included in the 2008 natural gas utility margin. However, only operations from the merger date through December 31, 2007, were included in the 2007 natural gas utility margin. Due to the seasonal nature of natural gas utilities, higher margins are generally derived during the heating season (first and fourth quarters).
  - The 2008 rate increase for PGL which resulted in an approximate \$61 million increase in margin.
  - Colder than normal weather experienced by both PGL and NSG resulted in an approximate \$7 million increase in 2008 margin before the decoupling mechanism went into effect on March 1, 2008.
- An increase in natural gas margin of \$19.4 million at the remaining natural gas utilities (WPS, MERC, and MGU), primarily driven by:
  - A combined 5.2% increase in natural gas throughput volumes at WPS, MERC, and MGU, which had an approximate \$11 million positive impact on natural gas utility margins. Colder year-over-year weather had an approximate \$14 million positive impact on margins. Partially offsetting the positive impact of colder weather, were energy conservation efforts by residential customers and a larger number of customer disconnections year-over-year, which had an approximate \$3 million negative impact on margins.
  - The interim rate increase for MERC, effective October 1, 2008, which had a positive impact on natural gas margin.

- An approximate \$2 million year-over-year increase in margin at MGU related to an adjustment for recovery of prior natural gas costs in an MPSC proceeding.

## Operating Income

Operating income at the regulated natural gas utility segment increased \$100.2 million, driven by the \$228.0 million increase in the natural gas utility margin, partially offset by a \$127.8 million increase in operating expenses.

The increase in operating expenses was primarily related to an increase in combined operating expenses at PGL and NSG of \$125.8 million, from \$368.7 million for 2007 to \$494.5 million for 2008.

The increase in operating expenses related to PGL and NSG was primarily driven by:

- The acquisition of these natural gas utilities on February 21, 2007. As a result, operating expenses for the period January 1, 2007 to the acquisition date were not included in the 2007 operating results.
- A non-cash goodwill impairment charge of \$6.5 million recognized in the second quarter of 2008 related to NSG.
- A combined increase in bad debt expense, driven by the impact of high energy prices and worsening economic conditions on overall accounts receivable balances.

## Other Expense

Other expense at the regulated natural gas utilities increased \$1.7 million, driven by a \$3.2 million increase in interest expense, partially offset by a \$1.5 million increase in miscellaneous income. The increase in other expense was a result of:

- A \$6.1 million increase in combined interest expense at PGL and NSG, from \$30.3 million in 2007 to \$36.4 million in 2008. The increase in interest expense at PGL and NSG is primarily due to the fact that these utilities were first acquired on February 21, 2007, and, therefore, did not recognize a full year of interest expense in 2007. The increase in interest expense was also due to additional long-term debt borrowings and higher interest rates on new and remarketed long-term debt.
- The increase in other expense was offset by:
  - A \$2.6 million increase in AFUDC at WPS related to the construction of natural gas laterals for connection to the Guardian II pipeline.
  - A decrease in interest expense resulting from a decrease in short-term borrowing levels and a decrease in interest rates for WPS's natural gas segment.

## Regulated Electric Utility Segment Operations

	Year Ended December 31			Change in 2009 Over 2008	Change in 2008 Over 2007
	2009	2008	2007		
Revenues	\$ 1,301.6	\$ 1,328.9	\$ 1,246.1	(2.1)%	6.6%
Fuel and purchased power costs	584.5	651.5	636.5	(10.3)%	2.4%
Margins	717.1	677.4	609.6	5.9%	11.1%
Operating and maintenance expense	392.0	375.3	321.1	4.4%	16.9%
Restructuring expense	8.6	-	-	N/A	N/A
Depreciation and amortization expense	90.3	84.3	80.1	7.1%	5.2%
Taxes other than income taxes	46.6	44.3	43.2	5.2%	2.5%
Operating income	179.6	173.5	165.2	3.5%	5.0%
Miscellaneous income	4.8	6.0	8.3	(20.0)%	(27.7)%
Interest expense	(41.6)	(36.7)	(32.4)	13.4%	13.3%
Other expense	(36.8)	(30.7)	(24.1)	19.9%	27.4%
Income before taxes	\$ 142.8	\$ 142.8	\$ 141.1	-%	1.2%
Sales in kilowatt-hours					
Residential	3,043.0	3,064.5	3,173.6	(0.7)%	(3.4)%
Commercial and industrial	8,155.5	8,632.8	8,750.9	(5.5)%	(1.3)%
Wholesale	5,079.1	4,764.6	4,024.9	6.6%	18.4%
Other	40.0	42.6	42.4	(6.1)%	0.5%
Total sales in kilowatt-hours	16,317.6	16,504.5	15,991.8	(1.1)%	3.2%
Weather – WPS:					
Heating degree days	7,962	7,969	7,102	(0.1)%	12.2%
Cooling degree days	274	464	634	(40.9)%	(26.8)%
Weather – UPPCO:					
Heating degree days	9,317	9,348	8,625	(0.3)%	8.4%
Cooling degree days	99	138	352	(28.3)%	(60.8)%

## 2009 Compared with 2008

## Revenues

Regulated electric utility segment revenues decreased \$27.3 million, driven by:

- A 5.5% decrease in commercial and industrial sales volumes and a 0.7% decrease in residential sales volumes, which resulted in an approximate \$23 million year-over-year decrease in revenue, after the impact of decoupling. The primary drivers of the decrease were:

- An approximate \$31 million year-over-year decrease due to lower demand related to changes in commercial and industrial customers' plant operations, which Integrys Energy Group attributed mainly to the general economic slowdown.
  
- An approximate \$6 million decrease primarily related to cooler year-over-year weather during the cooling season as evidenced by the decrease in cooling degree days at both WPS and UPPCO.

- These decreases in volumes were partially offset by the \$14.0 million impact that decoupling, which went into effect on January 1, 2009, had on WPS's revenue. Under decoupling, WPS is allowed to defer the difference between its actual margin and the rate case authorized margin recognized from residential and small commercial and industrial customers. This four-year pilot program for electric decoupling has an annual \$14.0 million cap for the deferral of any excess or shortfall from the rate case authorized margin. This cap was reached during the second quarter of 2009; therefore, no additional decoupling deferral was allowed for additional shortfalls from authorized margin for the second half of the year.
- An approximate \$22 million year-over-year reduction in revenue related to refunds due to customers in both 2009 and 2008 related to WPS's over-collection of fuel costs. On April 23, 2009, the PSCW made 2009 fuel cost recovery subject to refund, effective April 25, 2009, as actual and projected fuel costs for the remainder of the year were estimated to be below the 2% fuel window. See Note 24, "Regulatory Environment," for more information on WPS's fuel window.
- An approximate \$14 million year-over-year decrease in opportunity sales driven by lower demand and the availability of lower cost power from the MISO market.
- These decreases in regulated electric utility segment revenue were partially offset by:
  - An approximate \$19 million increase driven by higher wholesale volumes due to an increase in contracted sales volumes to a large wholesale customer and an increase in the wholesale demand rate, effective January 1, 2009, to recover costs related to Weston 4.
  - An approximate \$15 million increase in revenue from the combined effect of the July 4, 2008 fuel surcharge, a portion of which was incorporated into WPS's 2009 non-fuel base retail electric rates, and the full year's benefit of the 2008 retail electric rate increase, effective January 16, 2008, for WPS.

## Margins

The regulated electric utility segment margin increased \$39.7 million, driven by:

- An approximate \$20 million year-over-year increase in margin from wholesale customers related to increases in contracted sales volumes with an existing customer and an increase in the wholesale demand rate, effective January 1, 2009, to recover costs related to Weston 4.
- An approximate \$14 million year-over-year increase in margin from the combined effect of the July 4, 2008 fuel surcharge, a portion of which was incorporated into WPS's 2009 non-fuel base retail electric rates, and the full year's benefit of the 2008 retail electric rate increase, effective January 16, 2008, for WPS.
- An approximate \$11 million year-over-year increase in WPS's regulated electric utility margin due to fuel and purchased power costs that were approximately \$12 million lower than what was recovered in rates during 2009, compared with fuel and purchased power

costs that were approximately \$1 million lower than what was recovered in rates during 2008.

- The increase in margin was partially offset by an approximate \$4 million year-over-year decrease in margin, after the impact of the WPS decoupling mechanism, caused by a 4.3% year-over-year decrease in sales volumes to residential and commercial and industrial customers. The \$14.0 million impact of decoupling partially offset the approximate \$18 million decrease in margin due to lower sales volumes, which was attributed to the general economic slowdown and cooler year-over-year weather during the cooling season.

-40-

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## Operating Income

Operating income at the regulated electric utility segment increased \$6.1 million, driven by the \$39.7 million increase in margin, partially offset by a \$33.6 million increase in operating expenses.

The increase in operating expenses was driven by:

- \$8.6 million in restructuring expenses related to a reduction in workforce. See Note 3, "Restructuring Expense," for more information.
- An \$8.2 million increase in electric maintenance expenses at WPS, primarily related to a greater number of planned outages at the generation plants during 2009, compared with 2008.
- An \$8.1 million increase in employee benefit costs, primarily related to an increase in pension expense driven partially by negative pension investment returns in 2008, as well as higher health care related expenses in 2009.
- A \$5.6 million increase in depreciation and amortization expense at WPS, primarily related to Weston 4 being placed in service for accounting purposes in April 2008.

## Other Expense

Other expense at the regulated electric utilities increased \$6.1 million, driven by:

- A \$4.9 million increase in interest expense, primarily related to increased long-term borrowings at WPS in December 2008. The additional borrowings were utilized to fund various construction projects, most notably the Crane Creek wind generation project in Iowa.
- A \$2.5 million decrease in interest earned on the transmission facilities WPS funded on ATC's behalf. WPS was reimbursed by ATC for these transmission facilities in April 2008.

## 2008 Compared with 2007

### Revenues

Regulated electric utility segment revenue increased \$82.8 million, driven by:

- A 3.2% increase in electric sales volumes, which resulted in an approximate \$26 million increase in revenue year-over-year, related to:
  - An 18.4% increase in wholesale volumes year-over-year, which drove an approximate \$48 million increase in revenue. There was an approximate \$36 million increase in opportunity sales year-over-year as the electric utility had more low-cost generation with Weston 4 becoming commercially operational in 2008, combined with available capacity from lower sales volumes to residential customers. In addition, WPS

experienced an approximate \$12 million increase in wholesale revenue, driven by higher contracted sales volumes to a large wholesale customer year-over-year.

- The increase in revenue related to wholesale volumes was partially offset by a 3.4% decrease in residential sales volumes and a 1.3% decrease in commercial and industrial sales volumes year-over-year, which drove an approximate \$22 million decrease in revenue. Of this decrease in revenue, approximately \$13 million related to energy conservation efforts on the part of residential customers, which is believed to be the result of high energy prices and the general economic slowdown. Approximately \$6 million related to decreased demand by commercial and industrial customers in the third and fourth quarters of 2008 as the economy weakened. In addition, cooler weather during the 2008 cooling season compared with 2007 contributed approximately \$3 million to the decrease in revenue.
- An interim fuel surcharge approved by the PSCW for WPS's retail electric customers effective March 22, 2008, related to higher fuel and purchased power costs. In addition, a surcharge increase was approved by the PSCW effective July 4, 2008. Both orders combined had an overall impact on revenue of approximately \$25 million. Contributing factors in this rate change were increased purchased power costs due to lower-than-expected generation from the new Weston 4 power plant during the start-up phases, increased coal and coal transportation costs, and increased natural gas costs. On September 30, 2008, the PSCW reopened the 2008 fuel surcharge to review forecasted fuel costs as WPS's current and anticipated annual fuel costs were below those projected in the fuel surcharge. As a result of these lower costs, WPS accrued at December 31, 2008, a refund payable in 2009 to its electric customers of approximately \$5 million, which is excluded from the \$25 million noted above. See Note 24, "Regulatory Environment," for more information on WPS's interim fuel surcharges.
- A retail electric rate increase, effective January 16, 2008, which contributed an approximate \$23 million increase in revenue. The full benefit of the 2007 retail electric rate increase, effective January 12, 2007, also contributed to the increase in revenue year-over-year. Per the PSCW's order approving the PEC merger, WPS was not permitted to increase its base rates for natural gas or electric service prior to January 1, 2009. However, WPS was allowed to adjust rates for changes in purchased power costs as well as fuel costs related to electric generation due to changes in NYMEX natural gas futures prices, delivered coal prices, and transmission costs. The increase also included recovery of deferred 2005 and 2006 MISO Day 2 costs over a one-year period. See Note 24, "Regulatory Environment," for more information on WPS's rate increase.
- An approximate \$5 million increase in revenue at UPPCO related to increased energy and transmission costs in 2008 compared with 2007. Increases in fuel and purchased power costs at UPPCO are passed directly through to customers in rates.

## Margins

The regulated electric utility segment margin increased \$67.8 million, driven by an increase in electric margin at WPS. The \$68.4 million increase in the electric margin at WPS was a result of:

- A \$54.0 million partial refund to Wisconsin retail customers in 2007 for their portion of proceeds from the liquidation of the Kewaunee nonqualified decommissioning trust fund. Pursuant to regulatory accounting, the decrease in the 2007 margin related to the refund was offset by a corresponding decrease in operating and maintenance expense in 2007 and, therefore, did not have an impact on earnings. WPS completed this refund in 2007.

An approximate \$10 million increase in margin from the 2008 retail electric rate increase effective January 16, 2008, and the full benefit of the 2007 retail electric rate increase effective January 12, 2007.

An approximate \$10 million increase in margin driven by higher contracted sales volumes to a large wholesale customer year-over-year.

An approximate \$5 million increase in regulated electric utility margin year-over-year driven by fuel and purchased power costs that were approximately \$1 million lower than what was recovered in rates during 2008, compared with fuel and purchased power costs that were approximately \$4 million higher than what was recovered in rates during 2007. As a result of approximately \$23 million of under-recovered fuel and purchased power costs in the first quarter of 2008, the PSCW approved an interim rate surcharge effective March 22, 2008, and subsequently approved a higher final surcharge effective July 4, 2008. The \$5 million increase in electric margin includes lower fuel costs from the fuel window reset and the net impact of the refund accrued at December 31, 2008, payable in 2009 to electric customers from the reopening of the 2008 fuel surcharge on September 30, 2008, by the PSCW.

These increases in the electric margin were partially offset by an approximate \$11 million decrease in margin due to a decline in residential and commercial and industrial sales volumes. Of this decrease, approximately \$8 million related to energy conservation efforts on the part of residential customers, which is believed to be the result of high energy prices and the general economic slowdown. Approximately \$1 million related to decreased demand by commercial and industrial customers in the third and fourth quarters of 2008 as the economy worsened. In addition, cooler weather during the 2008 cooling season compared with 2007 contributed approximately \$2 million to the decrease in gross margin.

#### Operating Income

Operating income at the regulated electric utility segment increased \$8.3 million, driven by the \$67.8 million increase in the electric utility margin, partially offset by a \$59.5 million increase in operating expenses.

The increase in operating expenses was driven by:

A \$54.0 million year-over-year increase related to the partial amortization in 2007 of the regulatory liability previously recorded for WPS's obligation to refund proceeds received from the liquidation of the Kewaunee nonqualified decommissioning trust fund to Wisconsin retail electric ratepayers.

A \$13.8 million increase in electric transmission expenses, primarily related to higher rates charged by MISO and ATC due to additional transmission costs.

A \$6.1 million increase in cost of capital and depreciation expense charged by IBS for assets transferred from WPS to IBS in the beginning of 2008 and reported as operating and maintenance expense in 2008. Similar costs were reported as depreciation and amortization expense in 2007, prior to the start-up of IBS.

A \$4.2 million increase in depreciation and amortization expense, primarily related to \$9.2 million of depreciation expense from Weston 4 being placed in service for accounting purposes in April 2008, partially offset by a decrease in depreciation related to assets transferred to IBS and reported in operating and maintenance expense in 2008.



These increases in operating expenses were partially offset by:

An \$11.6 million decrease in electric maintenance expenses at WPS, primarily due to major planned outages at the Weston 2 and Weston 3 generation stations, the De Pere Energy Center, and the Pulliam generation station, as well as several unplanned outages at the Weston 3 generation station in 2007, compared with fewer outages in 2008.

A decrease in external costs to achieve merger synergies of \$6.6 million related to the merger with PEC, from \$12.3 million in 2007, to \$5.7 million in 2008. This decrease occurred primarily because all external costs to achieve merger synergies incurred from July 2006 through March 2007 were reallocated in 2007 from the holding company segment to the other reportable segments, including the regulated electric segment. These reportable segments are the beneficiaries of the synergy savings resulting from the costs to achieve merger synergies. In addition, the reduction in 2008 external costs to achieve merger synergies was due to less integration work required in 2008 compared with 2007.

#### Other Expense

Other expense at the regulated electric utilities increased \$6.6 million, driven by a \$4.3 million increase in interest expense and a \$2.3 million decrease in miscellaneous income.

The increase in interest expense was due to higher long-term borrowings at WPS, primarily utilized to fund various construction projects and to retire short-term borrowing levels related to construction.

The decrease in miscellaneous income was driven by:

- A \$1.4 million decrease in interest income recognized related to the construction of transmission facilities WPS funded on ATC's behalf related to Weston 4. WPS was reimbursed for these transmission facilities by ATC in April 2008.

- A \$1.8 million gain on the sale of a generation facility by UPPCO in July 2007.

- The decrease in miscellaneous income was partially offset by an increase in AFUDC related to the wind generation project.

#### IntegrYS Energy Services' Operations

IntegrYS Energy Services is a diversified nonregulated energy supply and services company serving residential, commercial, and industrial customers. See "Introduction," for a discussion of the revised strategy for IntegrYS Energy Services.

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Year Ended December 31

(Millions, except natural gas sales volumes)	2009	2008	2007	Change in 2009 Over 2008	Change in 2008 Over 2007
Revenues	\$ 3,994.0	\$ 9,735.2	\$ 6,979.7	(59.0)%	39.5%
Cost of fuel, natural gas, and purchased power	3,696.1	9,649.5	6,675.6	(61.7)%	44.5%
Margins	297.9	85.7	304.1	247.6%	(71.8)%
Margin Detail					
Electric and other margins	190.1	(15.7)	164.9	N/A	N/A
Natural gas margins	107.8	101.4	139.2	6.3%	(27.2)%
Operating and maintenance expense	190.8	181.7	159.4	5.0%	14.0%
Restructuring expense	27.2	-	-	N/A	N/A
Loss on Integrys Energy Services dispositions related to strategy change	28.9	-	-	N/A	N/A
Depreciation and amortization	19.3	14.5	14.4	33.1%	0.7%
Taxes other than income taxes	7.4	7.8	7.1	(5.1)%	9.9%
Operating income (loss)	24.3	(118.3)	123.2	N/A	N/A
Miscellaneous income (expense)	6.0	8.7	(0.3)	(31.0)%	N/A
Interest expense	(13.1)	(12.1)	(13.5)	8.3%	(10.4)%
Other expense	(7.1)	(3.4)	(13.8)	108.8%	(75.4)%
Income (loss) before taxes	\$ 17.2	\$ (121.7)	\$ 109.4	N/A	N/A
Gross volumes (includes volumes both physically delivered and net settled)					
Wholesale electric sales volumes in kwh	222,178.5	184,446.3	132,623.6	20.5%	39.1%
Retail electric sales volumes in kwh	15,264.3	16,680.9	14,849.7	(8.5)%	12.3%
Wholesale natural gas sales volumes in bcf	424.0	642.8	483.1	(34.0)%	33.1%
Retail natural gas sales volumes in bcf	239.3	339.2	368.8	(29.5)%	(8.0)%
Physical volumes (includes only transactions settled physically for the periods shown)					
Wholesale electric sales volumes in kwh *	3,965.2	4,634.1	3,599.7	(14.4)%	28.7%
Retail electric sales volumes in kwh *	15,045.3	16,561.3	14,584.4	(9.2)%	13.6%
Wholesale natural gas sales volumes in bcf *	402.5	594.9	445.6	(32.3)%	33.5%
Retail natural gas sales volumes in bcf *	236.7	336.0	319.4	(29.6)%	5.2%

\* Represents gross physical volumes.

kwh – kilowatt-hours

bcf – billion cubic feet

2009 Compared with 2008



## Revenues

- Revenues decreased \$5,741.2 million in 2009, compared with 2008, primarily due to:
  - Lower energy prices, as the average market price of natural gas and electricity decreased approximately 45% and 40% year-over-year, respectively.
  - Lower sales volumes, as wholesale transactions were scaled back in conjunction with the global credit crisis in the latter half of 2008, and continue to be scaled back with Integrys Energy Services' strategy change and ultimate decision to exit its wholesale natural gas and electric businesses. See "Introduction" above and Note 4, "Dispositions," for a discussion of the current strategy for Integrys Energy Services.

## Margins

Changes in commodity prices subject a portion of the nonregulated operations to earnings volatility, driven primarily by its wholesale trading and marketing operations. Integrys Energy Services uses financial instruments to economically hedge risks associated with physical transactions. The financial instruments essentially lock in margin on these transactions by mitigating the impact of fluctuations in

market conditions, changing commodity prices, volumetric exposure, and other associated risks. Because many of the derivative instruments utilized in these transactions may not qualify, or are not designated, as hedges under GAAP, reported earnings for the Integrys Energy Services segment includes changes in the fair values of many of the derivative instruments. These values may change significantly from period to period and are reflected as unrealized gains or losses within margin. Fluctuations in the fair value of the nonderivative instruments (such as certain customer contracts, as well as natural gas storage and transportation contracts) do not impact margin until settlement, as these transactions do not meet the GAAP definition of derivative instruments.

Integrys Energy Services' margins increased \$212.2 million in 2009, compared with 2008. The significant items contributing to the change in margin were as follows:

#### Electric and Other Margins

Integrys Energy Services' electric and other margins increased \$205.8 million during 2009, compared with 2008. The following items were the most significant contributors to the change in Integrys Energy Services' electric and other margins.

#### Realized wholesale electric margin

Realized wholesale electric margin increased \$18.8 million, from \$59.4 million during 2008, to \$78.2 million during 2009.

Wholesale transactions and structured origination activity were scaled back in conjunction with the global credit crisis in the latter half of 2008 and continue to be scaled back with Integrys Energy Services' strategy change and ultimate decision to exit its wholesale electric business. See "Introduction" above and Note 4, "Dispositions," for a discussion of the current strategy for Integrys Energy Services.

In general, realized margins are impacted by transaction activity in prior periods, as Integrys Energy Services recognizes realized margin when the contracts actually settle, which typically occurs over a 12- to 24-month period from the time the contract was actually entered into. In 2009, realized margins benefited from the settlement of contracts that were entered into prior to the implementation of Integrys Energy Services' strategy change.

#### Realized retail electric margin

The realized retail electric margin increased \$19.7 million, from \$62.3 million in 2008, to \$82.0 million in 2009. The increase was driven by:

A \$14.1 million increase in the more mature markets, such as Illinois and New York, as Integrys Energy Services realized the benefits of including higher capital costs in its pricing in the first half of the year.

A \$6.5 million increase from operations in the Texas market. This increase is a result of the positive year-over-year impact of lower ancillary service costs compared to the prior year and the effects of Hurricane Ike in the third quarter of 2008. Hurricane Ike disrupted the electric infrastructure in Texas for a period of time, causing some of Integrys Energy Services' customers to be without electricity or buy only a fraction of their normal energy usage during that period.

#### Retail and wholesale electric fair value adjustments

Integrys Energy Services' margin from retail and wholesale electric fair value adjustments increased \$167.3 million, as it recognized \$137.4 million of non-cash unrealized losses related to derivative instruments in 2008, compared with \$29.9 million of non-cash unrealized gains during 2009.

-46-

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The non-cash unrealized gains and losses resulted from the application of GAAP derivative accounting rules to Integrys Energy Services' portfolio of electric customer supply contracts, requiring that these derivative instruments be adjusted to fair market value. The fair value adjustments recorded in 2009 include margin reductions of \$2.0 million related to the settlement of derivative contracts entered into with the purchaser of the Canadian electric power portfolio, as discussed in Note 4, "Dispositions".

#### Natural Gas Margins

Integrys Energy Services' natural gas margins increased \$6.4 million in 2009, compared with 2008. The following items were the most significant contributors to the change in Integrys Energy Services' natural gas margins.

#### Lower-of-cost-or-market inventory adjustments

The combined effect of lower-of-cost-or-market inventory write-downs and withdrawals from storage of natural gas for which write-downs had previously been recorded resulted in a \$322.7 million year-over-year increase in the natural gas margin. The average market price of natural gas decreased approximately 5% during 2009 and decreased approximately 22% during 2008, driving a positive year-over-year change in natural gas margins of \$129.2 million related to lower-of-cost-or-market inventory write-downs. These lower-of-cost-or-market inventory write-downs were required to reflect natural gas in storage at the end of the period at its net realizable value, as required by GAAP. The natural gas withdrawn from storage and sold to customers in 2009 had a \$193.5 million lower cost basis as a result of lower-of-cost-or-market inventory write-downs recorded in prior periods. At December 31, 2009, natural gas inventory had a lower cost basis as a result of lower-of-cost-or-market inventory write-downs recorded in prior periods of \$11.6 million.

#### Other realized retail natural gas margins

Other realized retail natural gas margins increased \$17.2 million, from \$51.5 million in 2008, to \$68.7 million in 2009. The increase was due to Integrys Energy Services' withdrawal of a significant amount of natural gas during 2009 in order to improve its liquidity position, recognizing realized gains on these natural gas storage withdrawals. Also, per-unit retail natural gas margins were higher period-over-period as more recently contracted sales commitments reflect increased business risk and financing costs in the pricing. Offsetting the increase was a decrease in Integrys Energy Services' natural gas sales volumes year-over-year. Integrys Energy Services significantly reduced the number of natural gas storage transactions entered into as Integrys Energy Group implemented its strategy change for its nonregulated energy services business segment.

#### Other realized wholesale natural gas margins

Other realized wholesale natural gas margins decreased \$23.3 million, from \$64.1 million in 2008, to \$40.8 million in 2009. In conjunction with the global credit crisis in the latter half of 2008, wholesale natural gas transactions were scaled back and continue to be scaled back with Integrys Energy Services' strategy change and ultimate decision to exit its wholesale natural gas business. The reduced activity had a negative impact on realized margins in 2009. See "Introduction" above, and Note 4, "Dispositions," for a discussion of the current strategy for Integrys Energy Services.

#### Fair value adjustments

Fair value adjustments required under derivative accounting rules primarily related to changes in the fair market value of contracts utilized to mitigate market price risk associated with certain natural gas storage contracts, as well as basis swaps utilized to mitigate market price risk associated with natural gas transportation contracts and certain natural gas sales contracts.

The fair value adjustments (excluding lower-of-cost-or-market inventory adjustments) drove a \$310.2 million decrease in natural gas margins as unrealized losses on these instruments were

-47-

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\$157.1 million during 2009, compared with unrealized gains of \$153.1 million during 2008. The fair value adjustments recorded in 2009 include a net increase in margin of \$14.4 million related to the settlement of derivative contracts entered into with the purchasers of the wholesale natural gas marketing business and the Canadian natural gas portfolio, as discussed in Note 4, "Dispositions".

#### Operating Income (Loss)

Integrys Energy Services' operating income increased \$142.6 million year-over-year. This increase resulted from the \$212.2 million increase in margin discussed above, partially offset by losses of \$28.9 million related to dispositions completed in connection with the strategy change; \$27.2 million of restructuring expenses, which included employee-related costs, the write-off of capitalized development costs related to software that will not be utilized because of the restructuring, and consulting and legal fees; a \$9.1 million increase in operating and maintenance expense; and a \$4.8 million increase in depreciation and amortization expense primarily related to renewable energy asset additions.

The increase in operating and maintenance expense was driven by a one-time \$9.0 million novation fee related to an agreement with a counterparty that enabled Integrys Energy Services to consolidate certain wholesale financial and physical contracts that were previously entered into with multiple counterparties, allowing Integrys Energy Services to reduce collateral support requirements.

See Note 3, "Restructuring Expense," for a discussion of restructuring charges.

#### 2008 Compared with 2007

##### Revenues

Revenues increased \$2,755.5 million in 2008 compared with 2007, primarily due to increased volumes (in part due to the PEC merger in 2007) and higher average sales prices in 2008. Average sales prices rose in 2008 due to large market price increases from January 1, 2008 through June 30, 2008. Market prices began to decline beginning in the third quarter of 2008 and continued to decline through the end of the year to levels below that of January 1, 2008. Integrys Energy Services recognizes revenue at the time energy is delivered. As a result, revenues at the end of the year were recognized based on the higher market prices from contracts entered into earlier in the year.

##### Margins

Integrys Energy Services' margin decreased \$218.4 million from 2007 to 2008. The significant items contributing to the change in margin were as follows:

##### Electric and Other Margins

Integrys Energy Services' electric and other margins decreased \$180.6 million from 2007 to 2008. The 2008 and 2007 electric and other margin included the negative impact of \$8.8 million and \$15.2 million, respectively, of amortization related to purchase accounting adjustments required as a result of the PEC merger. 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 transactions increased \$6.2 million, from \$18.1 million in 2007 to \$24.3 million in 2008. Origination transactions are physical, customer-based agreements with municipalities, merchant generators, cooperatives, and regulated utilities. The increase was primarily due to growth in existing

markets with an emphasis on structured transactions with small environmentally friendly generators.

-48-

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#### All other realized wholesale electric margin

All other realized wholesale electric margin decreased \$19.4 million from 2007 to 2008. In general, realized margins are impacted by trading activity in prior periods. Integrys Energy Services recognizes realized margins when the contracts actually settle, which can lag as much as 12 to 24 months from the time the contract was actually entered into. The reduced volume of proprietary trading that began in 2007 reduced realized margins in 2008.

#### Realized retail electric margin

The realized retail electric margin increased \$28.1 million from \$34.2 million in 2007 to \$62.3 million in 2008. The change was primarily due to the following:

An increase of \$19.5 million from operations in Illinois due to the addition of new customers as a result of the PEC merger, as well as a reduced impact from purchase accounting in 2008.

A \$12.7 million increase due to expansion in the Mid-Atlantic region and the resolution of certain regulatory issues in Northern Maine.

Partially offsetting these increases was a \$3.4 million decrease from operations in Texas. This reduction was a result of higher ancillary costs in Texas and the effects of Hurricane Ike, which disrupted the electric infrastructure in Texas for a period of time, causing some of Integrys Energy Services' customers to be without electricity or take only a fraction of their normal load during that period.

#### Retail and wholesale fair value adjustments

From 2007 to 2008, Integrys Energy Services' margin from electric retail and wholesale fair value adjustments decreased \$176.8 million, as it recognized \$137.4 million of non-cash unrealized losses related to derivative instruments in 2008, compared with \$39.4 million of non-cash unrealized gains during 2007.

Although energy prices rose approximately 20% in the first half of 2008, they declined approximately 45% in the second half of the year, which led to the recognition of large non-cash unrealized losses in 2008 on these electric customer supply contracts. These unrealized losses turn around in future years as the contracts settle. The mark-to-market activity also reflects increases in portfolio reserves in recognition of the increased risk of credit losses and reduced market liquidity. Finally, the mark-to-market activity was also negatively impacted as the short-term cost of borrowing increased. The discount rate is a component of the fair value of Integrys Energy Services' derivative portfolio and, therefore, increased interest rates resulted in a reduction in the fair value presented on the balance sheet. In 2007, energy prices increased, resulting in unrealized gains.

#### Oil option activity

Oil option activity drove a \$19.6 million decrease in electric and other margins from 2007 to 2008. There was no activity related to these oil options in 2008. Prior to 2008, oil options were utilized to protect the value of a portion of Integrys Energy Services' Section 29/45K federal tax credits. However, companies can no longer generate tax credits from the production of synthetic fuel as the provisions of Section 29/45K of the Internal Revenue Code expired effective December 31, 2007. As a result, Integrys Energy Services exercised substantially all of its remaining oil options in 2007.

#### 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

-49-

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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 replacement contract increased the cost of purchased power needed to serve customers in Maine by \$0.9 million in 2007. There was no impact on electric margin in 2008, resulting in a \$0.9 million increase in realized wholesale electric margins from 2007 to 2008.

#### Natural Gas Margins

Integrys Energy Services' natural gas margins decreased \$37.8 million from 2007 to 2008. The 2008 and 2007 natural gas margins included the negative impact of \$5.0 million and \$6.1 million, respectively, of amortization related to purchase accounting adjustments required as a result of the PEC merger. The following items were the most significant contributors to the change in Integrys Energy Services' natural gas margins.

#### Lower-of-cost-or-market inventory adjustments

The spot price of natural gas decreased significantly during the second half of 2008 (below the average cost of natural gas in inventory which Integrys Energy Services had acquired and injected earlier in 2008), which resulted in a lower of cost or market inventory write-down, as required by GAAP. This write-down resulted in a \$160.3 million decrease in non-cash realized natural gas margins from 2007 to 2008. The negative impact on realized margin related to these inventory write-downs was offset by unrealized gains recognized in 2008 and 2007 on derivative instruments utilized to mitigate the price risk on natural gas inventory underlying natural gas storage transactions (See "Fair value adjustments" below).

#### Other realized natural gas margins

Other realized natural gas margins increased \$8.0 million, from \$107.6 million in 2007, to \$115.6 million in 2008, primarily related to realized gains on wholesale natural gas storage transactions. In 2008, Integrys Energy Services increased its storage withdrawals which drove the year-over-year increase in other realized natural gas margins. In addition, Integrys Energy Services placed greater emphasis on structured wholesale natural gas transactions in 2008 in existing markets, which also contributed to the increase. These structured transactions involve serving customers such as regulated utilities, pipelines, retail marketers, and other large end users of natural gas.

#### 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, 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 positive \$5.5 million impact on natural gas margins from 2007 to 2008. There was no material impact on margin as a result of the natural gas storage cycle in 2007 compared with a \$5.5 million positive impact in 2008. At December 31, 2008, the market value of natural gas in storage was not significantly different than the market value of future sales contracts related to the 2008/2009 natural gas storage cycle.



## Fair value adjustments

In 2008, fair value adjustments drove a \$109.0 million increase in the natural gas margins as unrealized gains on these instruments were \$147.6 million in 2008, compared with unrealized gains of \$38.6 million in 2007.

## Operating Income (Loss)

Operating income at Integrys Energy Services decreased \$241.5 million year-over-year. This decrease resulted primarily from the \$218.4 million decrease in margin discussed above. In addition, operating and maintenance expense increased \$22.3 million, driven largely by a \$9.1 million increase in bad debt expense, \$7.3 million of which resulted from the bankruptcy of Lehman Brothers in the third quarter of 2008; a \$5.1 million increase in broker commissions as a result of higher transaction volumes; and higher employee benefit costs.

## Other Expense

Other expense at Integrys Energy Services decreased \$10.4 million year-over-year. This decrease resulted primarily from an increase in miscellaneous income of \$9.0 million, driven by a \$13.8 million decrease in pre-tax net losses related to Integrys Energy Services' former investment in a synthetic fuel facility. This increase in miscellaneous income was partially offset by a decrease of \$1.5 million in foreign currency gains related to Integrys Energy Services' Canadian subsidiaries and a \$3.7 million decrease in interest and dividend income on margin deposits.

## Electric Transmission Investment Segment Operations

## 2009 Compared with 2008

## Other Income

Other income at the electric transmission investment segment increased \$9.2 million during 2009 compared with 2008, due to an increase in income from Integrys Energy Group's approximate 34% ownership interest in ATC. The increase in income was driven by ATC's continuing capital expenditure program, resulting in an increase in its rate base.

## 2008 Compared with 2007

## Other Income

Other income at the electric transmission investment segment increased \$15.6 million during 2008 compared with 2007, due to an increase in income from Integrys Energy Group's ownership interest in ATC. The increase in income was driven by ATC's continuing capital expenditure program, resulting in an increase in its rate base.

## Holding Company and Other Segment Operations

(Millions)	Year Ended December 31			Change in 2009 Over 2008	Change in 2008 Over 2007
	2009	2008	2007		
Operating loss	\$ (1.9)	\$ (0.7)	\$ (11.8)	171.4%	(94.1)%
Other expense	(58.1)	(53.2)	(62.8)	9.2%	(15.3)%
Loss before taxes	\$ (60.0)	\$ (53.9)	\$ (74.6)	11.3%	(27.7)%



2009 Compared with 2008

Operating Loss

Operating loss at the holding company and other segment increased \$1.2 million during 2009 compared with 2008, driven by restructuring expenses related to Integrys Energy Group's reduction in workforce, and by a decrease in operating income from MERC's nonutility home services business.

Other Expense

Other expense at the holding company and other segment increased \$4.9 million during 2009 compared with 2008, driven by a \$4.3 million increase in interest expense at the holding company primarily due to an increase in long-term borrowings in the second quarter of 2009 and an increase in the amortization of deferred financing fees related to credit facilities entered into in the second quarter of 2009 and the fourth quarter of 2008, partially offset by a decrease in interest expense on commercial paper.

2008 Compared with 2007

Operating Loss

Operating loss at the holding company and other segment improved \$11.1 million during 2008 compared with 2007. The decrease in the operating loss was driven by:

- Reductions in operating expenses related to consulting fees, compensation and benefits, and contractor costs at the holding company.
- Operating income of \$1.9 million generated at IBS, which related to return on capital included in its service charges beginning in 2008.
- Partially offsetting the decrease in operating loss, was a \$6.5 million increase in the year-over-year operating loss related to external costs to achieve merger synergies associated with the PEC merger. This increase occurred primarily because in March 2007 all external costs to achieve merger synergies incurred from July 2006 through March 2007 were allocated from the Holding Company and Other segment (where they were initially recorded) to the other reportable segments, which are the beneficiaries of the synergy savings resulting from these costs. This resulted in lower operating expenses at the Holding Company and Other segment during 2007.

Other Income (Expense)

Other income increased \$9.6 million, driven by a \$10.5 million decrease in external interest expense due to lower interest rates and lower average short-term borrowings used for working capital requirements at Integrys Energy Group. A portion of the proceeds received from the sale of PEP in September 2007 was used to pay down the short-term debt.

Provision for Income Taxes

	Year Ended December 31		
	2009	2008	2007
Effective Tax Rate	717.2%	29.1%	32.2%



#### 2009 Compared with 2008

The increase in the effective tax rate for 2009 was primarily related to the tax treatment of Integrys Energy Group's \$291.1 million non-cash pre-tax goodwill impairment loss. Although Integrys Energy Group had \$11.6 million of income before taxes for 2009, it recorded an \$83.2 million provision for income taxes because \$186.2 million of the total pre-tax goodwill impairment loss was not deductible for income tax purposes.

#### 2008 Compared with 2007

The decrease in the effective tax rate for 2008 was primarily driven by the impact of large permanent tax deductions pertaining to items that exceeded the related book expense being applied to the lower income before taxes in 2008, compared with 2007. In addition, in 2008 Integrys Energy Group recognized \$10.0 million of investment tax credits related to solar projects completed in the fourth quarter of 2008. These were offset by the reduction in Section 29/45K tax credits in 2008 due to the December 31, 2007, expiration of Section 29/45K of the Internal Revenue Code that made tax credits available from the production and sale of synthetic fuel. In 2007, Integrys Energy Group's ownership in the synthetic fuel operation resulted in recognizing the tax benefit of Section 29/45K federal tax credits of \$13.6 million compared with \$0.8 million of Section 29/45K tax credits recognized in 2008.

#### Discontinued Operations, Net of Tax

##### 2009 Compared with 2008

Income from discontinued operations, net of tax, decreased \$1.9 million in 2009 compared with 2008.

During 2009, Integrys Energy Services completed the sale of its energy management consulting business. The historical financial results of this business were not significant. The gain on the sale of this business recorded in discontinued operations during the third quarter of 2009 was \$3.9 million (\$2.4 million after-tax).

During 2008, Integrys Energy Services recognized a \$6.3 million (\$3.8 million after-tax) gain on the sale of its subsidiary, Mid-American Power, LLC, in discontinued operations when a previously contingent payment was paid by the buyer.

For more information on the discontinued operations discussed above, see Note 4, "Dispositions," and Note 25, "Segments of Business."

##### 2008 Compared with 2007

Income from discontinued operations, net of tax, decreased \$68.6 million in 2008, compared with 2007.

During 2008, Integrys Energy Services sold its subsidiary Mid-American Power, LLC, which owned the Stoneman generation facility, located in Wisconsin. The historical financial results of this business were not significant. In the fourth quarter of 2008, Integrys Energy Services recognized a \$6.3 million (\$3.8 million after-tax) gain on the sale of this business in discontinued operations when a previously contingent payment was earned and paid by the buyer. This contingent payment resulted from legislation that passed in the fourth quarter of 2008, which extended the production tax credits available for certain biomass facilities.

During 2007, Integrys Energy Group recognized \$58.5 million of income from discontinued operations related to the sale of PEP, which included an after-tax gain of \$7.6 million on the sale. In 2008, discontinued operations reflect the \$0.8 million positive impact of tax adjustments related to the 2007 PEP sale.



During 2007, WPS Niagara Generation, LLC recognized after-tax income of \$14.8 million from discontinued operations, primarily related to the \$14.7 million after-tax gain on the sale of this business.

-53-

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## BALANCE SHEET

Cash and cash equivalents decreased \$209.6 million, from \$254.1 million at December 31, 2008, to \$44.5 million at December 31, 2009. For a detailed explanation of the change in the cash and cash equivalents balance, see "Liquidity and Capital Resources."

Net accounts receivable and accrued unbilled revenues decreased \$934.6 million (49.4%) from \$1,892.6 million at December 31, 2008, to \$958.0 million at December 31, 2009. The decrease was driven by a reduction in Integrys Energy Services' wholesale transactions and natural gas storage transactions as a result of the change in strategy for this business segment. Also contributing to the decrease were lower revenues due to lower natural gas prices and warmer weather during the fourth quarter of 2009, compared with the same period in 2008.

Inventories decreased \$428.5 million (58.5%), from \$732.8 million at December 31, 2008, to \$304.3 million at December 31, 2009. The inventory balance at Integrys Energy Services decreased \$326.2 million (79.4%), primarily due to lower natural gas prices year-over-year and the sale of its wholesale natural gas marketing and trading business in December 2009. See Note 4, "Dispositions," for more information.

Goodwill decreased \$291.4 million (31.2%), from \$933.9 million at December 31, 2008, to \$642.5 million at December 31, 2009, driven by the impairment loss recorded in the first quarter of 2009 within the natural gas utility segment. Key factors contributing to the impairment charge included disruptions in the global credit and equity markets and the resulting increase in the weighted-average cost of capital used to value the natural gas utility operations, as well as the negative impact that the global decline in equity markets had on the valuation of natural gas distribution companies in general.

Detailed explanations for changes in the short-term and long-term debt balances year-over-year are included in Note 12, "Short-Term Debt and Lines of Credit," and Note 13, "Long-Term Debt."

Accounts payable decreased \$894.9 million (58.3%), from \$1,534.3 million at December 31, 2008, to \$639.4 million at December 31, 2009. Accounts payable at Integrys Energy Services decreased \$813.0 million, primarily due to lower natural gas prices and the reduction in natural gas payables and natural gas loans associated with its wholesale natural gas marketing and trading business. See Note 4, "Dispositions," for more information.

## LIQUIDITY AND CAPITAL RESOURCES

Integrys Energy Group believes that its cash balances, liquid assets, operating cash flows, access to equity and debt capital markets, and available borrowing capacity provide adequate resources to fund ongoing operating requirements and future capital expenditures related to expansion of existing businesses and development of new projects. Integrys Energy Group's borrowing costs can be impacted by short-term and long-term debt ratings assigned by independent credit rating agencies. Integrys Energy Group's operating cash flows and access to capital markets can be impacted by macroeconomic factors outside of its control.

The previously announced strategy change at Integrys Energy Services and other operating activities resulted in the generation of a significant amount of positive cash flow from operations during 2009, which drove an approximate \$1 billion reduction in consolidated short-term debt outstanding during 2009.

## Operating Cash Flows

### 2009 Compared with 2008

Net cash provided by operating activities was \$1,606.3 million in 2009, compared with net cash used for operating activities of \$250.0 million in 2008. The \$1,856.3 million year-over-year increase in cash provided by operating activities was mainly driven by a \$1,734.8 million increase related to lower working capital requirements, partially due to a \$444.1 million decrease in inventories during 2009, compared with a \$312.0 million increase in inventories in 2008. This change was primarily a result of an increase in natural gas withdrawn from storage in 2009 due to the previously announced strategy change at Integrys Energy Services, as well as lower year-over-year natural gas prices. Also contributing to the decrease in working capital requirements was an \$864.8 million decrease in accounts receivables and accrued unbilled revenues in 2009, compared with a \$207.7 million increase in accounts receivables and accrued unbilled revenues in 2008, primarily the result of lower natural gas prices and the Integrys Energy Services strategy change. Additionally, during 2009, Integrys Energy Services had a \$45.5 million net return of margin posted to various exchanges, compared with the net payment of \$239.2 million of margin posted to various exchanges in 2008, primarily due to the strategy change. Partially offsetting these changes was a \$604.7 million decrease in accounts payable in 2009, compared with a \$53.2 million decrease in accounts payable in 2008, primarily the result of lower natural gas prices.

### 2008 Compared with 2007

Net cash used for operating activities was \$250.0 million in 2008, compared with net cash provided by operating activities of \$238.5 million in 2007. The \$488.5 million year-over-year increase in cash used for operating activities was driven by:

- A \$177.0 million decrease in cash provided by accounts receivable collections, as colder weather conditions led to higher natural gas throughput volumes in the fourth quarter 2008, compared with the same quarter in 2007, contributing to higher accounts receivable balances. Also contributing to the increase in cash used for operating activities, Integrys Energy Group and its subsidiaries, primarily Integrys Energy Services, had net cash collateral payments of \$239.2 million in 2008, compared with net cash collateral receipts of \$82.0 million in 2007. The net cash collateral payments made in 2008 were driven by large mark-to-market losses incurred by Integrys Energy Services during the latter part of 2008, due to declining prices.
- A \$139.1 million increase in cash used for natural gas inventory purchases due to an increase in the average price of natural gas during the summer of 2008 (when natural gas is generally injected into inventory), compared with the same period in 2007.
- Partially offset by an \$88.7 million increase in cash related to net refunds of regulatory assets and liabilities, driven by a decrease in the refund to ratepayers in 2008, compared with 2007, of proceeds WPS received from the liquidation of the nonqualified decommissioning trust fund upon the sale of Kewaunee.

## Investing Cash Flows

### 2009 Compared with 2008

Net cash used for investing activities was \$440.7 million in 2009, compared with \$452.2 million in 2008. The \$11.5 million year-over-year decrease in cash used for investing activities was primarily driven by the \$88.6 million

decrease in cash used to fund capital expenditures (discussed below) and the payment of \$17.4 million in 2008 related to WPS's funding of the construction of the transmission facilities required to support Weston 4, partially offset by the 2008 reimbursement of \$99.7 million from ATC related to WPS's construction of the transmission facilities required to support Weston 4.

-55-

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## 2008 Compared with 2007

Net cash used for investing activities was \$452.2 million in 2008, compared with \$451.5 million in 2007. The \$0.7 million year-over-year increase in cash used for investing activities was primarily driven by a \$140.2 million increase in cash used for capital expenditures (discussed below), partially offset by the reimbursement of \$99.7 million from ATC, related to the construction of the transmission facilities required to support Weston 4, and a \$15.5 million year-over-year increase in cash proceeds received from the sale of property, plant, and equipment.

## Capital Expenditures

Capital expenditures by business segment for the years ended December 31 were as follows:

Reportable Segment (millions)	2009	2008	2007
Electric utility	\$ 250.4	\$ 207.4	\$ 202.6
Natural gas utility	136.9	237.3	158.8
IntegrYS Energy Services	22.4	68.1	20.5
Holding company and other	34.5	20.0	10.7
IntegrYS Energy Group	\$ 444.2	\$ 532.8	\$ 392.6

The increase in capital expenditures at the electric utility segment in 2009 compared with 2008 was primarily due to wind generation projects, partially offset by the year-over-year decrease in capital expenditures associated with Weston 4. The decrease in capital expenditures at the natural gas utility segment in 2009 compared with 2008 was primarily due to a decrease in costs related to the construction of natural gas laterals that connected WPS's natural gas distribution system to the Guardian II natural gas pipeline, which was completed in February 2009. The decrease in capital expenditures at IntegrYS Energy Services in 2009 compared with 2008 was primarily driven by fewer expenditures related to renewable energy projects in 2009, compared with 2008.

The increase in capital expenditures at the natural gas utility segment in 2008 compared with 2007 was primarily due to an increase in capital expenditures at PGL and NSG due to the fact that they were not acquired until February 21, 2007, as well as construction of the natural gas lateral infrastructure that connects WPS's natural gas distribution system to the Guardian II natural gas pipeline. The increase in capital expenditures at IntegrYS Energy Services in 2008 compared with 2007 was primarily due to solar energy projects as well as the construction of a pipeline that will transport methane gas produced at a landfill for use at a chemical plant as a replacement for natural gas.

## Financing Cash Flows

## 2009 Compared with 2008

Net cash used for financing activities was \$1,378.4 million in 2009, compared with net cash provided by financing activities of \$911.3 million in 2008. The \$2,289.7 million year-over-year increase in cash used for financing activities was primarily driven by \$973.6 million of net repayments of short-term debt and notes payable in 2009, compared with \$725.4 million of net short-term and notes payable borrowings in 2008. The repayments in 2009 were made possible by the increase in net cash provided by operating activities. Also, as a result of the previously announced strategy change at IntegrYS Energy Services, fewer structured natural gas loan agreements were entered into in 2009, compared with 2008, resulting in a \$368.4 million year-over-year decrease in proceeds from the sale of borrowed natural gas. Additionally, IntegrYS Energy Services had a \$188.0 million year-over-year increase in the purchase of natural gas to repay structured natural gas loan agreements, many of which were entered into in 2008.

## 2008 Compared with 2007

Net cash provided by financing activities was \$911.3 million in 2008, compared with net cash used for financing activities of \$459.2 million in 2007. In 2007, Integrys Energy Group was able to pay down short-term debt with a portion of the proceeds received from the sale of PEP. In 2008, proceeds were required to fund higher year-over-year working capital requirements.

## Significant Financing Activities

Dividends paid increased in 2009 compared with 2008. In February 2009, Integrys Energy Group increased its quarterly common stock dividend to 68 cents per share. The quarterly common stock dividend was increased from 66 cents per share to 67 cents per share in 2008.

Integrys Energy Group had outstanding commercial paper borrowings of \$212.1 million and \$552.9 million at December 31, 2009, and 2008, respectively. Integrys Energy Group had short-term notes payable outstanding of \$10.0 million and \$181.1 million at December 31, 2009, and 2008, respectively. Integrys Energy Group had no borrowings under revolving credit facilities at December 31, 2009 and \$475.0 million as of December 31, 2008. See Note 12, "Short-Term Debt and Lines of Credit" for more information.

For information on the issuance and redemption of long-term debt at Integrys Energy Group and its subsidiaries, see Note 13, "Long-Term Debt."

Prior to January 1, 2008, Integrys Energy Group issued new shares of common stock under its Stock Investment Plan and under certain stock-based employee benefit and compensation plans. As a result of the plans, equity increased \$45.6 million in 2007. During 2009 and 2008, shares of Integrys Energy Group's common stock were purchased on the open market to meet the requirements of its Stock Investment Plan and certain stock-based employee benefit and compensation plans. Integrys Energy Group did not repurchase any existing common stock during 2007. Beginning in the first quarter of 2010, Integrys Energy Group plans to issue new shares of common stock to meet the requirements of its Stock Investment Plan and certain stock-based employee benefit and compensation plans.

## Credit Ratings

Integrys Energy Group uses internally generated funds, commercial paper borrowings, and other short-term borrowings to satisfy most of its capital requirements. Integrys Energy Group also periodically issues long-term debt and common stock to reduce short-term debt, maintain desired capitalization ratios, and fund future growth.

Integrys Energy Group, WPS, and PGL have their own commercial paper borrowing programs.

WPS periodically issues long-term debt and receives equity contributions from Integrys Energy Group to reduce short-term debt, fund future growth, and maintain capitalization ratios as authorized by the PSCW.

PGL and NSG periodically issue long-term debt in order to reduce short-term debt, refinance maturing securities, maintain desired capitalization ratios, and fund future growth. The specific forms of long-term financing, amounts, and timing depend on business needs, market conditions, and other factors.

The current credit ratings for Integrys Energy Group, WPS, PEC, PGL, and NSG are listed in the table below.

Credit Ratings	Standard & Poor's	Moody's
<b>Integrys Energy Group</b>		
Issuer credit rating	BBB+	N/A
Senior unsecured debt	BBB	Baa1
Commercial paper	A-2	P-2
Credit facility	N/A	Baa1
Junior subordinated notes	BBB-	Baa2
<b>WPS</b>		
Issuer credit rating	A-	A2
First mortgage bonds	N/A	A1
Senior secured debt	A	A1
Preferred stock	BBB	Baa1
Commercial paper	A-2	P-1
Credit facility	N/A	A2
<b>PEC</b>		
Issuer credit rating	BBB+	N/A
Senior unsecured debt	BBB	Baa1
<b>PGL</b>		
Issuer credit rating	BBB+	A3
Senior secured debt	A-	A2
Commercial paper	A-2	P-2
<b>NSG</b>		
Issuer credit rating	BBB+	A3
Senior secured debt	A	A2

Credit ratings are not recommendations to buy or sell securities and are subject to change, and each rating should be evaluated independently of any other rating.

On January 26, 2010, Standard and Poor's revised the outlook for Integrys Energy Group and all of its subsidiaries to stable from negative. The revised outlook reflected Integrys Energy Group's decision to retain a selected portion of its nonregulated operations, which resulted in a revision to Integrys Energy Group's business risk profile to "strong" from "excellent." The revised outlook also reflected Integrys Energy Group's improved financial measures and decreasing regulatory risk, which resulted in a change in its financial risk profile to "significant" from "aggressive."

On June 9, 2009, Moody's assigned an "A3" issuer credit rating to PGL and NSG, and lowered the following ratings of Integrys Energy Group and its subsidiaries:

- The senior unsecured debt ratings of Integrys Energy Group and PEC were lowered from "A3" to "Baa1."
  - The credit facility rating of Integrys Energy Group was lowered from "A3" to "Baa1."
  - The junior subordinated notes rating of Integrys Energy Group was lowered from "Baa1" to "Baa2."
    - The issuer credit rating of WPS was lowered from "A1" to "A2."
- The senior secured debt rating and first mortgage bonds rating of WPS were lowered from "Aa3" to "A1."
  - The senior secured debt ratings of PGL and NSG were lowered from "A1" to "A2."
    - The preferred stock rating of WPS was lowered from "A3" to "Baa1."
    - The credit facility rating of WPS was lowered from "A1" to "A2."
  - The commercial paper rating of PGL was lowered from "P-1" to "P-2."

According to Moody's, the downgrade considers management's decision to divest of its nonregulated energy marketing business, and reflects the expected improvements in Integrys Energy Group's business

-58-

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risk and liquidity profiles after the divestiture, as well as the expected challenge of replacing the earnings generated by this nonregulated segment. Also according to Moody's, the downgrade reflects management's decision to leave its dividend policy unchanged despite expected near-term reduction in earnings and internal cash flow generation.

On March 5, 2009, Standard & Poor's lowered the following ratings of Integrys Energy Group and its subsidiaries:

- The issuer credit ratings of Integrys Energy Group, PGL, NSG, and PEC were lowered from "A-" to "BBB+."
  - The issuer credit rating of WPS was lowered from "A" to "A-."
- The senior unsecured debt ratings of Integrys Energy Group and PEC were lowered from "BBB+" to "BBB."
  - The junior subordinated notes rating of Integrys Energy Group was lowered from "BBB" to "BBB-."
    - The senior secured debt rating of WPS was lowered from "A+" to "A."
    - The preferred stock rating of WPS was lowered from "BBB+" to "BBB."

According to Standard & Poor's, Integrys Energy Group's corporate credit downgrade reflects weak financial measures that do not support an "A" category credit profile. Standard & Poor's also stated that the downgrade reflects the changes to Integrys Energy Group's business and financial risk profiles. Standard & Poor's revised Integrys Energy Group's business risk profile to "excellent" from "strong" and changed its financial risk profile to "aggressive" from "intermediate." The change in the business risk profile reflected the strategy change with respect to Integrys Energy Services and helped to moderate the downgrade.

#### Discontinued Operations

##### 2009 Compared with 2008

Net cash provided by discontinued operations was \$3.2 million in 2009 compared with \$3.8 million in 2008.

##### 2008 Compared with 2007

Net cash provided by discontinued operations was \$3.8 million in 2008 compared with \$690.2 million in 2007. The decrease in net cash provided by discontinued operations was driven by the approximate \$869.2 million of proceeds received from the sale of PEP.

## Future Capital Requirements and Resources

## Contractual Obligations

The following table shows the contractual obligations of Integrys Energy Group, including its subsidiaries, as of December 31, 2009.

(Millions)	Total Amounts Committed	Payments Due By Period			
		2010	2011 to 2012	2013 to 2014	2015 and Thereafter
Long-term debt principal and interest payments (1)	\$ 3,580.2	\$ 254.4	\$ 942.3	\$ 571.8	\$ 1,811.7
Operating lease obligations	68.4	11.6	19.6	13.6	23.6
Commodity purchase obligations (2)	5,735.6	2,399.9	1,858.0	689.8	787.9
Purchase orders (3)	515.3	514.1	1.2	-	-
Pension and other postretirement funding obligations (4)	683.4	103.3	267.4	138.1	174.6
Total contractual cash obligations	\$ 10,582.9	\$ 3,283.3	\$ 3,088.5	\$ 1,413.3	\$ 2,797.8

(1) Represents bonds issued, notes issued, and loans made to Integrys Energy Group and its subsidiaries. Integrys Energy Group records all principal obligations on the balance sheet. For purposes of this table, it is assumed that the current interest rates on variable rate debt will remain in effect until the debt matures.

(2) Energy supply contracts at Integrys Energy Services included as part of commodity purchase obligations are generally entered into to meet obligations to deliver energy to customers. The utility subsidiaries expect to recover the costs of their contracts in future customer rates.

(3) Includes obligations related to normal business operations and large construction obligations.

(4) Obligations for pension and other postretirement benefit plans, other than the Integrys Energy Group Retirement Plan, cannot be estimated beyond 2012.

The table above does not reflect any payments related to the manufactured gas plant remediation liability of \$657.7 million at December 31, 2009, as the amount and timing of payments are uncertain. Integrys Energy Group anticipates incurring costs annually to remediate these sites, but management believes that any costs incurred for environmental activities relating to former manufactured gas plant operations that are not recoverable through contributions from other entities or from insurance carriers have been prudently incurred and are, therefore, recoverable through rates for WPS, MGU, PGL, and NSG. See Note 16, "Commitments and Contingencies," for more information about environmental liabilities. In addition, the table does not reflect any payments for the December 31, 2009, liability related to uncertain tax positions, as the amount and timing of payments are uncertain. See Note 15, "Income Taxes," for more information about this liability.

## Capital Requirements

Estimated construction expenditures by company for the three-year period 2010 through 2012 are listed below.

(Millions)

WPS	
Environmental projects	\$ 164.1
Electric and natural gas distribution projects	150.9
Electric and natural gas delivery and customer service projects	59.1
Other projects	108.0
UPPCO	
Repairs and safety measures at hydroelectric facilities	37.3
Other projects	28.4
MGU	
Natural gas pipe distribution system, underground natural gas storage facilities, and other projects	29.8
MERC	
Natural gas pipe distribution system and other projects	48.5
PGL	
Natural gas pipe distribution system, underground natural gas storage facilities, and other projects *	481.1
NSG	
Natural gas pipe distribution system and other projects	45.9
IntegrYS Energy Services	
Solar and other projects	88.9
IBS	
Corporate services infrastructure projects	53.7
Total capital expenditures	\$ 1,295.7

\*Includes approximately \$114 million of expenditures related to the accelerated replacement of cast iron mains at PGL in 2011 and 2012. On January 21, 2010, the ICC approved a rider mechanism to allow PGL to recover the incremental cost of an accelerated natural gas main replacement program. See Note 24, "Regulatory Environment," for more information.

IntegrYS Energy Group expects to provide additional capital contributions to ATC (not included in the above table) of approximately \$7 million in 2010, \$8 million in 2011, and \$7 million in 2012.

All projected capital and investment expenditures are subject to periodic review and may vary significantly from the estimates depending on a number of factors, including, but not limited to, industry restructuring, regulatory constraints, acquisition opportunities, market volatility, and economic trends.

## Capital Resources

As of December 31, 2009, Integrys Energy Group and each of its subsidiaries were in compliance with all respective covenants related to outstanding short-term and long-term debt and expect to be in compliance with all such debt covenants for the foreseeable future.

-61-

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See Note 12, "Short-Term Debt and Lines of Credit," for more information on Integrys Energy Group's credit facilities and other short-term credit agreements, including short-term debt covenants. See Note 13, "Long-Term Debt," for more information on Integrys Energy Group's long-term debt covenants.

Integrys Energy Group plans to meet its capital requirements for the period 2010 through 2012 primarily through internally generated funds (net of forecasted dividend payments) and debt and equity financings. During 2010, over \$1.3 billion of Integrys Energy Group's revolving credit facilities will mature. It is the intent of management to renew a substantial portion of the maturing credit facilities by the end of the second quarter of 2010. Integrys Energy Group plans to maintain current debt to equity ratios at appropriate levels to support current credit ratings and corporate growth. Management believes Integrys Energy Group has adequate financial flexibility and resources to meet its future needs.

In March 2009, Integrys Energy Group filed a shelf registration statement which allows it to publicly issue debt, equity, certain types of hybrid securities, and other financial instruments. Specific terms and conditions of securities issued will be determined prior to the actual issuance of any specific security.

Under an existing shelf registration statement, WPS may issue up to \$250.0 million of senior debt securities with amounts, prices, and terms to be determined at the time of future offerings. In December 2008, WPS issued \$125.0 million of 6.375%, 7-year Senior Notes under this shelf registration statement.

#### Other Future Considerations

##### Integrys Energy Services Business Segment Strategy Change

At December 31, 2009, Integrys Energy Group had completed a substantial portion of its previously announced strategy to divest of or significantly reduce the size of its nonregulated energy services business segment to a smaller segment with significantly reduced credit and collateral support requirements. One of the remaining parts of the strategy change is the pending sale of the wholesale electric business, which is expected to close in the first half of 2010.

Integrys Energy Group has repositioned its nonregulated energy services business segment from a focus on significant growth in wholesale and retail markets across the United States and Canada, to a focus on selected retail markets in the United States with the expectation that recurring customer based business will result in dependable cash and earnings contributions with a reduced risk and capital profile. In addition, Integrys Energy Services will continue to invest in energy assets with renewable attributes.

Once fully implemented, Integrys Energy Group expects its liquidity needs to decrease and expects to reduce its existing credit facilities. Integrys Energy Group may also use the proceeds from the sales of any portions of this business segment, as well as the return of invested capital, to reduce outstanding debt or invest in areas with more desirable risk adjusted rates of return to achieve the highest value for its shareholders. See Note 4, "Dispositions," for more information.

#### Customer Usage

Due to the general economic slowdown and the increased focus on energy efficiency, sales volumes excluding the impact of weather have been decreasing at the utilities. In certain jurisdictions, decoupling mechanisms have been implemented, which allow utilities to adjust rates going forward to recover or refund all or a portion of the differences between the actual and authorized margin per customer impact of variations in volumes. The mechanisms do not adjust for changes in volume resulting from changes in customer count. Decoupling for residential and small commercial and industrial sales was approved by the ICC on a four-year trial basis for PGL and NSG, effective March 1, 2008. Interveners, including the Illinois Attorney General, oppose decoupling and have appealed the ICC's

approval. PGL and NSG are actively supporting the ICC's decision to approve decoupling. The PSCW approved the implementation of decoupling on a four-year trial basis, effective January 1, 2009, for WPS's natural gas and electric residential and small commercial sales. This decoupling mechanism includes an annual \$14.0 million cap

-62-

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for electric service and an annual \$8.0 million cap for natural gas service. The \$14.0 million cap for electric service was reached in the second quarter of 2009. On December 16, 2009, decoupling for UPPCO was approved for all customer groups by the MPSC effective January 1, 2010. MGU requested decoupling in its rate case filed in July 2009. The partial settlement approved in that rate case did not address the decoupling request. Therefore the request will be addressed by the MPSC through the normal rate case process, which is expected to conclude in the second quarter of 2010. In Minnesota, the legislature required the MPUC to evaluate decoupling. The MPUC is currently engaged in that process and has sought and received comments on decoupling mechanisms from utilities and interveners in Minnesota.

#### Uncollectible Accounts

The reserves for uncollectible accounts at Integrys Energy Group reflect management's best estimate of probable losses on the accounts receivable balances. The reserves are based on known troubled accounts, historical experience, and other currently available evidence. Provisions for bad debt expense are affected by changes in various factors, including the impacts of the economy, energy prices, and weather.

The impact of the weak economic environment could cause more accounts receivable to become uncollectible. Higher levels of uncollectible balances could negatively impact Integrys Energy Group's results of operations and could result in higher working capital requirements. Recoveries (or refunds) under Illinois Senate Bill (SB) 1918 and an Uncollectible Expense Tracking Mechanism (UETM) in Michigan will affect bad debt expense as described in Note 24, "Regulatory Environment."

#### Goodwill Impairment Testing

Integrys Energy Group performs its required annual goodwill impairment tests each April 1. Interim impairment tests are performed between required annual testing dates if certain conditions exist. One of these conditions is a change in business climate, which may be evidenced by, among other things, a prolonged decline in a company's market capitalization below book value. Any annual or interim goodwill impairment test could result in the recognition of a goodwill impairment loss. See Note 10, "Goodwill and Other Intangible Assets," for more information on goodwill balances for Integrys Energy Group's reporting units at December 31, 2009.

#### Climate Change

Recently, efforts have been initiated to develop state and regional greenhouse gas programs, to create federal legislation to limit carbon dioxide emissions, and to create national or state renewable portfolio standards. Some examples of these efforts are the Waxman-Markey bill, which passed the United States House of Representatives; the Kerry-Boxer draft bill, which was introduced in the United States Senate; and the Wisconsin Clean Energy Jobs Act, which has been introduced in the Wisconsin legislature to implement recommendations from the Governor's Global Warming Task Force. The Wisconsin Clean Energy Jobs Act establishes statewide goals for the reduction of greenhouse gas emissions and requires certain actions, including an increased renewable portfolio standard, to meet those goals. In addition, in April 2009, the EPA declared carbon dioxide and several other greenhouse gases to be a danger to public health and welfare, which is the first step towards the EPA potentially regulating greenhouse gases under the Clean Air Act. A risk exists that such legislation or regulation will increase the cost of energy. However, Integrys Energy Group believes the capital expenditures being made at its generation units are appropriate under any reasonable mandatory greenhouse gas program and that future expenditures related to control of greenhouse gas emissions or renewable portfolio standards by its regulated electric utilities will be recoverable in rates. Integrys Energy Group will continue to monitor and manage potential risks and opportunities associated with future greenhouse gas legislative or regulatory actions.

The majority of Integrys Energy Group's generation and distribution facilities are located in the upper Midwest region of the United States. The same is true for the majority of our customers' facilities. The physical risks posed by climate change are not expected to be significant at this time. Ongoing

-63-

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evaluations will be conducted as more information on the extent of such physical changes becomes available.

#### New Laws

In February 2009, the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law. ARRA contains various provisions intended to stimulate the economy. Included in ARRA are several tax provisions that may affect the company. Most notably, a provision of ARRA provides Integrys Energy Group with additional opportunities to claim tax deductions for bonus depreciation for certain assets placed in service during 2009, extending the bonus depreciation period established by the Economic Stimulus Act of 2008. The additional first year deduction for bonus depreciation is estimated to be approximately \$200 million. Other provisions of ARRA provide Integrys Energy Group with elections to select among a production tax credit, an investment tax credit, or a federal grant for various renewable generating facilities that went into service in 2009. Integrys Energy Group currently plans to take production tax credits on power generated by wind facilities, but is evaluating the other alternatives mentioned.

In February 2009, Wisconsin Act 2 was signed into law. Act 2 contains various tax provisions intended to reduce Wisconsin's current budget gap. Most notably, this Act will require Integrys Energy Group and its subsidiaries to file a Wisconsin income tax return as a combined group. As a result, all of Integrys Energy Group's income became subject to apportionment and taxation in Wisconsin beginning January 1, 2009. In the future, Integrys Energy Group may experience higher or lower Wisconsin income taxes depending on the mix and type of income. In the short-term, after the adjustment to deferred taxes at the time of the law change, this law is expected to generate a small benefit for Integrys Energy Group.

#### Property Tax Assessment on Natural Gas

Integrys Energy Group's natural gas retailers, including its five natural gas utilities, purchase storage services from pipeline companies on the pipelines' interstate natural gas storage and transmission systems. Once a shipper delivers natural gas to the pipeline's system, that specific natural gas cannot be physically traced back to the shipper, and the physical location of that specific natural gas is not ascertainable. Some states tax natural gas as personal property and have recently sought to assess personal property tax obligations against natural gas quantities held as working gas in facilities located in their states. Because the pipeline does not have title to the working gas inventory in these facilities, the state imposes the tax on the shippers as of the assessment date, based on allocated quantities. Shippers that are being assessed a tax are actively protesting these property tax assessments. PGL and MERC are currently pursuing protests through litigation in Texas and Kansas, respectively.

#### OFF BALANCE SHEET ARRANGEMENTS

See Note 17, "Guarantees," for information regarding guarantees.

#### MARKET PRICE RISK MANAGEMENT ACTIVITIES

Market price risk management activities include the electric and natural gas marketing and related risk management activities of Integrys Energy Services.

Integrys Energy Services measures the fair value of derivative instruments on a mark-to-market basis. The fair value is included in assets or liabilities from risk management activities on Integrys Energy Group's Consolidated Balance Sheets, with an offsetting impact to other comprehensive income (for the effective portion of cash flow hedges), also on Integrys Energy Group's Consolidated Balance Sheets, or to earnings. The following table provides an assessment of the factors impacting the change in the net value of Integrys Energy Services' assets and liabilities from risk management activities for the year ended December 31, 2009.



Integrys Energy Services  
Mark-to-Market Roll Forward

(Millions)	Natural Gas	Electric	Total
Fair value of contracts at December 31, 2008 (1)	\$ 294.0	\$ (135.4)	\$ 158.6
Less: Contracts realized or settled during period (2)	317.0	(225.9)	91.1
Plus: Changes in fair value of contracts in existence at December 31, 2009 (3)	60.0	(187.9)	(127.9)
Fair value of contracts at December 31, 2009 (1)	\$ 37.0	\$ (97.4)	\$ (60.4)

(1) Reflects the values reported on the balance sheets for net mark-to-market current and long-term risk management assets and liabilities as of those dates. The fair value of contracts at December 31, 2008, includes \$0.6 million of liabilities held for sale, related to the sale of generation assets and the associated sales and service contracts in Northern Maine, which closed during the first quarter of 2010. The fair value of Integrys Energy Services' contracts at December 31, 2009, was impacted by the reduction in wholesale trading and marketing activity associated with its strategy change, as well as an overall decline in energy prices in 2009.

(2) Includes the value of contracts in existence at December 31, 2008, that were no longer included in the net mark-to-market assets as of December 31, 2009.

(3) Includes unrealized gains and losses on contracts that existed at December 31, 2008, and contracts that were entered into subsequent to December 31, 2008, which were included in Integrys Energy Services' portfolio at December 31, 2009.

There were, in many cases, derivative positions entered into and settled during the period resulting in gains or losses being realized during the current period. The realized gains or losses from these derivative positions are not reflected in the table above.

The table below shows Integrys Energy Services' risk management instruments categorized by fair value hierarchy levels and by maturity. For more information on the fair value hierarchy, including definitions of Level 1, Level 2, and Level 3, see Note 1(r), "Summary of Significant Accounting Policies – Fair Value."

Integrys Energy Services  
Risk Management Contract Aging at Fair Value  
As of December 31, 2009 (Millions)

Fair Value Hierarchy Level	Maturity Less Than 1 Year	Maturity 1 to 3 Years	Maturity 4 to 5 Years	Maturity in Excess of 5 years	Total Fair Value
Level 1	\$ (52.2)	\$ 0.6	\$ (0.3)	\$ -	\$ (51.9)
Level 2	(56.4)	(75.7)	4.1	1.6	(126.4)
Level 3	37.1	80.8	(0.6)	0.6	117.9
Total fair value	\$ (71.5)	\$ 5.7	\$ 3.2	\$ 2.2	\$ (60.4)

### CRITICAL ACCOUNTING POLICIES

Integrys Energy Group has determined that the following accounting policies are critical to the understanding of its financial statements because their application requires significant judgment and reliance on estimations of matters that are inherently uncertain. Integrys Energy Group's management has discussed these critical accounting policies with the Audit Committee of the Board of Directors.

#### Risk Management Activities

Integrys Energy Group has entered into contracts that are accounted for as derivatives. All derivative contracts are recorded at fair value on the Consolidated Balance Sheets, unless they qualify for the normal purchases and sales exception, which provides that recognition of gains and losses in the consolidated financial statements is not required until the settlement of the contracts. Changes in fair value, except effective portions of derivative instruments designated as hedges or qualifying for regulatory

-65-

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deferral, generally affect income available for common shareholders at each financial reporting date until the contracts are ultimately settled.

At December 31, 2009, those derivatives not designated as hedges were primarily commodity contracts used to manage price risk associated with natural gas and electricity purchase and sale activities. Cash flow hedge accounting treatment may be used when Integrys Energy Group enters into contracts to buy or sell a commodity at a fixed price for future delivery to protect future cash flows corresponding with anticipated physical sales or purchases. In addition, Integrys Energy Group uses cash flow hedge accounting to protect against changes in interest rates. Fair value hedge accounting may be used when Integrys Energy Group holds assets, liabilities, or firm commitments and enters into transactions that hedge the risk of changes in commodity prices or interest rates. To the extent that the hedging instrument is fully effective in offsetting the transaction being hedged, there is no impact on income available for common shareholders prior to settlement of the hedge.

In conjunction with the implementation of SFAS No. 157, "Fair Value Measurements" (now incorporated as part of the Fair Value Measurements and Disclosures Topic of the FASB ASC), on January 1, 2008, Integrys Energy Group categorized its fair value measurements into three levels within a fair value hierarchy. See Note 1(r), "Summary of Significant Accounting Policies – Fair Value," and Note 22, "Fair Value," for more information.

Integrys Energy Group has based its valuations on observable inputs whenever possible. However, at times, the valuation of certain derivative instruments requires the use of internally developed valuation techniques and/or significant unobservable inputs. These valuations require a significant amount of management judgment and are classified as Level 3 measurements. Of the total risk management assets on Integrys Energy Group's Consolidated Balance Sheets, \$1,593.0 million (68.7%) utilized Level 3 measurements. Of the total risk management liabilities, \$1,471.6 million (61.6%) utilized Level 3 measurements. Integrys Energy Group believes these valuations represent the fair values of these instruments as of the reporting date; however, the actual amounts realized upon settlement of these instruments could vary materially from the reported amounts due to movements in market prices and changes in the liquidity of certain markets.

Beginning January 1, 2008, Integrys Energy Services no longer includes transaction costs in fair value determinations.

As a component of fair value determinations, Integrys Energy Group considers counterparty credit risk (including its own credit risk) and liquidity risk. The liquidity component of the fair value determination may be especially subjective when limited liquid market information is available. Changes in the underlying assumptions for these components of fair value at December 31, 2009, would have had the following effects:

Change in Components	Effect on Fair Value of Net Risk Management Liabilities at December 31, 2009	
	(Millions)	
100% increase	\$15.8 decrease	
50% decrease	\$7.9 increase	

These hypothetical changes in fair value would be included in current and long-term assets and liabilities from risk management activities on the Consolidated Balance Sheets and as part of nonregulated revenue on the Consolidated Statements of Income, unless the related contracts are designated as cash flow hedges, in which case potential changes would be included in Other Comprehensive Income – Cash Flow Hedges on the Consolidated Statements of Common Shareholders' Equity.

## Asset Impairment

Integrys Energy Group reviews certain assets for impairment as required by the Property, Plant, and Equipment Topic and Intangibles – Goodwill and Other Topic of the FASB ASC.

## Goodwill

Goodwill is tested for impairment using a two-step process that begins with an estimation of the fair value of a reporting unit. A reporting unit can be an operating segment, or one level below an operating segment, as defined by the Segment Reporting Topic of the FASB ASC. At Integrys Energy Group, goodwill has been assigned to each of the five reporting units that comprise the natural gas utility segment and also to the Integrys Energy Services segment. The carrying value of goodwill by reporting unit and reportable segment for the year ended December 31, 2009 was:

(Millions)	Carrying Value of Goodwill
WPS	\$ 36.4
PGL	401.2
NSG	36.1
MERC	127.7
MGU	34.5
Total Natural Gas Utility Segment	\$ 635.9
Integrys Energy Services	6.6
Balance at December 31, 2009	\$ 642.5

The goodwill for each of the reporting units is tested for impairment annually on April 1 or more frequently when events or circumstances warrant. The fair market value of each reporting unit is estimated using certain key assumptions that require significant judgment. This judgment includes developing cash flow projections (including the selection of appropriate returns on equity, long-term growth rates, and capital expenditure levels), selecting appropriate discount rates, and identifying relevant market comparables.

The fair value of WPS currently exceeds the carrying amount by a significant amount, such that Integrys Energy Group believes WPS is unlikely to fail step one of the goodwill impairment test in the foreseeable future.

However, in the first quarter of 2009, the combination of the decline in equity markets as well as the increase in the expected weighted-average cost of capital indicated that a potential impairment of goodwill might exist for PGL, NSG, MERC, MGU, and Integrys Energy Services, triggering an interim goodwill impairment analysis effective February 28, 2009 for these reporting units. For this analysis, the estimated fair value for the PGL, NSG, MERC, and MGU reporting units was determined by utilizing a combination of the income approach and the market approach methodologies. More weight was given to the income approach as Integrys Energy Group believes that the income approach more accurately captures the anticipated economics and related performance expectations for each of these reporting units. In the first quarter of 2009, Integrys Energy Group announced a strategy change for Integrys Energy Services. Because it was likely that Integrys Energy Group would sell a significant portion of Integrys Energy Services, the goodwill at Integrys Energy Services was tested for impairment during each interim period in 2009 as well as at the time of the April 1, 2009 annual testing date. At each testing date, the fair value of Integrys Energy Services exceeded its carrying amount. Based on the interim test performed at December 31, 2009, the fair value of Integrys Energy Services exceeded its carrying amount by more than 10%.

The income approach was based on discounted cash flows which were derived from internal forecasts and economic expectations. The key assumptions used to determine fair value under the income approach included the cash flow period, terminal values based on a terminal growth rate, and the discount rate. The discount rate represents the estimated cost of debt and equity financing weighted by

-67-

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the percentage of debt and equity in a company's target capital structure. The discount rates used in the income approach for PGL, NSG, MERC, and MGU ranged from 7.25% to 7.5%. The discount rate used for Integrys Energy Services was 10.2%. The terminal growth rates used in the income approach ranged from 2% to 3%.

The market approach for PGL, NSG, MERC, and MGU utilized the guideline company method, which calculates valuation multiples based on operating and valuation metrics from publicly traded guideline companies in the regulated natural gas distribution industry. Multiples derived from the guideline companies provided an indication of how much a knowledgeable investor in the marketplace would be willing to pay for an investment in a similar company. These multiples were then applied to the appropriate operating metric for PGL, NSG, MERC, and MGU to determine indications of fair value.

Aggregate fair values of all of Integrys Energy Group's operating segments were compared to its market capitalization as an assessment of the appropriateness of the fair value measurements. When assessing Integrys Energy Group's market capitalization, the average stock price 15 days before and after the interim February 28, 2009, valuation date was used. The comparison between the aggregate fair values of all reporting units of Integrys Energy Group and the market capitalization indicated an implied control premium. A control premium analysis indicated that the implied premium was within a range of the overall premiums observed in the market place.

As a result of applying the first step of goodwill impairment testing to determine if potential goodwill impairment existed at the February 28, 2009 interim testing date, Integrys Energy Services passed (fair value exceeded carrying amount) and PGL, NSG, MERC, and MGU failed (carrying amount exceeded fair value). As a result, a \$291.1 million pre-tax impairment loss was recorded in the first quarter of 2009, which included a \$148.0 million goodwill impairment loss related to PGL, a \$38.2 million goodwill impairment loss related to NSG, a \$16.7 million goodwill impairment loss related to MERC, and an \$88.2 million goodwill impairment loss related to MGU. See Note 10, "Goodwill and Other Intangible Assets," for information.

On the April 1, 2009 annual goodwill impairment testing date, an increase in equity values for United States companies, as well as a decrease in the discount rate since February 28, 2009, resulted in the fair values of PGL, NSG, MERC and MGU exceeding their respective carrying amounts. The resulting fair values exceeded the carrying amount by less than 10% for each of these four reporting units.

#### Other

Integrys Energy Group evaluates property, plant, and equipment for impairment whenever indicators of impairment exist. These indicators include a significant underperformance of the assets relative to historical or projected future operating results, a significant change in the use of the assets or business strategy related to such assets, and significant negative industry or economic trends. If the sum of the undiscounted expected future cash flows from an asset is less than the carrying value of the asset, an asset impairment must be recognized in the income statement. For assets held for sale, impairment charges are recorded if the carrying value of such assets exceeds the estimated fair value less costs to sell. The amount of impairment recognized is calculated by reducing the carrying value of the asset to its fair value (or fair value less costs to sell if held for sale). For Integrys Energy Group's regulated utilities, an asset impairment requires further assessment to determine if a regulatory asset should be recorded.

The review for impairment of tangible assets is more critical to Integrys Energy Services than to any other segment because of its lack of access to rate setting based on cost of service that is available to the regulated segments. At December 31, 2009, the carrying value of Integrys Energy Services' property, plant, and equipment totaled \$143.9 million. Management's assumptions about future market sales prices and generation volumes require significant judgment because actual prices and generation volumes have fluctuated in the past as a result of changing fuel costs and required plant maintenance and are expected to continue to do so in the future.





The primary assumptions used at Integrys Energy Services in the impairment analyses are future revenue streams that depend on future commodity prices, capital expenditures, environmental landscape, and operating costs. A combination of inputs from both internal and external sources is used to project revenue streams. Integrys Energy Services forecasts future operating costs with input from external sources. These assumptions are modeled over the projected remaining life of the asset.

Throughout 2009, Integrys Energy Services tested various assets for impairment whenever events or changes in circumstances indicated that a test was required. No material impairment charges were recorded in 2009 as a result of the recoverability tests. Results of past impairment tests may not necessarily be an indicator of future results given the nature of the accounting estimates involved, as discussed more fully above. Future results or changes in assumptions could result in an impairment.

#### Receivables and Reserves

The regulated natural gas and electric utilities and Integrys Energy Services accrue estimated amounts of revenues for services rendered but not yet billed. Estimated unbilled revenues are calculated using a variety of factors based on customer class or contracted rates. At December 31, 2009 and 2008, Integrys Energy Group's unbilled revenues were \$337.0 million and \$525.5 million, respectively. Any difference between actual revenues and the estimates are recorded in revenue in the next period. Differences historically have not been significant.

The majority of the bad debt expense at the utilities is recovered through rates. Integrys Energy Services calculates the reserve for potential uncollectible customer receivable balances by applying an estimated bad debt experience rate to each past due aging category and reserving for 100% of specific customer receivable balances deemed to be uncollectible. If the assumption that historical uncollectible experience matches current customer default is incorrect, or if a specific customer with a large account receivable that has not previously been identified as a risk defaults, there could be significant changes to bad debt expense and the uncollectible reserve balance. At December 31, 2009 and 2008, Integrys Energy Services' reserve for uncollectible accounts was \$19.4 million and \$16.7 million, respectively.

#### Pension and Other Postretirement Benefits

The costs of providing non-contributory defined benefit pension benefits and other postretirement benefits, described in Note 18, "Employee Benefit Plans," are dependent upon numerous factors resulting from actual plan experience and assumptions regarding future experience.

Pension and other postretirement benefit costs are impacted by actual employee demographics (including age, compensation levels, and employment periods), the level of contributions made to the plans, and earnings on plan assets. Pension and other postretirement benefit costs may be significantly affected by changes in key actuarial assumptions, including anticipated rates of return on plan assets, discount rates used in determining the projected pension and other postretirement benefit obligations and costs, and health care cost trends. Changes made to the plan provisions may also impact current and future pension and other postretirement benefit costs.

Integrys Energy Group's pension and other postretirement benefit plan assets are primarily made up of equity and fixed income investments. Fluctuations in actual equity and fixed income market returns, as well as changes in general interest rates, may result in increased or decreased benefit costs in future periods. Management believes that such changes in costs would be recovered at the regulated segments through the ratemaking process.

The following table shows how a given change in certain actuarial assumptions would impact the projected benefit obligation and the reported net periodic pension cost. Each factor below reflects an evaluation of the change based on a change in that assumption only.



Actuarial Assumption (Millions, except percentages)	Percentage- Point Change in Assumption	Impact on Projected Benefit Obligation	Impact on 2009 Pension Cost
Discount rate	(0.5)	\$ 75.5	\$ 7.5
Discount rate	0.5	(64.1)	(4.2)
Rate of return on plan assets	(0.5)	N/A	5.4
Rate of return on plan assets	0.5	N/A	(5.4)

The following table shows how a given change in certain actuarial assumptions would impact the accumulated other postretirement benefit obligation and the reported net periodic other postretirement benefit cost. Each factor below reflects an evaluation of the change based on a change in that assumption only.

Actuarial Assumption (Millions, except percentages)	Percentage-Point Change in Assumption	Impact on Postretirement Benefit Obligation	Impact on 2009 Postretirement Benefit Cost
Discount rate	(0.5)	\$ 29.0	\$ 2.2
Discount rate	0.5	(27.1)	(2.2)
Health care cost trend rate	(1.0)	(48.4)	(6.8)
Health care cost trend rate	1.0	58.1	8.3
Rate of return on plan assets	(0.5)	N/A	1.1
Rate of return on plan assets	0.5	N/A	(1.1)

Integrys Energy Group uses an interest rate yield curve to enable it to make appropriate judgments about discount rates. The yield curve is comprised of non-callable (or callable with make-whole provisions), high-quality corporate bonds with maturities between 0 and 30 years. The included bonds are generally rated "Aa" with a minimum amount outstanding of \$50 million. The expected annual benefit cash flows are discounted for each of Integrys Energy Group's pension and retiree welfare plans using this yield curve, and a single-point discount rate is developed matching each plan's expected payout structure.

Integrys Energy Group establishes its expected return on asset assumption based on consideration of historical and projected asset class returns, as well as the target allocations of the benefit trust portfolios. The assumed long-term rate of return was 8.5% in 2009, 2008, and 2007. For 2009, 2008, and 2007, the actual rates of return on pension plan assets, net of fees, were 22.0%, (25.9)%, and 6.2%, respectively.

The determination of expected return on qualified plan assets is based on a market-related valuation of assets, which reduces year-to-year volatility. Cumulative gains and losses in excess of 10% of the greater of the pension or other postretirement benefit obligation or market-related value are amortized over the average remaining future service to expected retirement ages. Changes in fair value are recognized over the subsequent five years for plans sponsored by WPS, while differences between actual investment returns and the expected return on plan assets are recognized over a five-year period for pension plans sponsored by IBS and PEC. Because of this method, the future value of assets will be impacted as previously deferred gains or losses are included in market-related value.

In selecting assumed health care cost trend rates, past performance and forecasts of health care costs are considered. For more information on health care cost trend rates and a table showing future payments that Integrys Energy Group expects to make for pension and other postretirement benefits, see Note 18, "Employee Benefit Plans."

Regulatory Accounting

The electric and natural gas utility segments of Integrys Energy Group follow the guidance under the Regulated Operations Topic of the FASB ASC, and the financial statements reflect the effects of the different ratemaking principles followed by the various jurisdictions regulating these segments. Certain items that would otherwise be immediately recognized as revenues and expenses are deferred as regulatory assets and regulatory liabilities for future recovery or refund to customers, as authorized by

-70-

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Integrys Energy Group's regulators. Future recovery of regulatory assets is not assured, and is generally subject to review by regulators in rate proceedings for matters such as prudence and reasonableness. Management regularly assesses whether these regulatory assets and liabilities are probable of future recovery or refund by considering factors such as changes in the regulatory environment, earnings at the utility segments, and the status of any pending or potential deregulation legislation. Once approved, the regulatory assets and liabilities are amortized into income over the rate recovery period. If recovery or refund of costs is not approved or is no longer deemed probable, these regulatory assets or liabilities are recognized in current period income.

The application of the Regulated Operations Topic of the FASB ASC would be discontinued if the regulated electric and natural gas utility segments or a separable portion of those segments would no longer meet the criteria for application. Assets and liabilities recognized solely due to the actions of rate regulation would no longer be recognized on the balance sheet, but rather classified as an extraordinary item in income for the period in which the discontinuation occurred. A write-off of all of Integrys Energy Group's regulatory assets and regulatory liabilities at December 31, 2009, would result in a 13.1% decrease in total assets and a 4.2% decrease in total liabilities. See Note 8, "Regulatory Assets and Liabilities," for more information.

#### Environmental Activities Relating to Former Manufactured Gas Operations

Integrys Energy Group's natural gas utilities, their predecessors, and certain former affiliates operated facilities in the past at multiple sites for the purpose of manufacturing and storing manufactured gas. The utility subsidiaries are accruing and deferring the costs incurred in connection with environmental activities at the manufactured gas plant sites pending recovery through rates or from other entities. The amounts deferred include costs incurred but not yet recovered through rates and management's best estimates of the costs that the utilities will incur in investigating and remediating the manufactured gas sites. Management's estimates are based upon a probabilistic model and an ongoing review by management of future investigative and remedial costs.

Management considers this policy critical due to the substantial uncertainty in the estimation of future costs with respect to the amount and timing of costs, and the extent of recovery from other potential responsible parties. See Note 16, "Commitments and Contingencies," for further discussion of environmental matters.

#### Tax Provision

Integrys Energy Group is required to estimate income taxes for each of the jurisdictions in which it operates as part of the process of preparing Integrys Energy Group's consolidated financial statements. This process involves estimating actual current tax liabilities together with assessing temporary differences resulting from differing treatment of items, such as depreciation, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within Integrys Energy Group's Consolidated Balance Sheets. Integrys Energy Group must also assess the likelihood that its deferred tax assets will be recovered through future taxable income. To the extent Integrys Energy Group believes that recovery is not likely, it must establish a valuation allowance, which is offset by an adjustment to the provision for income taxes in the Consolidated Statements of Income.

Uncertainty associated with the application of tax statutes and regulations and the outcomes of tax audits and appeals require that judgment and estimates be made in the accrual process and in the calculation of effective tax rates. Integrys Energy Group adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes – an Interpretation of FAS 109" (now incorporated as part of the Income Taxes Topic of the FASB ASC), which requires that only income tax benefits that meet the "more likely than not" recognition threshold be recognized or continue to be recognized. The change in the unrecognized tax benefits needs to be reasonably estimated based on an evaluation of the nature of uncertainty, the nature of event that could cause the change, and an estimate of the range of reasonably possible changes. As allowed under Interpretation No. 48, Integrys Energy Group also elected to change its method of accounting to record interest and penalties paid on income tax obligations as a component of provision for income taxes.

Significant management judgment is required in determining Integrys Energy Group's provision for income taxes, deferred tax assets and liabilities, and any valuation allowance recorded against deferred tax assets. The assumptions involved are supported by historical data, reasonable projections, and technical interpretations of applicable tax laws and regulations across multiple taxing jurisdictions. Significant changes in these assumptions could have a material impact on Integrys Energy Group's financial condition and results of operations. See Note 1(o), "Summary of Significant Accounting Policies – Income Taxes," and Note 15, "Income Taxes," for a discussion of accounting for income taxes.

#### IMPACT OF INFLATION

Integrys Energy Group's financial statements are prepared in accordance with GAAP. The statements provide a reasonable, objective, and quantifiable statement of financial results, but generally do not evaluate the impact of inflation. For Integrys Energy Group's regulated operations, to the extent it is not recovering the effects of inflation, it will file rate cases as necessary in the various jurisdictions in which it operates. Integrys Energy Group's nonregulated businesses include inflation in forecasted costs.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Market Risks and Other Significant Risks

Integrys Energy Group has potential market risk exposure related to commodity price risk (including regulatory recovery risk), interest rate risk, and equity return and principal preservation risk. Integrys Energy Group is also exposed to other significant risks due to the nature of our subsidiaries' businesses and the environment in which we operate. Integrys Energy Group has risk management policies in place to monitor and assist in controlling these risks and may use derivative and other instruments to manage some of these exposures, as further described below.

### Commodity Price Risk and Regulatory Recovery Risk

#### Utilities

The electric utilities of Integrys Energy Group purchase natural gas, fuel oil, and coal for use in power generation. They also buy power from the MISO market at a price that is often reflective of the underlying cost of natural gas used in power generation. Prudent fuel and purchased power costs are recovered from customers under one-for-one recovery mechanisms by UPPCO and by the wholesale electric operations and Michigan retail electric operations of WPS. The costs of natural gas used by the natural gas utility subsidiaries are generally also recovered from customers under one-for-one recovery mechanisms. These recovery mechanisms greatly reduce commodity price risk for the utilities.

WPS's Wisconsin retail electric operations do not have a one-for-one recovery mechanism for price fluctuations. Instead, a "fuel window" mechanism has partially mitigated the year-to-year price risk. See Note 1(e), "Summary of Significant Accounting Policies – Revenue and Customer Receivables," for more information.

To manage commodity price risk, our regulated utilities enter into contracts of various durations for the purchase and/or sale of natural gas, fuel for electric generation, and electricity. In addition, the electric operations of WPS and the natural gas operations of WPS, PGL, NSG, and MERC employ risk management techniques, which include the use of derivative instruments such as swaps, futures, and options.

#### Integrys Energy Services

Integrys Energy Services seeks to reduce market price risk from its generation and energy supply portfolios through the use of various financial and physical instruments.

To measure commodity price risk exposure, Integrys Energy Group employs a number of controls and processes, including a value-at-risk (VaR) analysis of its exposures. Integrys Energy Services' VaR calculation is utilized to quantify exposure to market risk associated with its marketing and trading portfolio (primarily natural gas and power positions), which also includes near-term positions managed under its asset management strategy through tolling agreements with the merchant generating fleet. The VaR calculation excludes the long-dated positions created by owning merchant generation and associated coal, sulfur dioxide emission allowances, and other ancillary fuels. Additionally, financial transmission rights, renewable energy credits, and certain portions of long-dated natural gas storage and transportation contracts are also excluded from the VaR calculation. The capped downside nature of the risks and duration of these positions would result in a VaR that would not be representative of the actual exposure. Therefore, Integrys Energy Services evaluates the exposures for these types of contracts by assessing the maximum potential loss of the positions which would represent the cost of the physical asset or the fixed demand charges for the contract.





VaR is used to describe a probabilistic approach to quantifying the exposure to market risk. The VaR amount represents an estimate of the potential change in fair value that could occur from changes in market factors, within a given confidence level, if an instrument or portfolio is held for a specified time period. VaR models are relatively sophisticated. However, the quantitative risk information is limited by the parameters established in creating the model. The instruments being used may have features that could trigger a potential loss in excess of the calculated amount if the changes in the underlying commodity price exceed the confidence level of the model used. VaR is not necessarily indicative of actual results that may occur. In addition to VaR, Integrys Energy Services employs other risk measurements including mark-to-market valuations, stress testing, and scenario based testing. In conjunction with the VaR analysis, these other risk measurements provide the risk management analysis for Integrys Energy Services' risk exposure. Additionally, Integrys Energy Services also uses volume limits and stop loss limits to limit its exposure to commodity price movements.

VaR has a number of limitations that are important to consider when evaluating the calculation results. Most importantly, VaR does not represent the maximum potential loss of the portfolio. Price movements outside of the relevant confidence levels can and do occur and may result in losses exceeding the reported VaR. Large short-term price moves can be caused by catastrophic weather events or other drivers of short term supply and demand disruptions. Also, the holding period may not always be an adequate assessment of the timeframe to close out positions. Short-term reductions in market liquidity could cause Integrys Energy Services to hold positions open longer than anticipated, resulting in greater than predicted losses. Additionally, there are other risks not captured by the VaR metric including, but not limited to, the risk of customer and vendor nonperformance and the risks associated with the liquidity in the markets in which Integrys Energy Services transacts. Customer and vendor nonperformance risk could result in bad debt losses, realized and unrealized losses on commodity contracts, or increased supply costs in the event that contractual obligations of our counterparties are not met. Market liquidity risk refers to the risk that Integrys Energy Services will not be able to efficiently enter or exit commodity positions.

Integrys Energy Services' VaR is calculated using non-discounted positions with a delta-normal approximation based on a one-day holding period and a 95% confidence level, as well as a ten-day holding period and 99% confidence level. The delta-normal approximation is based on the assumption that changes in the value of the portfolio over short time periods, such as one day or ten days, are normally distributed. Integrys Energy Services' VaR calculation includes financial and physical commodity instruments, such as forwards, futures, swaps, and options, as well as natural gas inventory, natural gas storage, and transportation contracts, to the extent such positions are significant, but excludes the positions mentioned above.

The VaR for Integrys Energy Services' portfolio at a 95% confidence level and a one-day holding period is presented in the following table:

(Millions)	2009	2008
As of December 31	\$ 0.6	\$ 1.3
Average for 12 months ended December 31	0.8	1.4
High for 12 months ended December 31	1.1	2.3
Low for 12 months ended December 31	0.6	0.9

The VaR for Integrys Energy Services' portfolio at a 99% confidence level and a ten-day holding period is presented below:

(Millions)	2009	2008
As of December 31	\$ 2.9	\$ 5.6
Average for 12 months ended December 31	3.8	6.2
High for 12 months ended December 31	4.7	10.2
Low for 12 months ended December 31	2.9	4.8

The average, high, and low amounts were computed using the VaR amounts at each of the four quarter ends.

The year-over-year decrease in VaR was driven by a substantial reduction in trading activity, as a result of Integrys Energy Services' strategy change and ultimate decision to exit its wholesale natural gas and electric businesses, and its Canadian energy marketing business.

#### Interest Rate Risk

Integrys Energy Group is exposed to interest rate risk resulting from its variable rate long-term debt and short-term borrowings. Exposure to interest rate risk is managed by limiting the amount of variable rate obligations and continually monitoring the effects of market changes on interest rates. Integrys Energy Group enters into long-term fixed rate debt when it is advantageous to do so. Integrys Energy Group may also enter into derivative financial instruments, such as swaps, to mitigate interest rate exposure.

Due to decreases in short-term borrowings in the last year, Integrys Energy Group has decreased its exposure to variable interest rates. Based on the variable rate debt of Integrys Energy Group outstanding at December 31, 2009, a hypothetical increase in market interest rates of 100 basis points would have increased annual interest expense by \$3.5 million. Comparatively, based on the variable rate debt outstanding at December 31, 2008, an increase in interest rates of 100 basis points would have increased interest expense by approximately \$11.7 million. This sensitivity analysis was performed assuming a constant level of variable rate debt during the period and an immediate increase in interest rates, with no other changes for the remainder of the period.

#### Equity Return and Principal Preservation Risk

Integrys Energy Group currently funds liabilities related to employee benefits through various external trust funds. The trust funds are managed by numerous investment managers and hold investments in debt and equity securities. Changes in the market value of these investments can have an impact on the future expenses related to these liabilities. Declines in the equity markets or declines in interest rates may result in increased future costs for the plans and possible future required contributions for the pension plans. Integrys Energy Group monitors the trust fund portfolio by benchmarking the performance of the investments against certain security indices. Most of the employee benefit costs relate to Integrys Energy Group's regulated utilities. As such, the majority of these costs are recovered in customers' rates, mitigating the equity return and principal preservation risk on these exposures. Effective May 1, 2008, and July 1, 2008, the defined pension plans were closed to new union hires at PGL and NSG, respectively. Effective April 19, 2009, and December 18, 2009, the defined benefit pension plans were closed to new union hires at UPPCO and WPS, respectively. Effective January 15, 2010, the defined pension plans were closed to new Local 12295 union hires at MGU.



ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

A. MANAGEMENT REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Integrys Energy Group and its subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting. Integrys Energy Group's control systems were designed to provide reasonable assurance to Integrys Energy Group's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Integrys Energy Group's management assessed the effectiveness of its internal control over financial reporting as of December 31, 2009. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. Based on this assessment, management believes that, as of December 31, 2009, Integrys Energy Group's internal control over financial reporting is effective based on those criteria.

Integrys Energy Group, Inc.'s independent registered public accounting firm has issued an audit report on the effectiveness of Integrys Energy Group's internal control over financial reporting.

B. REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Integrys Energy Group, Inc.:

We have audited the internal control over financial reporting of Integrys Energy Group, Inc. and subsidiaries (the "Company") as of December 31, 2009, based on criteria established in Internal Control –Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control –Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2009 of the Company and our report dated February 25, 2010 expressed an unqualified opinion on those financial statements and financial statement schedules.

/s/ Deloitte & Touche LLP

Milwaukee, Wisconsin  
February 25, 2010

-78-

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## C. CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31 (Millions, except per share data)	2009	2008	2007
Nonregulated revenues	\$ 4,004.0	\$ 9,737.9	\$ 6,987.0
Utility revenues	3,495.8	4,309.9	3,305.4
Total revenues	7,499.8	14,047.8	10,292.4
Nonregulated cost of fuel, natural gas, and purchased power	3,701.3	9,654.3	6,676.2
Utility cost of fuel, natural gas, and purchased power	1,919.8	2,744.1	2,044.2
Operating and maintenance expense	1,100.6	1,081.2	922.1
Goodwill impairment loss	291.1	6.5	-
Restructuring expense	43.5	-	-
Loss on Integrys Energy Services dispositions related to strategy change	28.9	-	-
Depreciation and amortization expense	230.9	221.4	195.1
Taxes other than income taxes	96.3	93.6	87.4
Operating income	87.4	246.7	367.4
Miscellaneous income	89.0	87.3	64.1
Interest expense	(164.8)	(158.1)	(164.5)
Other expense	(75.8)	(70.8)	(100.4)
Income before taxes	11.6	175.9	267.0
Provision for income taxes	83.2	51.2	86.0
Net income (loss) from continuing operations	(71.6)	124.7	181.0
Discontinued operations, net of tax	2.8	4.7	73.3
Net income (loss)	(68.8)	129.4	254.3
Preferred stock dividends of subsidiary	(3.1)	(3.1)	(3.1)
Noncontrolling interest in subsidiaries	1.0	0.1	0.1
Net income (loss) attributed to common shareholders	\$ (70.9)	\$ 126.4	\$ 251.3
Average shares of common stock			
Basic	76.8	76.7	71.6
Diluted	76.8	77.0	71.8
Earnings (loss) per common share (basic)			
Net income (loss) from continuing operations	\$ (0.96)	\$ 1.59	\$ 2.49
Discontinued operations, net of tax	0.04	0.06	1.02
Earnings (loss) per common share (basic)	\$ (0.92)	\$ 1.65	\$ 3.51
Earnings (loss) per common share (diluted)			
Net income (loss) from continuing operations	\$ (0.96)	\$ 1.58	\$ 2.48
Discontinued operations, net of tax	0.04	0.06	1.02



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Earnings (loss) per common share (diluted)	\$	(0.92)	\$	1.64	\$	3.50
Dividends per common share declared	\$	2.72	\$	2.68	\$	2.56

The accompanying notes to Integrys Energy Group's consolidated financial statements are an integral part of these statements.

## D. CONSOLIDATED BALANCE SHEETS

At December 31 (Millions)	2009	2008
<b>Assets</b>		
Cash and cash equivalents	\$ 44.5	\$ 254.1
Collateral on deposit	184.9	262.7
Accounts receivable and accrued unbilled revenues, net of reserves of \$57.5 and \$62.5, respectively	958.0	1,892.6
Inventories	304.3	732.8
Assets from risk management activities	1,522.1	2,223.7
Regulatory assets	121.1	244.0
Deferred income taxes	92.9	-
Assets held for sale	26.5	26.3
Other current assets	257.9	280.8
<b>Current assets</b>	<b>3,512.2</b>	<b>5,917.0</b>
Property, plant, and equipment, net of accumulated depreciation of \$2,847.2 and \$2,701.0, respectively	4,945.1	4,748.5
Regulatory assets	1,434.9	1,444.8
Assets from risk management activities	795.4	758.7
Goodwill	642.5	933.9
Other long-term assets	517.8	469.6
<b>Total assets</b>	<b>\$ 11,847.9</b>	<b>\$ 14,272.5</b>
<b>Liabilities and Equity</b>		
Short-term debt	\$ 222.1	\$ 1,209.0
Current portion of long-term debt	116.5	150.9
Accounts payable	639.4	1,534.3
Liabilities from risk management activities	1,607.1	2,189.7
Regulatory liabilities	100.4	58.8
Liabilities held for sale	0.3	7.5
Deferred income taxes	-	71.6
Other current liabilities	461.8	494.7
<b>Current liabilities</b>	<b>3,147.6</b>	<b>5,716.5</b>
Long-term debt	2,394.7	2,285.7
Deferred income taxes	658.2	435.7
Deferred investment tax credits	36.2	36.9
Regulatory liabilities	277.6	275.5
Environmental remediation liabilities	658.8	640.6
Pension and other postretirement benefit obligations	640.7	636.5
Liabilities from risk management activities	783.1	762.7
Asset retirement obligations	194.8	178.9
Other long-term liabilities	147.4	152.8
<b>Long-term liabilities</b>	<b>5,791.5</b>	<b>5,405.3</b>

## Commitments and contingencies

Common stock - \$1 par value; 200,000,000 shares authorized; 76,418,843 shares issued; 75,980,143 shares outstanding	76.4	76.4
Additional paid-in capital	2,497.8	2,487.9
Retained earnings	345.6	624.6
Accumulated other comprehensive loss	(44.0)	(72.8)
Treasury stock and shares in deferred compensation trust	(17.2)	(16.5)
Total common shareholders' equity	2,858.6	3,099.6
Preferred stock of subsidiary - \$100 par value; 1,000,000 shares authorized; 511,882 shares issued; 510,495 shares outstanding	51.1	51.1
Noncontrolling interest in subsidiaries	(0.9)	-
Total liabilities and equity	\$ 11,847.9	\$ 14,272.5

The accompanying notes to Integrys Energy Group's consolidated financial statements are an integral part of these statements.

## E. CONSOLIDATED STATEMENTS OF EQUITY

Integrys Energy Group Common Shareholders'  
Equity

(Millions)	Deferred Compensation Trust and Treasury Stock	Common Stock	Additional Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Common Shareholders' Equity	Preferred Stock of Noncontrolling Subsidiary	Interest	Total Equity
Balance at December 31, 2006	\$ (13.5)	\$ 43.4	\$ 889.3	\$ 628.2	\$ (13.8)	\$ 1,533.6	\$ 51.1	\$ 0.2	\$ 1,584.9
Net income attributed to common shareholders	-	-	-	251.3	-	251.3	-	(0.1)	251.2
Other comprehensive income									
Cash flow hedges (net of tax of \$3.1)	-	-	-	-	4.9	4.9	-	-	4.9
Unrecognized pension and other postretirement costs (net of taxes of \$3.0)	-	-	-	-	3.8	3.8	-	-	3.8
Available-for-sale securities (net of tax of \$0.2)	-	-	-	-	0.4	0.4	-	-	0.4
Foreign currency translation (net of tax of \$2.2)	-	-	-	-	3.6	3.6	-	-	3.6
Comprehensive income						264.0			263.9
Issuance of common stock	-	1.1	44.5	-	-	45.6	-	-	45.6
PEC merger	-	31.9	1,527.4	-	-	1,559.3	-	-	1,559.3
Stock based compensation	-	-	8.7	-	-	8.7	-	-	8.7
Dividends on common stock	-	-	-	(177.0)	-	(177.0)	-	-	(177.0)
Net contributions from noncontrolling parties	-	-	-	-	-	-	-	0.1	0.1
Other	(1.5)	-	3.9	(0.6)	(0.2)	1.6	-	(0.2)	1.4
	\$ (15.0)	\$ 76.4	\$ 2,473.8	\$ 701.9	\$ (1.3)	\$ 3,235.8	\$ 51.1	\$ -	\$ 3,286.9

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Balance at December 31, 2007									
Net income attributed to common shareholders	-	-	-	126.4	-	126.4	-	(0.1)	126.3
Other comprehensive income (loss)									
Cash flow hedges (net of tax of \$33.7)	-	-	-	-	(52.8)	(52.8)	-	-	(52.8)
Unrecognized pension and other postretirement costs (net of taxes of \$8.1)	-	-	-	-	(12.7)	(12.7)	-	-	(12.7)
Available-for-sale securities (net of tax of \$0.3)	-	-	-	-	(0.5)	(0.5)	-	-	(0.5)
Foreign currency translation (net of tax of \$3.4)	-	-	-	-	(5.5)	(5.5)	-	-	(5.5)
Comprehensive income						54.9			54.8
Cumulative effect of change in accounting principle	-	-	-	4.5	-	4.5	-	-	4.5
Effects of changing pension plan measurement date pursuant to SFAS No. 158	-	-	-	(3.5)	-	(3.5)	-	-	(3.5)
Purchase of deferred compensation shares	(2.7)	-	-	-	-	(2.7)	-	-	(2.7)
Stock based compensation	0.1	-	12.5	-	-	12.6	-	-	12.6
Dividends on common stock	-	-	-	(203.9)	-	(203.9)	-	-	(203.9)
Net contributions from noncontrolling parties	-	-	-	-	-	-	-	0.1	0.1
Other	1.1	-	1.6	(0.8)	-	1.9	-	-	1.9
Balance at December 31, 2008	\$ (16.5)	\$ 76.4	\$ 2,487.9	\$ 624.6	\$ (72.8)	\$ 3,099.6	\$ 51.1	\$ -	\$ 3,150.7
Net loss attributed to common shareholders	-	-	-	(70.9)	-	(70.9)	-	(1.0)	(71.9)
Other comprehensive income (loss)									

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Cash flow hedges (net of tax of \$17.0)	-	-	-	-	31.5	31.5	-	-	31.5
Unrecognized pension and other postretirement costs (net of taxes of \$3.2)	-	-	-	-	(6.7)	(6.7)	-	-	(6.7)
Available-for-sale securities (net of tax of \$0.1)	-	-	-	-	(0.1)	(0.1)	-	-	(0.1)
Foreign currency translation (net of tax of \$2.6)	-	-	-	-	4.1	4.1	-	-	4.1
Comprehensive loss						(42.1)			(43.1)
Purchase of deferred compensation shares	(3.1)	-	-	-	-	(3.1)	-	-	(3.1)
Stock based compensation	0.1	-	11.3	-	-	11.4	-	-	11.4
Dividends on common stock	-	-	-	(206.9)	-	(206.9)	-	-	(206.9)
Net contributions from noncontrolling parties	-	-	-	-	-	-	-	0.1	0.1
Other	2.3	-	(1.4)	(1.2)	-	(0.3)	-	-	(0.3)
Balance at December 31, 2009	\$ (17.2)	\$ 76.4	\$ 2,497.8	\$ 345.6	\$ (44.0)	\$ 2,858.6	\$ 51.1	\$ (0.9)	\$ 2,908.8

The accompanying notes to Integrys Energy Group's consolidated financial statements are an integral part of these statements.

## F. CONSOLIDATED STATEMENTS OF CASH FLOWS

Year Ended December 31 (Millions)	2009	2008	2007
<b>Operating Activities</b>			
Net income (loss)	\$ (68.8)	\$ 129.4	\$ 254.3
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities			
Discontinued operations, net of tax	(2.8)	(4.7)	(73.3)
Goodwill impairment loss	291.1	6.5	-
Depreciation and amortization expense	230.9	221.4	195.1
Refund of nonqualified decommissioning trust	(0.5)	(0.5)	(70.6)
Recoveries and refunds of other regulatory assets and liabilities	41.3	51.2	32.6
Net unrealized losses (gains) on nonregulated energy contracts	104.2	(15.8)	(59.5)
Nonregulated lower of cost or market inventory adjustments	44.2	167.3	7.0
Bad debt expense	54.6	76.8	39.1
Pension and other postretirement expense	72.4	50.7	67.5
Pension and other postretirement contributions	(53.3)	(40.8)	(35.3)
Deferred income taxes and investment tax credit	57.8	62.4	66.8
(Gain) loss on sale of assets	25.5	(1.2)	(1.6)
Equity income, net of dividends	(16.1)	(15.1)	2.4
Other	38.5	9.9	(24.1)
<b>Changes in working capital</b>			
Collateral on deposit	45.5	(239.2)	82.0
Accounts receivable and accrued unbilled revenues	864.8	(207.7)	(30.7)
Inventories	444.1	(312.0)	(172.9)
Other current assets	39.6	(124.6)	0.9
Accounts payable	(604.7)	(53.2)	(96.5)
Other current liabilities	(2.0)	(10.8)	55.3
Net cash provided by (used for) operating activities	1,606.3	(250.0)	238.5
<b>Investing Activities</b>			
Capital expenditures	(444.2)	(532.8)	(392.6)
Proceeds from the sale or disposal of assets	44.6	31.1	15.6
Purchase of equity investments	(34.1)	(37.8)	(66.5)
Cash paid for transaction costs related to PEC merger	-	-	(14.4)
Restricted cash for repayment of long-term debt	-	-	22.0
Cash paid for transmission interconnection	-	(17.4)	(23.9)
Proceeds received from transmission interconnection	-	99.7	-
Other	(7.0)	5.0	8.3
Net cash used for investing activities	(440.7)	(452.2)	(451.5)
<b>Financing Activities</b>			
Short-term debt, net	(815.7)	569.7	(463.7)
Issuance of notes payable	-	155.7	-
Redemption of notes payable	(157.9)	-	-
Proceeds from sale of borrowed natural gas	162.0	530.4	211.9

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Purchase of natural gas to repay natural gas loans	(445.2)	(257.2)	(177.5)
Issuance of long-term debt	230.0	181.5	125.2
Repayment of long-term debt	(157.8)	(58.1)	(26.5)
Payment of dividends			
Preferred stock	(3.1)	(3.1)	(3.1)
Common stock	(206.9)	(203.9)	(177.0)
Issuance of common stock	-	-	45.6
Proceeds from derivative contracts related to divestitures classified as financing activities	33.9	-	-
Other	(17.7)	(3.7)	5.9
Net cash (used for) provided by financing activities	(1,378.4)	911.3	(459.2)
Change in cash and cash equivalents - continuing operations	(212.8)	209.1	(672.2)
Change in cash and cash equivalents - discontinued operations			
Net cash used for operating activities	-	-	(109.3)
Net cash provided by investing activities	3.2	3.8	799.5
Change in cash and cash equivalents	(209.6)	212.9	18.0
Cash and cash equivalents at beginning of year	254.1	41.2	23.2
Cash and cash equivalents at end of year	\$ 44.5	\$ 254.1	\$ 41.2

The accompanying notes to Integrys Energy Group's consolidated financial statements are an integral part of these statements.



## G. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1--SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Operations--Integrys Energy Group is a holding company whose primary wholly owned subsidiaries at December 31, 2009 included WPS, UPPCO, MGU, MERC, PGL, NSG, IBS, and Integrys Energy Services. Of these subsidiaries, six are regulated electric and/or natural gas utilities, one, IBS, is a wholly owned centralized service company, and one, Integrys Energy Services, is a nonregulated energy supply and services company. In addition, WPS Investments, LLC holds an approximate 34% interest in ATC.

The term "utility" refers to the regulated activities of the electric and natural gas utility segments, while the term "nonutility" refers to the activities of the electric and natural gas utility segments that are not regulated. The term "nonregulated" refers to activities at Integrys Energy Services, the Integrys Energy Group holding company, and the PEC holding company.

(b) Consolidated Basis of Presentation--The consolidated financial statements include the accounts of Integrys Energy Group and all majority owned subsidiaries, after eliminating intercompany transactions and balances. If a noncontrolling owner's equity is reduced to zero, Integrys Energy Group's policy is to record 100% of the subsidiary's losses until the noncontrolling owner makes capital contributions or commits to fund its share of the operating costs. The cost method of accounting is used for investments when Integrys Energy Group does not have significant influence over the operating and financial policies of the investee. Investments in businesses not controlled by Integrys Energy Group, but over which it has significant influence regarding the operating and financial policies of the investee, are accounted for using the equity method. For additional information on equity method investments, see Note 9, "Investments in Affiliates, at Equity Method." These consolidated financial statements also reflect Integrys Energy Group's proportionate interests in certain jointly owned utility facilities.

(c) Use of Estimates--Integrys Energy Group prepares its consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Integrys Energy Group makes estimates and assumptions that affect assets, liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

(d) Cash and Cash Equivalents--Short-term investments with an original maturity of three months or less are reported as cash equivalents.

The following is supplemental disclosure to the Integrys Energy Group Consolidated Statements of Cash Flows:

(Millions)	2009	2008	2007
Cash paid for interest	\$ 164.8	\$ 156.8	\$ 144.5
Cash paid for income taxes	19.1	100.9	198.1

Significant non-cash transactions were:

(Millions)	2009	2008	2007
Construction costs funded through accounts payable	\$ 30.4	\$ 34.2	\$ 26.1
Intangible assets (customer contracts) received in exchange for risk management assets	17.0	-	-
Equity issued for net assets acquired in PEC merger	-	-	1,559.3
Realized gain on settlement of contracts due to PEC merger	-	-	4.0
PEP post-closing adjustments funded through other current liabilities	-	-	9.9

(e) Revenue and Customer Receivables--Revenues are recognized on the accrual basis and include estimated amounts for electric and natural gas services provided but not billed. At December 31, 2009, and 2008, Integrys Energy Group's unbilled revenues were \$337.0 million and \$525.5 million, respectively. At December 31, 2009, there were no customers or industries that accounted for more than 10% of Integrys Energy Group's revenues.

Prudent fuel and purchased power costs are recovered from customers under one-for-one recovery mechanisms by UPPCO and by the wholesale electric operations and Michigan retail electric operations of WPS, which provide for subsequent adjustments to rates for changes in commodity costs. There is a portion of WPS's wholesale electric business that limits cost recovery to no greater than the 2-year average rate charged to large industrial retail customers for that same period. The costs of natural gas prudently incurred by the natural gas utility subsidiaries are also recovered from customers under one-for-one recovery mechanisms.

WPS's Wisconsin retail electric operations do not have a one-for-one recovery mechanism. Instead, a "fuel window" mechanism is used to recover fuel and purchased power costs. Under the fuel window, if actual fuel and purchased power costs deviate by more than 2% from costs included in the rates charged to customers, a rate review can be triggered. Once a rate review is triggered, rates may be reset (subject to PSCW approval) for the remainder of the year to recover or refund, on an annualized basis, the projected increase or decrease in the cost of fuel and purchased power.

All of Integrys Energy Group's utility subsidiaries are required to provide service and grant credit (with applicable deposit requirements) to customers within their service territories. The companies continually review their customers' credit-worthiness and obtain or refund deposits accordingly. The utilities are generally precluded from discontinuing service to residential customers during winter moratorium months.

PGL credits proceeds from its interstate services against natural gas costs, resulting in a reduction to utility customers' natural gas charges.

WPS and UPPCO both sell and purchase power in the MISO market. If WPS or UPPCO is a net seller in a particular hour, the net amount is reported as revenue. If WPS or UPPCO is a net purchaser in a particular hour, the net amount is recorded as utility cost of fuel, natural gas, and purchased power on the Consolidated Statements of Income.

Integrys Energy Group presents revenues net of pass-through taxes on the Consolidated Statements of Income.

(f) Inventories--Inventories consist of natural gas in storage, liquid propane, and fossil fuels, including coal. Average cost is used to value fossil fuels, liquid propane, and natural gas in storage for the regulated utilities, excluding PGL and NSG. PGL and NSG price natural gas storage injections at the calendar year average of the costs of natural gas supply purchased. Withdrawals from storage are priced on the LIFO cost method. Inventories stated on a LIFO basis represented approximately 34% of total inventories at December 31, 2009, and 16% of total inventories at December 31, 2008. The estimated replacement cost of natural gas in inventory at December 31, 2009, and December 31, 2008, exceeded



the LIFO cost by approximately \$220.5 million and \$212.2 million, respectively. In calculating these replacement amounts, PGL and NSG used a Chicago city-gate natural gas price per dekatherm of \$6.14 at December 31, 2009, and \$5.80 at December 31, 2008.

Inventories at Integrys Energy Services are valued at the lower of cost or market unless hedged pursuant to a fair value hedge, in which case changes in the fair value of inventory subsequent to the hedge designation are recorded directly to inventory. Integrys Energy Services recorded net write-downs of \$44.2 million, \$167.3 million, and \$7.0 million in 2009, 2008, and 2007, respectively.

(g) **Risk Management Activities**--As part of its regular operations, Integrys Energy Group enters into contracts, including options, swaps, futures, forwards, and other contractual commitments, to manage market risks such as changes in commodity prices and interest rates, which are described more fully in Note 2, "Risk Management Activities." Derivative instruments at the utilities are entered into in accordance with the terms of the risk management plans approved by their respective Boards of Directors and, if applicable, by their respective regulators.

All derivatives are recognized on the balance sheet at their fair value unless they qualify for the normal purchases and sales exception. Integrys Energy Group continually assesses its contracts designated as normal and will discontinue the treatment of these contracts as normal if the required criteria are no longer met. Most energy-related physical and financial derivatives at the utilities qualify for regulatory deferral. These derivatives are marked to fair value; the resulting risk management assets are offset with regulatory liabilities or decreases to regulatory assets, and risk management liabilities are offset with regulatory assets or decreases to regulatory liabilities. Management believes any gains or losses resulting from the eventual settlement of these derivative instruments will be refunded to or collected from customers in rates.

Integrys Energy Group classifies unrealized gains and losses on derivative instruments that do not qualify for hedge accounting or regulatory deferral as a component of margins or operating and maintenance expense, depending on the nature of the transactions. Unrealized gains and losses on fair value hedges are recognized currently in revenue, as are the changes in fair value of the hedged items. To the extent they are effective, the changes in the values of contracts designated as cash flow hedges are included in other comprehensive income, net of taxes. Fair value hedge ineffectiveness and cash flow hedge ineffectiveness are recorded in revenue or operating and maintenance expense on the Consolidated Statements of Income, based on the nature of the transactions. Cash flows from derivative activities are presented in the same category as the item being hedged within operating activities on the Consolidated Statements of Cash Flows unless the derivative contracts contain an other-than-insignificant financing element, in which case the cash flows are classified within financing activities.

FASB ASC 815-10-45 provides the option to present certain asset and liability derivative positions net on the balance sheet and to net the related cash collateral against these net derivative positions. Integrys Energy Group elected not to net these items. On the Consolidated Balance Sheets, cash collateral provided to others is shown separately as collateral on deposit, and cash collateral received from others is reflected in other current liabilities.

(h) **Emission Allowances**--Integrys Energy Services accounts for emission allowances as intangible assets, with cash inflows and outflows related to purchases and sales of emission allowances recorded as investing activities in the Consolidated Statements of Cash Flows. Integrys Energy Services uses the guidance under the Property, Plant, and Equipment Topic of the FASB ASC to test allowances for impairment. The utilities account for emission allowances as inventory at average cost by vintage year. Charges to income result when allowances are utilized in operating the utilities' generation plants. Gains on sales of allowances at the utilities are returned to ratepayers.

(i) **Property, Plant, and Equipment**--Utility plant is stated at original cost, including any associated AFUDC and asset retirement costs. The costs of renewals and betterments of units of property (as distinguished from minor items of property) are capitalized as additions to the utility plant accounts. Except for land, no gain or loss is recognized in

connection with ordinary retirements of utility property

-85-

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units. Maintenance, repair, replacement, and renewal costs associated with items not qualifying as units of property are considered operating expenses. PGL and NSG charge the cost of units of property retired, sold, or otherwise disposed of to the accumulated provision for depreciation and record the cost of removal, less salvage value, associated with the retirement to depreciation expense. The other utilities charge the cost of units of property retired, sold, or otherwise disposed of, less salvage value, to the accumulated provision for depreciation and record a regulatory liability for removal costs included in rates, with actual removal costs charged against the liability as incurred. Consistent with the ICC rate order issued January 22, 2010, PGL and NSG changed their method for recognizing net dismantling costs from as incurred to allocating the cost over the life of the asset.

Integrys Energy Group records straight-line depreciation expense over the estimated useful life of utility property, using depreciation rates as approved by the applicable regulators. Annual utility composite depreciation rates are shown below.

Annual Utility Composite Depreciation Rates	2009	2008	2007
WPS – Electric	3.04%	3.09%	3.35%
WPS – Natural gas	3.30%	3.39%	3.52%
UPPCO	3.05%	2.98%	3.01%
MGU	2.66%	2.67%	2.67%
MERC	3.10%	3.32%	3.42%
PGL	2.29%	2.55%	2.86% *
NSG	1.66%	1.80%	1.85% *

\* Composite depreciation rate from the February 22, 2007 PEC merger date through the end of 2007.

Interest capitalization is applied to nonutility property during construction, and a gain or loss is recognized for retirements. At December 31, 2009, and 2008, nonutility property at the regulated utilities consisted primarily of land.

Nonregulated plant is stated at cost, which includes capitalized interest. The costs of renewals, betterments, and major overhauls are capitalized as additions to plant. The gains or losses associated with ordinary retirements are recorded in the period of retirement. Maintenance, repair, and minor replacement costs are expensed as incurred.

Depreciation is computed for the majority of the nonregulated subsidiaries' assets using the straight-line method over the assets' useful lives.

Integrys Energy Group capitalizes certain costs related to software developed or obtained for internal use and amortizes those costs to operating expense over the estimated useful life of the related software, which ranges from 3 to 15 years. If software is retired prior to being fully amortized, the difference is recorded as a loss on the Consolidated Statements of Income.

See Note 6, "Property, Plant, and Equipment," for details regarding Integrys Energy Group's property, plant, and equipment balances.

(j) Capitalized Interest and AFUDC--The nonregulated subsidiaries capitalize interest for construction projects, while the utilities capitalize the cost of funds used for construction using a calculation that includes both internal equity and external debt components. The internal equity component of capitalized AFUDC is accounted for as other income, and the external debt component is accounted for as a decrease to interest expense.

Approximately 50% of WPS's retail jurisdictional construction work in progress expenditures are subject to the AFUDC calculation. For 2009, WPS's average AFUDC retail rate was 8.61%, and its average AFUDC wholesale rate was 7.78%. WPS's allowance for equity funds used during construction for 2009, 2008, and 2007 was \$5.1 million,

\$5.2 million, and \$0.9 million, respectively. WPS's allowance for borrowed

-86-

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funds used during construction for 2009, 2008, and 2007 was \$2.0 million, \$1.8 million, and \$0.3 million, respectively.

The AFUDC calculation for IBS and the other utilities is determined by the respective state commissions, each with specific requirements. Based on these requirements, IBS and the other utilities did not record significant AFUDC for 2009, 2008, or 2007.

Interest capitalized at the nonregulated subsidiaries was not significant during 2009, 2008, and 2007.

(k) **Regulatory Assets and Liabilities**--Regulatory assets represent probable future revenue associated with certain costs or liabilities that have been deferred and are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent amounts that are expected to be refunded to customers in future rates or amounts collected in rates for future costs. If at any reporting date a previously recorded regulatory asset is no longer probable of recovery, the regulatory asset is reduced to the amount considered probable of recovery with the reduction charged to expense in the year the determination is made. See Note 8, "Regulatory Assets and Liabilities," for more information.

(l) **Asset Impairment**--Goodwill and other intangible assets with indefinite lives are not amortized, but are subject to an annual impairment test. Other long-lived assets require an impairment review when events or circumstances indicate that the carrying amount may not be recoverable. Integrys Energy Group bases its evaluation of other long-lived assets on the presence of impairment indicators such as the future economic benefit of the assets, any historical or future profitability measurements, and other external market conditions or factors.

Integrys Energy Group's reporting units containing goodwill perform annual goodwill impairment tests during the second quarter of each year, and interim impairment tests are performed when impairment indicators are present. The carrying amount of the reporting unit's goodwill is considered not recoverable if the carrying amount of the reporting unit as a whole exceeds the reporting unit's fair value. An impairment charge is recorded for any excess of the carrying value of the goodwill over the implied fair value. For more information on Integrys Energy Group's goodwill and other intangible assets, see Note 10, "Goodwill and Other Intangible Assets."

The carrying amount of assets held and used is considered not recoverable if it exceeds the undiscounted sum of cash flows expected to result from the use and eventual disposition of the asset. If the carrying value is not recoverable, the impairment loss is measured as the excess of the asset's carrying value over its fair value.

The carrying value of assets held for sale is not recoverable if it exceeds the fair value less cost to sell the asset. An impairment charge is recorded for any excess of the carrying value over the fair value less estimated cost to sell.

The carrying values of cost and equity method investments are assessed for impairment by comparing the fair values of these investments to their carrying values, if a fair value assessment was completed, or by reviewing for the presence of impairment indicators. If an impairment exists and it is determined to be other-than-temporary, a charge is recognized equal to the amount the carrying value exceeds the investment's fair value.

(m) **Retirement of Debt**--Any call premiums or unamortized expenses associated with refinancing utility debt obligations are amortized consistent with regulatory treatment of those items. Any gains or losses resulting from the retirement of nonutility debt are recorded through earnings, while gains or losses resulting from the retirement of utility debt that is not refinanced are either amortized over the remaining life of the original debt or recorded through earnings.

(n) **Asset Retirement Obligations**--Integrys Energy Group recognizes legal obligations at fair value associated with the retirement of tangible long-lived assets that result from the acquisition, construction or development, and/or



normal operation of the assets. A liability is recorded for these obligations as long as

-87-

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the fair value can be reasonably estimated, even if the timing or method of settling the obligation is unknown. The asset retirement obligations are accreted using a credit-adjusted risk-free interest rate commensurate with the expected settlement dates of the asset retirement obligations; this rate is determined at the date the obligation is incurred. The associated retirement costs are capitalized as part of the related long-lived assets and are depreciated over the useful lives of the assets. See Note 14, "Asset Retirement Obligations," for more information.

(o) **Income Taxes--Deferred income taxes** have been recorded to recognize the expected future tax consequences of events that have been included in the financial statements by using currently enacted tax rates for the differences between the tax basis of assets and liabilities and the basis reported in the financial statements. Integrys Energy Group records valuation allowances for deferred tax assets when it is uncertain if the benefit will be realized in the future. Integrys Energy Group's regulated utilities defer certain adjustments made to income taxes that will impact future rates and record regulatory assets or liabilities related to these adjustments.

Investment tax credits that reduce income taxes payable for the current year are recognized as a reduction of the provision for income taxes if the credits are generated in Integrys Energy Group's nonregulated operations unless it is likely that the related property that generated the tax credits will be sold after the end of the year with the tax credits transferred to the seller as permitted under tax law. For investment tax credits generated within regulated operations, regulators reduce Integrys Energy Group's future rates over the lives of the property to which the tax credits relate. Accordingly, Integrys Energy Group defers the investment tax credits in the year the taxes payable are reduced and reduces the provision for income taxes over the useful lives of the related property. Production tax credits generally reduce the provision for income taxes in the year that electricity from the qualifying facility is generated and sold. Investment tax credits and production tax credits that do not reduce income taxes payable for the current year are eligible for carryover and recognized as a deferred tax asset. A valuation allowance is established unless it is more likely than not that the credits will be realized during the carryforward period.

Integrys Energy Group files a consolidated United States income tax return that includes domestic subsidiaries of which its ownership is 80% or more. Integrys Energy Group and its consolidated subsidiaries are parties to a tax allocation arrangement under which each entity determines its provision for income taxes on a stand-alone basis. In several states, combined or consolidated filing is required for certain members of Integrys Energy Group doing business in that state. The tax allocation arrangement equitably allocates the state taxes associated with these combined or consolidated filings.

Integrys Energy Group reports interest and penalties accrued related to income taxes as a component of provision for income taxes in the Consolidated Statements of Income, as well as regulatory assets or regulatory liabilities in the Consolidated Balance Sheets.

For more information regarding Integrys Energy Group's accounting for income taxes, see Note 15, "Income Taxes."

(p) **Guarantees--Integrys Energy Group** follows the guidance of the Guarantees Topic of the FASB ASC, which requires that the guarantor recognize, at the inception of the guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. For additional information on guarantees, see Note 17, "Guarantees."

(q) **Employee Benefits--The costs of pension and other postretirement benefits** are expensed over the periods during which employees render service. The transition obligation related to other postretirement plans that existed at Integrys Energy Group prior to the PEC merger is being recognized over a 20-year period beginning in 1993. In computing the expected return on plan assets, Integrys Energy Group uses a market-related value of plan assets. Changes in fair value are recognized over the subsequent five years for plans sponsored by WPS, while differences between actual investment returns and the expected return on plan assets are recognized over a five-year period for pension plans sponsored by IBS and PEC. The benefit costs associated with employee benefit plans are allocated among Integrys Energy Group's subsidiaries based on employees' time reporting and actuarial



calculations, as applicable. Integrys Energy Group's regulators allow recovery in rates for the regulated utilities' net periodic benefit cost calculated under GAAP.

Integrys Energy Group recognizes the funded status of defined benefit postretirement plans on the balance sheet, and recognizes changes in the plans' funded status in the year in which the changes occur. Integrys Energy Group's nonregulated segments record changes in the funded status in other comprehensive income, and the regulated utilities record these changes to regulatory asset or liability accounts.

Integrys Energy Group uses a December 31 measurement date for all of its pension and other postretirement benefit plans.

For additional information on Integrys Energy Group's employee benefits, see Note 18, "Employee Benefit Plans."

(r) Fair Value--Effective January 1, 2008, Integrys Energy Group adopted SFAS No. 157, "Fair Value Measurements" (now incorporated as part of the Fair Value Measurements and Disclosures Topic of the FASB ASC). This standard defined fair value and required enhanced disclosures about assets and liabilities carried at fair value. These disclosures can be found in Note 22, "Fair Value."

A fair value measurement is required to reflect the assumptions market participants would use in pricing an asset or liability based on the best available information. These assumptions include the risks inherent in a particular valuation technique (such as a pricing model) and the risks inherent in the inputs to the model. Also, transaction costs should not be considered in the determination of fair value. On January 1, 2008, Integrys Energy Group recognized an increase in nonregulated revenues of \$11.0 million due to the exclusion of transaction costs from Integrys Energy Services' fair value estimates.

SFAS No. 157 nullified a portion of Emerging Issues Task Force Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities." Under Issue No. 02-3, inception gains or losses were deferred unless the fair value of the derivative was substantially based on quoted prices or other current market transactions. However, SFAS No. 157 provided a framework to consider, in evaluating a transaction, whether a transaction represents fair value at initial recognition. Integrys Energy Services recognized a pre-tax cumulative effect increase to retained earnings of \$4.5 million on January 1, 2008, related to the nullification of the aforementioned portion of Issue No. 02-3.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). Integrys Energy Group utilizes a mid-market pricing convention (the mid-point price between bid and ask prices) as a practical expedient for valuing certain derivative assets and liabilities.

SFAS No. 157 established a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are defined as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are observable, either directly or indirectly, but are not quoted prices included within Level 1. Level 2 includes those financial instruments that are valued using external inputs within models or other valuation methodologies.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's

-89-

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best estimate of fair value. Level 3 instruments include those that may be more structured or otherwise tailored to customers' needs.

Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

(s) Subsequent Events--Subsequent events at Integrys Energy Group were evaluated for potential recognition or disclosure through February 25, 2010, which is the date the consolidated financial statements were issued.

(t) New Accounting Pronouncements--SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)" (now incorporated as part of the Consolidation Topic of the FASB ASC), was issued in June 2009. This statement introduces a requirement to perform ongoing assessments to determine whether an entity is a variable interest entity and whether an enterprise is the primary beneficiary of a variable interest entity. In addition, this statement clarifies that the enterprise that is required to consolidate a variable interest entity will have a controlling financial interest evidenced by (1) the power to direct the activities that most significantly affect the entity's economic performance, and (2) the obligation to absorb losses or the right to receive benefits that are potentially significant to the variable interest entity. Additional disclosures are required regarding involvement with variable interest entities, as well as the methodology used to determine the primary beneficiary of any variable interest entities. This standard was effective for Integrys Energy Group beginning January 1, 2010. Management is currently evaluating the impact that the adoption will have on Integrys Energy Group's first quarter 2010 consolidated financial statements.

#### NOTE 2--RISK MANAGEMENT ACTIVITIES

The following table shows Integrys Energy Group's assets and liabilities from risk management activities:

(Millions)	Balance Sheet Presentation *	Risk Management Assets		Risk Management Liabilities	
		December 31 2009	December 31 2008	December 31 2009	December 31 2008
Utility Segments					
Non-hedge derivatives					
Commodity contracts	Current	\$ 10.8	\$ 28.6	\$ 24.7	\$ 161.6
Commodity contracts	Long-term	2.0	-	1.5	9.0
Cash flow hedges					
Commodity contracts	Current	-	-	0.2	1.5
Commodity contracts	Long-term	-	-	0.1	-
Nonregulated Segments					
Non-hedge derivatives					
Commodity contracts	Current	1,503.9	2,080.9	1,548.4	1,944.2
Commodity contracts	Long-term	787.2	750.0	769.5	729.7
Interest rate swaps	Current	-	-	1.0	1.0
Interest rate swaps	Long-term	-	-	2.5	3.3
Foreign exchange contracts	Current	1.0	2.8	0.9	0.5
Foreign exchange contracts	Long-term	0.9	2.5	0.9	2.3
Fair value hedges					
Commodity contracts	Current	-	14.2	-	-
Interest rate swaps	Current	1.8	1.1	-	-
Interest rate swaps	Long-term	0.8	2.1	-	-
Cash flow hedges					

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Commodity contracts	Current	4.6	81.3	30.1	79.4
Commodity contracts	Long-term	4.5	4.1	8.6	14.8
Interest rate swaps	Current	-	-	1.8	1.5
Interest rate swaps	Long-term	-	-	-	3.6
Foreign exchange contracts	Current	-	14.8	-	-
Total		\$ 2,317.5	\$ 2,982.4	\$ 2,390.2	\$ 2,952.4

\* Assets and liabilities from risk management activities are classified as current or long-term based upon the maturities of the underlying contracts.

At December 31, 2008, \$0.6 million of current non-hedge commodity derivative contracts were classified as liabilities held for sale in the nonregulated Integrys Energy Services segment. For more information see Note 4, "Dispositions."

The following table shows Integrys Energy Group's cash collateral positions:

(Millions)	December 31, 2009	December 31, 2008
Cash collateral provided to others	\$ 184.9	\$ 262.7
Cash collateral received from others	55.2	18.9

Certain of Integrys Energy Group's derivative and nonderivative commodity instruments contain provisions that could require "adequate assurance" in the event of a material adverse change in Integrys Energy Group's creditworthiness, or the posting of additional collateral for instruments in net liability positions, if triggered by a decrease in credit ratings. The aggregate fair value of all derivative instruments with specific credit-risk related contingent features that were in a liability position at December 31, 2009, was \$579.6 million. As of December 31, 2009, Integrys Energy Group had not posted any cash collateral related to the credit-risk related contingent features of these commodity instruments.

If all of the credit-risk related contingent features contained in commodity instruments (including derivatives, non-derivatives, normal purchase and normal sales contracts, and applicable payables and receivables) had been triggered at December 31, 2009, Integrys Energy Group would have been required to post collateral of \$566.3 million. Of this amount, Integrys Energy Group had already satisfied \$51.9 million with letters of credit. Therefore, the remaining collateral requirement would have been \$514.4 million.

#### Utility Segments

##### Non-Hedge Derivatives

Utility derivatives include a limited number of natural gas purchase contracts, financial derivative contracts (futures, options, and swaps), and financial transmission rights (FTRs) used to manage electric transmission congestion costs. The futures, options, and swaps were used by both the electric and natural gas utility segments to mitigate the risks associated with the market price volatility of natural gas supply costs and the costs of gasoline and diesel fuel used by utility vehicles.

The table below shows the unrealized gains (losses) recorded related to non-hedge derivatives at the utilities.

(Millions)	Financial Statement Presentation	2009
Commodity contracts	Balance Sheet – Regulatory assets (current)	\$ 122.5
Commodity contracts	Balance Sheet – Regulatory assets (long-term)	7.3
Commodity contracts	Balance Sheet – Regulatory liabilities (current)	(1.0)
Commodity contracts	Balance Sheet – Regulatory liabilities (long-term)	-
Commodity contracts	Income Statement – Utility cost of fuel, natural gas, and purchased power	0.1

At December 31, 2009, the utilities had the following notional volumes of outstanding non-hedge derivative contracts:

	Purchases	Other Transactions
Natural gas (millions of therms)	833.2	N/A
FTRs (millions of kilowatt-hours)	N/A	4,546.6
Petroleum products (barrels)	42,823	N/A





## Cash Flow Hedges

PGL uses commodity contracts designated as cash flow hedges to hedge changes in the price of natural gas used to support operations. These contracts extend through December 2011. At December 31, 2009, PGL had the following notional volumes of outstanding contracts that were designated as cash flow hedges:

	Purchases
Natural gas (millions of therms)	9.6

Changes in the fair values of the effective portions of these contracts are included in other comprehensive income (OCI), net of taxes. Amounts recorded in OCI related to these cash flow hedges will be recognized in earnings when the hedged transactions occur, or if it is probable that the hedged transaction will not occur. The tables below show the amounts related to cash flow hedges recorded in OCI and in earnings.

(Millions)	Unrealized Loss Recognized in OCI on Derivative Instruments (Effective Portion) 2009
Commodity contracts	\$ (1.4)

(Millions)	Income Statement Presentation	Loss Reclassified from Accumulated OCI into Income (Effective Portion) 2009
Settled commodity contracts	Operating and maintenance expense	\$ (2.6)

The amount reclassified from accumulated OCI into earnings as a result of the discontinuance of cash flow hedge accounting for certain hedge transactions was not significant during 2009, was a pre-tax loss of \$2.7 million during 2008, and was not significant during 2007. Cash flow hedge ineffectiveness related to these commodity contracts was not significant during 2009 and 2008, and was a pre-tax loss of \$4.4 million in 2007. When testing for effectiveness, no portion of the derivative instruments was excluded. In the next 12 months, PGL expects that an insignificant pre-tax loss will be recognized in earnings as the hedged transactions occur.

## Nonregulated Segments

## Non-Hedge Derivatives

IntegrYS Energy Group's nonregulated segments enter into derivative contracts such as futures, forwards, options, and swaps that are not designated as accounting hedges under GAAP. In most cases, these contracts are used to manage commodity price risk associated with customer related contracts, interest rate risk associated with expected future

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natural gas purchases, and foreign currency exchange rate risk related to the wrap up of the Canadian marketing operations.

At December 31, 2009, the nonregulated segments had the following notional volumes of outstanding non-hedge derivative contracts:

(Millions)	Purchases	Sales	Other Transactions
Commodity contracts			
Natural gas (therms)	2,990.4	2,917.1	N/A
Power (kilowatt-hours)	132,200.4	125,983.1	N/A
Interest rate swaps	N/A	N/A	\$ 219.2
Foreign exchange contracts	\$ 35.1	\$ 35.1	N/A

-92-

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Gains (losses) related to non-hedge derivatives are recognized currently in earnings, as shown in the table below.

(Millions)	Income Statement Presentation	2009
Commodity contracts	Nonregulated revenue	\$ (5.1)
Commodity contracts	Nonregulated revenue (reclassified from accumulated OCI)	(3.2) *
Interest rate swaps	Interest expense	(1.7)
Foreign exchange contracts	Nonregulated revenue	(1.8)
Total		\$ (11.8)

\*Represents amounts amortized out of accumulated OCI related to cash flow hedges that were dedesignated in prior quarters.

#### Fair Value Hedges

At PEC, an interest rate swap designated as a fair value hedge is used to hedge changes in the fair value of \$50.0 million of PEC Series A 6.9% notes due January 15, 2011. The changes in the fair value of this hedge are recognized currently in earnings, as are the changes in fair value of the hedged item. Unrealized gains (losses) related to the fair value hedge and the related hedged item are shown in the table below.

(Millions)	Income Statement Presentation	2009
Interest rate swap	Interest expense	\$ (0.6)
Debt hedged by swap	Interest expense	0.6
Total		\$ -

Fair value hedge ineffectiveness recorded in interest expense on the Consolidated Statements of Income was not significant in 2009, 2008, and 2007. No amounts were excluded from effectiveness testing related to the interest rate swap during 2009, 2008, and 2007.

During the year ended December 31, 2009, Integrys Energy Services did not have any commodity derivative contracts designated as fair value hedges. During the years ended December 31, 2008, and 2007, Integrys Energy Services had commodity derivative contracts designated as fair value hedges to mitigate the risk of changes in the price of natural gas held in storage. Fair value hedge ineffectiveness recorded in nonregulated revenue on the Consolidated Statements of Income was not significant in 2008 and 2007. Changes in the difference between the spot and forward prices of natural gas were excluded from the assessment of hedge effectiveness and reported directly in nonregulated revenue. The amount excluded was a pre-tax gain of \$5.5 million during 2008 and was not significant during 2007.

#### Cash Flow Hedges

Commodity futures, forwards, and swaps that are designated as cash flow hedges extend through April 2014, and are used to mitigate the risk of cash flow variability associated with future purchases and sales of natural gas and electricity. Integrys Energy Group also has two interest rate swaps that are designated as cash flow hedges to fix the interest rate on an unsecured term loan through June 2010. At

December 31, 2009, the nonregulated segments had the following notional volumes of outstanding contracts that were designated as cash flow hedges: